An economic analysis of remuneration systems: effective distribution of financial products

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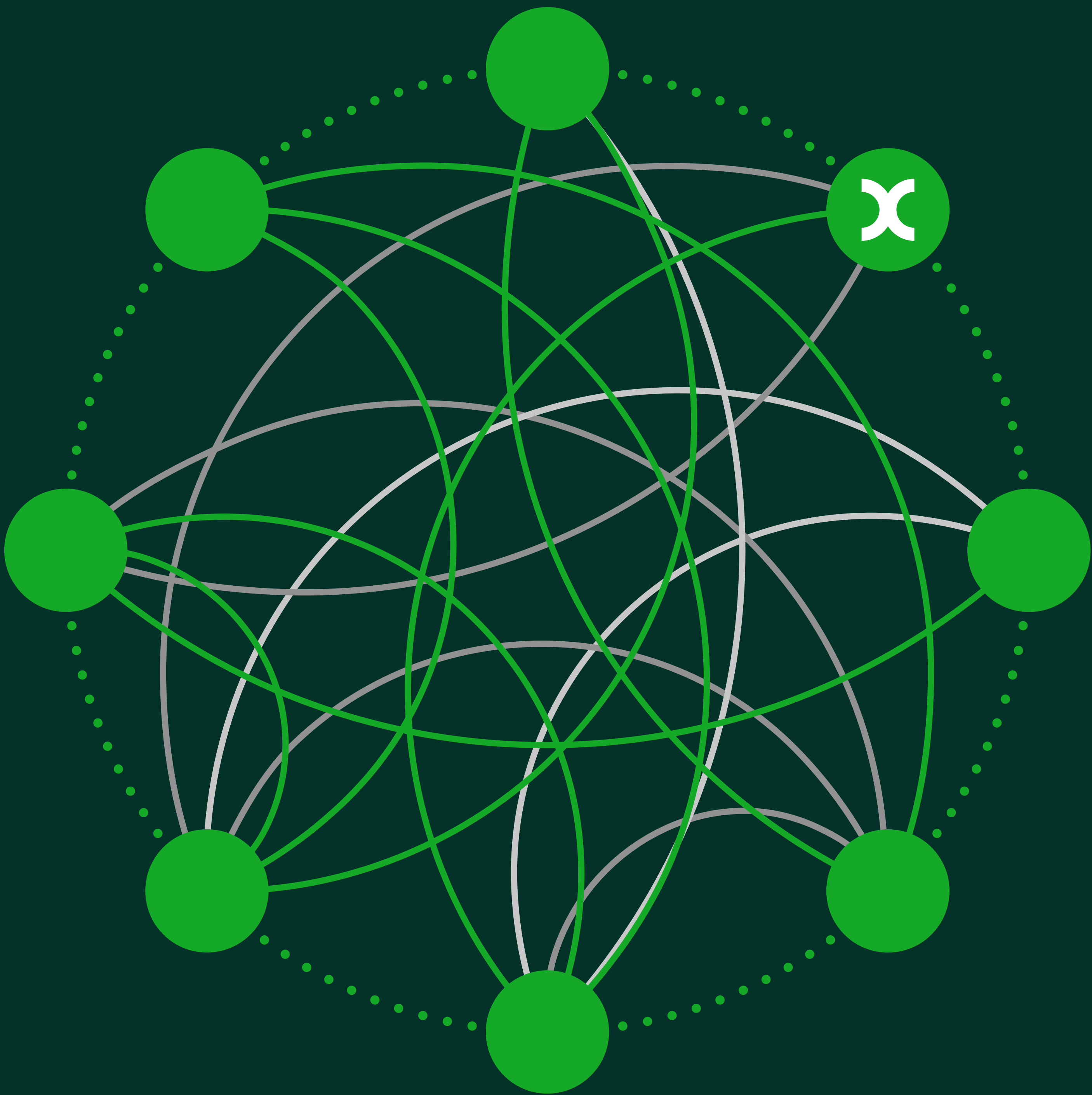

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Executive summary

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The remuneration of financial intermediaries has been the subject of debate across Europe for a number of years. Attention has been drawn to the perceived conflicts of interest arising from models of remuneration that involve paying commissions (or inducements more generally) to financial intermediaries, with some arguing that such commissions should be banned.

Various stakeholders have referred to the experiences of consumers in countries which have (to varying extents) banned commissions to financial intermediaries—most notably, the Netherlands and the UK. Some have cited these two countries as proof of the positive consequences of a ban on commissions, claiming that the ban removes conflicts of interest, while others have noted negative consequences such as an advice gap.

Either way, this is a simplification. The reality of the regulatory interventions in the Netherlands and the UK is more complex and the consequences far more nuanced. And importantly, there are policy trade-offs to consider.

This report presents a comprehensive and balanced review of the insights from the economics literature and the positive and the negative effects of the commission ban based on the experiences in the Netherlands and the UK.

What does our analysis of the evidence tell us?

Banning commissions is a tool that may look attractive, as it gives the impression that the perceived problem is being addressed head on. No beating around the bush—you simply remove what you believe causes the problems in the market: commission payments!

At first sight, the logic of the arguments in favour of banning commissions indeed looks intuitive and makes one wonder why other countries have not followed the Netherlands and the UK. The core of the argument is that if advisers are paid by providers in the form of commissions, then they will be incentivised to recommend products with higher commissions that benefit themselves rather than their customers. Imposing a ban on commissions will remove this conflict of interest and will then, according the argument, result in a market where advisers deliver unbiased quality advice and are no longer disincentivised from recommending lower cost products (such as tracker funds) to the benefit of consumers.

Closer inspection shows that this line of argument is based on assumptions which are not supported by evidence. To inform policy-making and regulation at EU-level, one should be careful to identify what has been proven and what remains unproven in the case of the Netherlands and the UK, and not to extrapolate from the Netherlands and the UK case studies alone. Financial markets vary significantly across member states, and were a ban to be introduced, its impact would differ depending on the conditions in the individual markets.

The impact of the commission ban in the Netherlands

The Dutch authorities introduced a package of regulatory measures (including a ban on commissions for certain products) and have been successful in removing problematic 'complex products' from the market, and related steering behaviour on the part of advisors. Also more generally, various elements of the markets for mortgages, insurance, and investments seem to be working well in the Netherlands and, traditionally, retail investor participation in capital markets in the Netherlands has been relatively high compared with some other European countries.

That said, as recognised by the Dutch Minister of Finance in their report to Parliament, it is not possible to disentangle the impact of the ban on commissions from the broader series of regulatory interventions that accompanied and preceded it (such as commission disclosure, prohibition of certain types of inducement such as volume-based bonuses, and limits to the share of commissions that could be paid upfront). The changing trends in the main outcomes of interest across the primary products of concern were observed *prior to* the ban on commissions, and in large part due to market-specific regulations and developments unrelated to the ban.

Other positive trends in the Netherlands such as the increase in the use of index tracking are reflecting a more general trend which is also observed in other countries including in countries where there is no commission ban (such as the USA).

There has been a meaningful decrease in the extent to which Dutch consumers seek financial advice but importantly this has not resulted in a reduction in for example the use of pension products. The Netherlands has a multi-pillar pension system with significant mandatory public and semi-mandatory occupational group coverage. In other European countries that rely to a larger extent on voluntary pension systems, the role of advice is more important and the potential negative impact of a commission ban on the use of pension products would be of much greater concern.

Unintended negative consequences

Good consumer decisions on investments, insurance and pensions are vital for people's financial wellbeing. But making good financial decisions is hard.

The behavioural economics literature shows that consumers are subject to inertia, and that many are loss- and risk-averse and may put low weight on what happens in the future. Many consumers insufficiently engage with financial planning and products, and are not willing to pay for financial advice. Furthermore, investment decisions are often highly influenced by emotional and social drivers such as gut instinct, irrational exuberance, and perception of other people's investment success.

One of the benefits of a commission-based system is that it helps overcome consumer inertia; and the engagement makes it more likely that consumers plan for their retirement and take financial products. A ban is therefore likely to affect the use of advice and engagement with financial planning resulting in insufficient use of in particular insurance and pension products.

As explained, this is of particular concern in some European countries that rely to a larger extent on voluntary pension systems. This would affect people's financial well-being in the longer-term. The costs of not taking certain insurance and pension products can be substantial in the long term, particularly for lower-income consumers who risk having their savings eroded, especially in high inflationary environments.

It is also worth noting that just because a consumer chooses not to receive regulated financial advice does not mean that they do not look for similar types of guidance and information from unregulated sources such as on social media, where the information is of variable quality and accuracy.

Conflict of interest and consumer outcomes

The relationship between a consumer and financial intermediary can be described as a principal-agent relationship. Economic theory tells us that any principal–agent relationship can result in conflicts of interest. That is because the principal and the agent have differing incentives and interests. Whether the distributor is paid by the provider or directly by a consumer with imperfect knowledge, these incentives may not be aligned and the conflict of interest may lead to (high) costs for the consumer.

There is no simple remedy that can remove all material conflicts of interest. Economic theory tells us that any financial intermediary will ultimately act in their own interest. This also applies to financial advisors who receive fees from customers. Advisers have an incentive to recommend a needless transaction when there is a fee to be justified, to make their work less time consuming advisors may consider a smaller range of products than perhaps optimal for their customers, and an advisor under pressure to justify a fee might direct customers to suboptimal products just because they were not easily accessible to the public.

At the same time, the presence of a potential conflict of interest does not necessarily result in actual consumer harm, compared to the counterfactual. This depends on whether the conflict of interest is material enough to change the behaviour of the economic agents. This is an empirical question. For example, if there are sufficient clawback mechanisms for commissions, this will incentivise intermediaries not to sell products that the customer later cancels. This reduces the impact of potential conflicts of interest associated with commissions. Further, due to regulation, a financial intermediary may not incentivise customer-facing staff to prioritise the firm's interests over the consumer's interests. In this context, the incremental benefit of banning commissions is likely to be small. Indeed, in the case of a compliant firm, there might be no effect while, if a firm has a weak compliance culture, we should not expect a ban on commissions to result in the delivery of high-quality and unbiased advice.

Therefore, it is important to consider the extent to which a possible conflict of interest (as a result of commission payments) actually results in harm relative to the harm that would arise under other forms of remuneration. This depends on the regulatory framework, the extent to which regulation is enforced and compliance is supervised by the relevant authorities and the quality of conduct risk management by the intermediaries themselves.

From a public policy perspective, the extent of possible harm caused by a potential conflict of interest (due to commission payments) would also have to be weighed up against the potential harm of banning commissions that would be caused if the client does not take advice, would not take insurance or pension products and would therefore lose out on the return that investments can deliver.

To assess consumer decision-making, regulatory authorities have used the framework of the 'four As': for consumers to make good decisions, they need to **a**ttend to (or engage with) the market and financial products in the first place, **a**ccess information about the products available in the market, **a**ssess that information and determining those that best suits them, and **a**ct on that information, by purchasing their preferred product.

A commission ban attempts to improve the **a**ssessment of what product is best for a consumer (by removing the potential conflict of interest caused by commissions). In public policy terms, there are three issues with such an approach. First, it assumes that by banning commissions, the adviser will be free of any conflict and will deliver unbiased advice (which, as explained above, is not the case). Second, it overlooks the fact that a commission ban can have a negative effect on consumers' engagement (**a**ttend) with financial products and on the use of financial advice and products (**a**ccess), which would affect consumers' **a**ctions. Third, it overlooks other regulatory approaches to improve the conduct of advisers which do not come with a negative impact on consumers' engagement and use of financial products.

In the UK, where a commission ban was introduced in 2013 for certain complex products, a general Consumer Duty is being introduced. This Duty requires firms to act to deliver good outcomes for retail customers and, importantly, applies to situations with and without commission payments. This is happening because of serious concerns that distributors and providers irrespective of how they are paid were not sufficiently focused on delivering good outcomes for consumers. The FCA did not see extending the commission ban to a wider range of products as the solution. Furthermore, the introduction of the Consumer Duty shows that the FCA believes that the prohibition on commission payments did not resolve the potential for conflicts of interest – many of these still exist.

Regulatory options

A ban on commissions[1] is in many ways a blunt tool for improving outcomes for consumers. It carries with it significant risks which includes a negative impact on the take-up of insurance and pension products in some European countries (affecting household's financial well-being in the long term), insufficient use of financial advice and reliance on social norms, and information from unregulated sources where information is of variable quality and accuracy.

Given the risks and limitations of a ban on commissions, it is important to consider the range of alternative policy options that have become part of the debate and could reduce the risk of unintended consequences of a ban while addressing some of the concerns about the commission-based remuneration model.

These not only include greater use of measures centred around disclosure of product and distribution fees but also value-for-money assessments. Under such a measure, firms would bear the responsibility of ensuring that their products and services deliver value-for-money . This form of Product Oversight and Governance (POG) regulation would require active supervision by the supervisory authorities. Such alternative options are highly relevant to the discussion over market reforms.

[1] This could be an outright ban on all types of commission across all channels, a partial ban focusing on specific channels, or a de-facto ban where, for example, the conditions under which a commission could be paid are so stringent that in practice it would have the same or a similar effect as a commission ban.

1 Introduction

1.1 Objectives and scope

The European Commission ('the Commission') has announced the launch of a new Retail Investment Strategy ('RIS') in May 2023, with the aim to:[2]

'ensure that consumers who invest in capital markets can do so with confidence and trust, that market outcomes are improved and that consumer participation is increased'.

The RIS may include proposals around the remuneration of financial intermediaries, such as agents or brokers. We understand that any potential proposals would be informed by the experiences in the Netherlands and the UK, for example, where bans on commissions were introduced in 2013.

The Gesamtverband der Deutschen Versicherungswirtschaft (GDV), the German insurance association, asked Oxera to conduct an independent study looking at the way in which distributors are paid for their services and how this can affect the distribution of financial services.

The study sets out the role of commission payments, the rationale for any potential regulation, and the impacts that can arise from restricting payment through commissions. The aim is to provide insights and guidance on the issues a regulator needs to take into account when deciding whether regulation is required, what types of regulation to introduce, and their likely impacts.

Drawing on the economics literature, the study compares the experiences and consumer outcomes across countries with varied regulatory approaches, to better understand the impact of commissions. We also consider what types of regulatory intervention have the best prospect of achieving the aims of the RIS.

Commissions and inducements

Commissions represent monetary inducements made to the intermediary distributing the relevant product; whereas inducements also include non-monetary benefits (e.g. training for sales staff, IT support or help in dealing with customers) which are paid for or received in connection with the sale of an insurance product.

Article 2(2) of the Delegated Regulation (EU) 2017/2359 defines an inducement as:

'any fee, commission, or any non-monetary benefit provided by or to such an intermediary or undertaking in connection with the distribution of an insurance-based investment product, to or by any party except the customer involved in the transaction in question or a person acting on behalf of that customer'.

[2] European Commission (2023), 'EU strategy for retail investors', February.

1.2 The current debate and the contribution of this report

The remuneration of financial intermediaries has been the subject of debate across Europe for a number of years. Attention has been drawn to the perceived potential conflicts of interest arising from models of remuneration that involve commissions (or inducements more generally) to financial intermediaries, with some arguing that such commissions should be banned.[3]

Various stakeholders have referred to the experiences of consumers in countries which have (to varying extents) banned commissions to financial intermediaries—most notably, the Netherlands and the UK. Some have cited these two countries as proof of the positive consequences of a ban on commission, in that they remove the conflicts of interest, while others have noted negative consequences for example in the form of an advice gap.

Either way, this is a simplification. The reality of the regulatory interventions in the Netherlands and the UK is more complex and the consequences more nuanced. This report presents a comprehensive and balanced review of both the positive and negative results of the ban on commissions in both countries.[4] The analysis draws on the economics literature, existing impact assessments and Oxera's own extensive experience in analysing the functioning of financial markets which includes our work for the European Commission (DG FISMA), EIOPA, and national regulatory authorities.[5]

The report also draws out the lessons for other European countries. Even if the experience of the Netherlands and the UK has been positive (or negative) overall, this does not mean that the interventions would, by definition, be appropriate (or inappropriate) in other countries. As we explain in this report, the impact of a ban on commissions may vary across countries and may depend on the existing models for the distribution of financial services in each country.

To draw out these lessons, we start by reviewing the latest understanding of consumer behaviour based on behavioural economics. We also assess the advantages and disadvantages of different remuneration models from an economics perspective.

[3] This could be an outright ban on all types of commission across all channels, a partial ban focusing on specific channels, or a de-facto ban where, for example, the conditions under which a commission could be paid are so stringent that in practice it would have the same or a similar effect as a commission ban.

[4] There are a limited number of EU Member States where a commission ban is in place, in addition to the Netherlands: in Finland, Denmark, Norway, and Sweden, there was a ban on commissions for certain products for brokers, and in Spain, there was a ban for independent advisors advising on unit-linked products. These bans were imposed before the implementation of the Insurance Distribution Directive. No further bans have been introduced since then.

[5] Oxera (2020) 'Primary and secondary equity markets in the EU Final report', Prepared for the European Commission; Oxera advised EIOPA on its approach towards business model analysis (MBA) for the purposes of its thematic review (see detail EIOPA (2022), 'Credit protection Insurance (cpi) sold via banks'. Oxera advised the FSA on the Retail Distribution Review – see Oxera (2009), 'Retail Distribution Review proposals: Impact on market structure and competition' and Oxera (2012), 'Safe as houses? The implications of the Mortgage Market Review', April.

1.3 Approach and report structure

The report is structured as follows.

- Section **Error! Reference source not found.** explores the context of c onsumer decision-making in relation to financial services drawing on insights from behavioural economics. It also analyses the pros and cons of different remuneration models from an economics perspective.
- Sections 3 and 4 analyse the impact of a ban on commissions on certain products and distribution channels in the Netherlands and the UK, respectively.
- Section 5 concludes and discusses different regulatory interventions.

2 Consumer behaviour and payment for the distribution of products and services

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Box 2.1 Key takeaways

Whether different models of distribution for financial services lead to good or poor consumer outcomes depends on how consumers behave. A rich understanding of consumer decision-making informs the policy debate on inducements.

Behavioural economics gives us deep insights into consumer behaviour, and there is now a vast body of literature and evidence to build upon. Indeed, behavioural economics provides the framework regulators and competition authorities use to assess markets and policies.[6]

In this section, we examine the core insights from behavioural economics on how consumers make decisions, and what affects consumer decisions and therefore outcomes in the context of financial markets. We then outline the pros and cons of different remuneration models for the distribution of financial products, given real-world consumer decision-making.

Our analysis shows that the mere identification of a conflict of interest arising from inducements to financial intermediaries is insufficient evidence that a ban on inducements would benefit consumers overall. This is a more complex and nuanced question and, importantly, there are trade-offs that policy-makers and regulators would need to consider.

Source: Oxera.

2.1 The impact of behavioural biases on consumer outcomes

Behavioural economics tells us that people (and therefore consumers) have cognitive limitations, which means that they have to ration carefully their scarce mental effort. In other words, consumers are subject to bounded rationality. They tend to ration their mental effort by using mental shortcuts and by focusing their attention on the most important information and decisions.

These shortcuts lead to what is known as 'consumer bias'. The term does not necessarily mean a 'mistake', but rather refers to situations where the decision-making process deviates from classical economic assumptions. Indeed, biases may result in swifter and more efficient decision-making given that consumers have scarce time, attention,

[6] For an analysis of the insights of behavioural economics for policy-making see for example: Financial Conduct Authority (2013), 'Applying behavioural economics at the Financial Conduct Authority', April and Oxera (2013), 'Behavioural economics and its impact on competition policy—A practical assessment with illustrative examples from financial services', Prepared for The Netherlands Authority for Consumers and Markets (ACM), May.

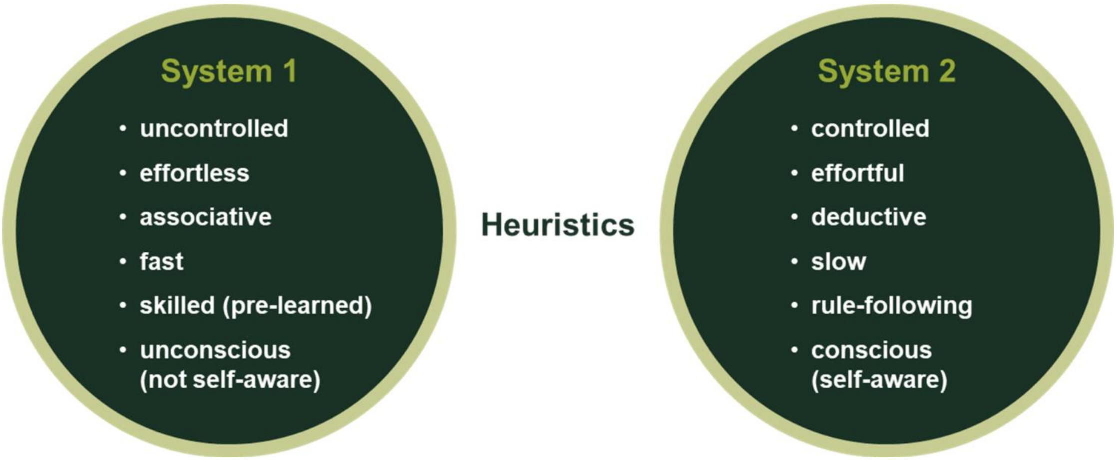
and effort. However, in certain contexts biases can lead to consumer detriment.

Below, we focus on the most relevant biases for this study before exploring the importance of financial literacy, mistaken beliefs, and 'rational' costs.

2.1.1 Behavioural biases

Nobel-laureate, Daniel Kahneman, suggested a metaphor for decision-making whereby consumers apply either their 'System 1' or their 'System 2'.[7] System 1 is rapid and effortless, whereas System 2 is slow and effortful (as illustrated in Figure 2.1 below). There are also rules of thumb (heuristics), which may be learned using System 2 and then applied as part of System 1.

Figure 2.1 System 1 and System 2



Source: Oxera, based on Thaler, R. and Sunstein, C. (2008), *Nudge: Improving Decisions about Health, Wealth, and Happiness*, Yale University Press.

Whether a consumer uses their System 1 or System 2 depends, in part, on how the information is presented to them; this is known as the 'choice architecture'.

Greater 'friction' in the decision-making process can shift consumers from using their System 1 to their System 2. Financial regulators have become concerned that there is too little friction in the customer journey for certain high-risk investments (such as cryptocurrency), leading to consumers investing without pausing to reflect on their decision.[8]

Recent research finds that the characteristics of investors are changing, as well as the way they invest. For example, substantial proportions of cryptocurrencies and crowdfunding investments are held by younger people. [9] Regulators are concerned that these new

[7] See Oxera (2021), 'System failure: a problem for behavioural economists?', *Agenda*, September.
[8] For example, Financial Conduct Authority (2022), 'Beyond disclosure for high-risk investments: slow down and think', research article.
[9] For example, in the UK, 44% of cryptocurrencies and 31% of crowdfunding investments are held by people aged under 34. See: https://www.fca.org.uk/publications/corporate-documents/consumer-investments-strategy.

investors in high-risk investments may not appreciate the risks involved.[10]

However, System 2 is not perfect, as the consumer is still subject to their cognitive limitations and level of financial literacy, and ‘facts’ may be viewed differently through an emotional lens. Certain biases remain prevalent even when a consumer is really engaging with a decision.

However, System 2 is not perfect, as the consumer is still subject to their cognitive limitations and level of financial literacy, and ‘facts’ may be viewed differently through an emotional lens. Certain biases remain prevalent even when a consumer is really engaging with a decision.

A large body of empirical literature exists on the impact of behavioural biases on decisions relating to financial products and services. We now focus on the biases most relevant for this study.

First, consumers are subject to inertia. Inertia has been suggested as a key factor in explaining why many people do not invest.[11] Financial decisions are often complicated for consumers. Both the context of the decision and the products can be non-trivial to understand. For example, in the pensions sector, a well-informed decision involves understanding the pension products on offer, state pension provision, tax incentives, and their own financial situation and goals. Therefore, financial decisions typically require consumers to pay significant amounts of attention and expend significant mental effort. Given that attention and effort are scarce, consumers may choose to avoid engaging with financial products and services.

Consumers may also wish to avoid thinking about negative events. For example, purchasing life insurance may require them to think about what happens when they die, and if they or their close family have any health conditions.

Governments have explicitly targeted inertia in market interventions by changing the ‘default option’. For example, making saving for a pension an ‘opt-out’. Default option remedies tend to be effective in changing behaviour, but the outcomes for consumer welfare may be mixed.[12]

Second, inertia may be reinforced by social norms. Consumers are informed by the (perceived) behaviour of others. Whether and how a consumer invests can be partly explained by whether they agree that ‘people like them’ invest.[13] Perceived social norms may be affected by

[10] For example, FCA research found that 45% of non-advised investors fail to recognise that ‘losing some money’ is a risk of investing; https://www.fca.org.uk/publication/research/understanding-self-directed-investors.pdf
[11] Haliassos, M. and Bertaut, C. C. (1995), ‘Why do so few hold stocks?’, *The Economic Journal*, 105:432, pp. 1110–1129.
[12] Beshears, J., Choi, J.J., Laibson, D., Madrian, B.C. and Skimmyhorn, W.L. (2022), ‘Borrowing to Save? The Impact of Automatic Enrollment on Debt’, *The Journal of Finance*, 77, pp. 403–447.
[13] Oxera (2022), ‘The keys to unlocking greater investment in Stocks and Shares ISAs’, November.

friends or 'finfluencers' (i.e. financial influencers) via online platforms and social media, explaining why regulators are increasingly focusing on what consumers are hearing from influencers.[14] It appears that young people (e.g. 'Gen Z') are more likely to receive financial advice from social media platforms.[15]

Third, information overload can lead to inertia. Too much information can be as bad as no information, as it can cause consumers to disengage entirely and discourage them from making any financial decisions. For example, having too many options for retirement savings discourages individuals from saving for retirement. Therefore, in an ideal world, the number of choices presented to an individual should be consistent with that individual's financial literacy and reflect their preferences. Taking the consumer's perspective into account, what they need and how they process information, is likely to lead to a better understanding and also facilitate better decisions.[16]

Fourth, consumers tend to focus on the most salient information. In rationing their attention, consumers may not read beyond the most prominent information presented to them. This is why regulators often mandate disclosure remedies, whereby the most salient information is highlighted prominently to consumers.[17]

Fifth, many consumers are loss- and risk-averse. There is a body of evidence from across different countries showing that loss aversion (and to a lesser extent, risk aversion) explains why many consumers prefer not to invest.[18] In other words, the potential for investments to decrease in value is often seen by consumers as a 'loss', and many consumers are averse to this.

Sixth, some consumers put low weight on what happens in the future. 'Present bias', as this phenomenon is known, can partly explain why some consumers (especially younger ones) do not invest or save for the future.[19] It may also explain why some consumers do not prioritise insurance.

[14] See for example: AFM (2021), 'The pitfalls of 'finfluencing'—Exploratory study by the AFM into investor protection requirements relating to social media posts, December.
[15] World Economic Forum (2022), ‚This is where Gen Z goes for financial advice', August. See also European Commission (2022), 'Flash Eurobarometer 509 Retail financial services and products', Report, October, section 1.3.
[16] Batsaikhan, U. and Demertzis, M. (2018), 'Financial literacy and inclusive growth in the European Union', *Bruegel Policy Contribution*, no. 2018/08, Bruegel, Brussels. Iyengar, S. S. and Jiang, W. (2003), 'Choosing not to choose: The effect of more choices on retirement savings decisions', mimeo, Columbia University.
[17] See Oxera (2014), 'Review of literature on product disclosure', prepared for the Financial Conduct Authority, October.
[18] Oxera (2022), 'The keys to unlocking greater investment in Stocks and Shares ISAs', November. Zeisberger, S. (2022), 'Do people care about loss probabilities?', *Journal of Risk and Uncertainty*, 65:2, no. 3, pp. 185–213. Zeisberger, S. (2021), 'What is risk? How investors perceive risk in return distributions', working paper.
[19] Oxera (2022), 'The keys to unlocking greater investment in Stocks and Shares ISAs', November.
European Insurance and Occupational Pensions Authority (EIOPA) (2022), "Consumer Trends Report 2022", https://www.eiopa.europa.eu/system/files/2023-01/eiopa-consumer-trends-report-2022.pdf, p.15.

Lastly, it is worth acknowledging the role of emotions in influencing the biases that consumers exhibit.[20] The emotional state of the consumer affects their decisions about financial products and services, with certain emotions linked to types of preference and behavioural bias (e.g. the relationship between fear and risk aversion).[21] In short, consumers' decisions on investments, insurance, pensions and other financial services will be, in part, a function of their emotional state at the point of purchase. Further, financial products are often less tangible than other goods and services, arguably requiring a higher level of trust on the part of the consumer that they are buying a good product.

Consumer behavioural biases relating to secondary products

Different behavioural factors are likely to apply when products are sold as secondary products at the point of sale (i.e. as an 'add-on' product). Given the current debates over secondary products, we explain below what these are and how they are different to the issues considered in this report.[22]

First, consumers' attention may be focused on the primary product (e.g. a mortgage product) rather than on the secondary product (e.g. an insurance product to cover this mortgage). This might be because the cost of the primary product is higher, or because the primary product is the main reason for the purchase.

Second, consumers tend to value something more highly if they already own it, or if they feel like they already own it. Consumers may not want to 'lose' the primary product after having gone through much of the sales process, and therefore may be more likely to purchase the secondary product towards the end of the sales process.

Third, judgements over value tend to be influenced by reference points (or 'anchors'). Secondary products may appear to be relatively low cost compared to the primary products.

Therefore, because consumers pay less attention to secondary products, they may exhibit lower price sensitivity for secondary products than if these were sold stand alone.

2.1.2 Mistaken beliefs

Even a (hypothetical) unbiased consumer can be subject to misperceptions or mistaken beliefs. Not surprisingly, studies show that consumers' beliefs about financial products and services are an important determinant of whether they purchase such products and services. For example, the perceived probability of losing money from

[20] Lerner, J.S., Li, Y., Valdesolo, P. and Kassam, K.S. (2015), 'Emotion and Decision Making', *Annual Review of Psychology*, 66, pp. 799–823.
[21] Meier, A.N. (2022), 'Emotions and Risk Attitudes', *American Economic Journal: Applied Economics*, 14:3, pp. 527–558.
[22] See, for example, EIOPA (2023), 'Thematic Review on credit protection insurance (CPI) sold via banks', 4 October. EIOPA commissioned Oxera to advise it on the approach towards business model analysis (BMA) for the purposes of the thematic review and to provide support with applying the BMA in practice.

investing in equities is correlated with consumers' decisions to invest (or not).[23]

Studies show that subjective beliefs can be measured in a reliable way and that a consumer's belief is related to their actual behaviour. For example, the results suggest that stock market expectations are an important component of portfolio selection.[24] It has also been found that non-investors overestimate historical loss probabilities in contrast to investors. These loss expectations affect allocations in investments.[25] But also fundamentally and over long-term horizons, people overestimate the risk of being able to lose money when investing compared to historical performance.[26] The subjective expectations about actual changes in share prices are influenced by recent share gains or losses.[27]

In theory, some mistaken beliefs are easier to 'correct' than behavioural biases. Education or information campaigns may play a role in this. It is likely that financial advice also plays a role in educating consumers and correcting mistaken beliefs. As a result of good financial advice, consumers should have a better understanding of the available options open to them, and the impact of their choices.

At the same time, some mistaken beliefs may be the result of behavioural biases. For example, when considering whether to buy insurance, consumers are likely to evaluate the chances of the insurance event occurring (e.g. the likelihood of their home being flooded). This perceived likelihood may be affected by the ease with which the insurable event (e.g. flooding) comes to mind. If flooding has recently been in the news, or there has been flooding in the consumer's area, it may come to mind more easily. As such, the consumer subconsciously substitutes 'ease of event recall' for 'probability of event'. Thus, the perceived likelihood of the insurable event can be biased (an example of 'availability bias').

2.1.3 Financial literacy

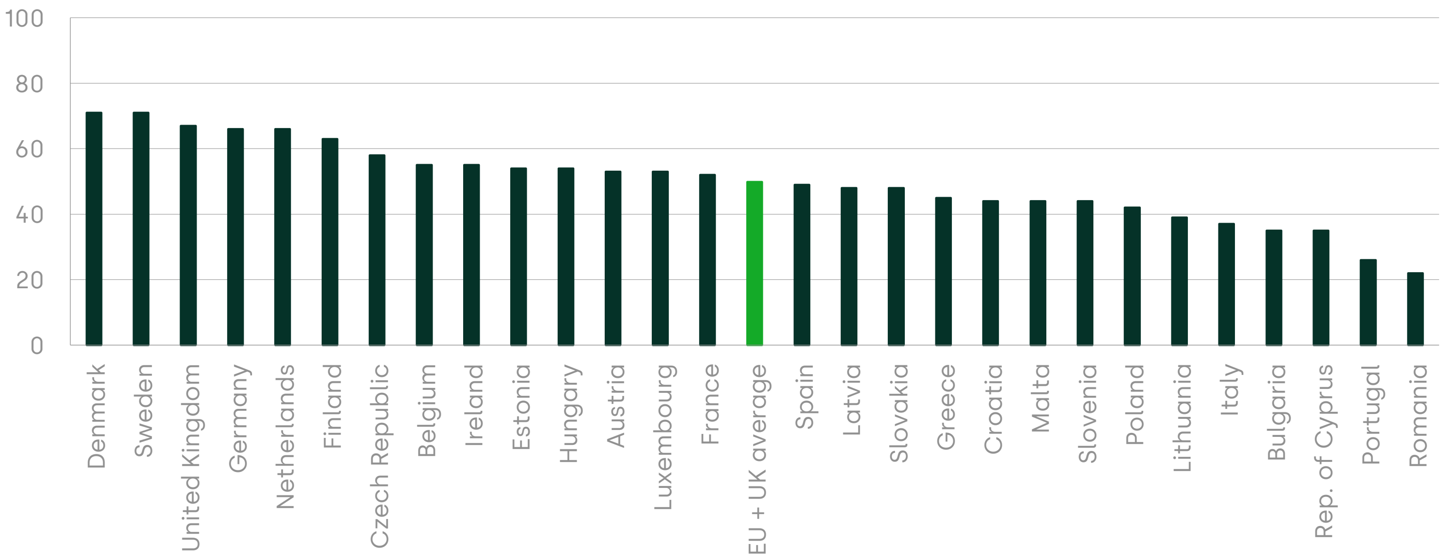
The ability of a consumer to engage with financial products and services is limited by their financial literacy (i.e. their applied numeracy skills). Low financial literacy can explain why many consumers do not engage with financial markets.[28] Financial literacy is thus an important determinant for participating in financial markets.[29]

[23] Holzmeister, F., Huber, J., Kirchler, M., Lindner, F., Weitzel, U. and Zeisberger, S. (2020), 'What drives risk perception? A global survey with financial professionals and laypeople', *Management Science*, 66:9, pp. 3977–4002.
[24] Zimpelmann, C. (2021), 'Stock Market Beliefs and Portfolio Choice in the General Population', CRC TR 224 Discussion Paper Series, no.258, University of Bonn and University of Mannheim, Germany.
[25] Strucks, M. and Zeisberger, S. (2022), 'Why Do People (Not) Invest? The Role of Return and Risk Expectations', working paper.
[26] Oxera (2022), 'The keys to unlocking greater investment in Stocks and Shares ISAs', November.
[27] Hurd, M., Van Rooij, M. and Winter, J. (2011), 'Stock market expectations of Dutch households', *Journal of Applied Econometrics*, 26:3, pp.416–436.
[28] See Oxera (2022), 'Interminable: who can read the T&Cs?', *Agenda*, October.
[29] Van Rooij, M., Lusardi, A. and Alessie, R. (2011), 'Financial literacy and stock market participation', *Journal of Financial Economics*, 101:2, pp. 449–472.

Financial literacy can also help overcome any information asymmetry (or else consumers may not know the right questions to ask). As shown in Figure 2.2, financial literacy rates vary by country, with low financial literacy prevalent across Europe.

As shown in Figure 2.2, financial literacy rates vary by country, with low financial literacy prevalent across Europe.

Figure 2.2 Financial literacy in Europe



Note: Financial literacy is assumed here when an adult respondent gives three correct answers within four categories: risk diversification, inflation, numeracy (interest), and compound interest. The average for the countries in the chart is 50.
Source: Oxera analysis based on Standard & Poor's Global Financial Literacy Survey 2018. The 2020 data for a subset of countries can be found at https://www.oecd.org/financial/education/oecd-infe-2020-international-survey-of-adult-financial-literacy.pdf. Low financial literacy may also explain how consumers use heuristics, or focus on a limited number of key facts. These factors may lead to suboptimal decision-making, reducing the ability of the consumer to achieve their financial goals.

Although it is hard for policymakers to improve levels of financial literacy, this remains a priority for them (as well as for the European Supervisory Authorities).[30] A large number of countries around the world have implemented national strategies to increase financial literacy and to address this issue, primarily aimed at:

- facilitating access to information and advice through multi-channel delivery;
- considering the individual phase of a customer's life (addressing consumers in key phases of their professional or personal life: having a child, buying a home, retiring) and using existing learning environments and networks;

[30] EIOPA (2022), 'Financial education and literacy: a priority for the ESAs', news article, 3 February, https://www.eiopa.europa.eu/financial-education-and-literacy-priority-esas-2022-02-03_en.

- encouraging individual motivation, engagement and decision-making whilst also taking into account the findings of behavioural economics.[31]

2.1.4 'Rational' costs

Even a (hypothetical) unbiased consumer might choose not to engage in a market under certain conditions. A consumer may determine that the costs of engaging in the market—such as shopping-around, reading product materials and online reviews, educating themselves about the costs and risks—may outweigh the likely benefits of engaging in the market.[32] An example might be where a consumer has a small sum to invest (i.e. the benefits of investing may be low in € terms).

Further, some have argued that it would be 'rational' for people who are aware that they have low financial literacy to avoid investing, as they know that they are not well placed to make decisions about equities. For example, one study found that the welfare loss from Swedish households not investing is less than one might think. This is because (a) many households which do invest are investing in less diversified portfolios, and (b) the households that do not invest appear more similar to the households investing inefficiently.[33]

2.1.5 Consumer trust

We note the role of consumer trust in financial services providers; as a lack of trust could be a barrier to consumers engaging with financial services providers. However, studies indicate that consumer trust is not a major barrier to engaging with financial services markets.[34]

This suggests that policymakers looking to improve consumer engagement should not overly focus on improving trust (as this is not the problem); the focus should be overcoming some of the biases such as inertia, present biases and consumers being loss- and risk-averse.

2.1.6 The four 'A's framework

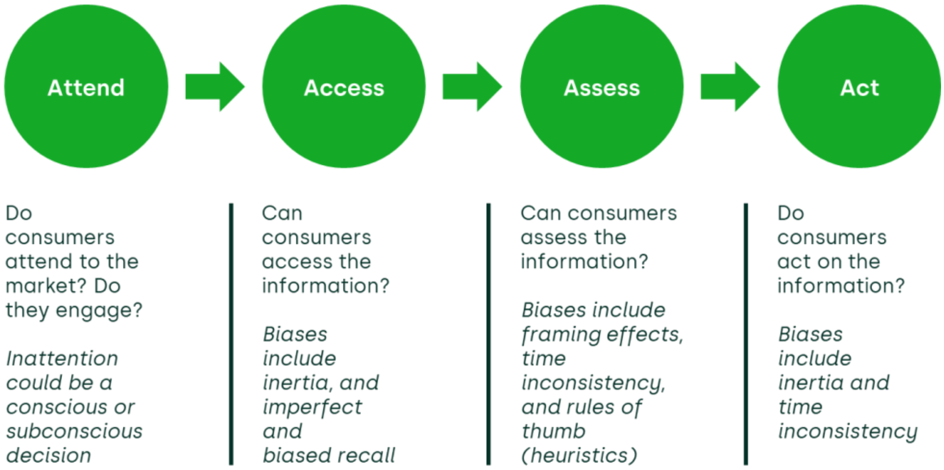
Given the above, it is useful to consider consumer decision-making in a framework that includes engagement, inertia and consumer biases. A commonly used framework is known as the 'four 'A's'.[35]

In order for consumers to make good decisions, they need to:

[31] See, for example, OECD (2015), ‚National Strategies for Financial Education, OECD/INFE Handbook'.
[32] Campbell, J.Y. (2006), 'Household Finance', NBER Working Paper, no. 12149.
[33] Calvet, L. E., Campbell, J. Y. and Sodini, P. (2007), 'Down or Out: Assessing the Welfare Costs of Household Investment Mistakes', *Journal of Political Economy*, 115:5, pp. 707–747.
[34] For example, mistrust does not appear to be one of the major barriers to consumers investing. See, for example, European Commission (2022), 'Flash Eurobarometer 509 Retail financial services and products', Report, October, section 2.2. See also Oxera (2022), 'The keys to unlocking greater investment in Stocks and Shares ISAs', November, section 4.2.3. This behavioural economics analysis shows that factors such as loss-aversion and consumers over-estimating the likelihood of realising a loss from an investment in equities appear to be barriers to taking out investment products.
[35] Fletcher, A. (2020), 'Engaging the disengaged: why does it matter, and why is it hard?, Oxera *Agenda*, June.

- **attend** to (or engage with) the market in the first place;
- **access** information about the products (goods or services) available in the market;
- **assess** that information, in terms of making comparisons across the various products and determining those that best suits them;
- **act** on that information, by purchasing their preferred product.

Figure 2.3 The four 'A's'



Source: Oxera, Fletcher, A. (2020), '[Engaging the disengaged: why does it matter, and why is it hard?]'.

Biases, emotions, beliefs and financial literacy can affect consumers at all four stages. For example, we have discussed how biases like social norms interact with inertia (and the decision not to attend to/engage with the market).

In this context, various models of distribution have arisen, with the intention of facilitating engagement (attend) and the availability of information (access). For example, financial intermediaries play a role in these.

The exact role played by intermediaries varies by country and market. For example, the demand for mortgages is very much driven by people's (strong) desire to own a house. The way mortgages are distributed may therefore not have a significant impact on the demand for mortgages.

Also, some products are compulsory by law (e.g. motor insurance), and others may be required as ancillary services (e.g. mortgage lenders typically require borrowers to take out home insurance). So, the purchase of these products may not be materially affected by the design of distribution.

In the case of other products, such as non-compulsory insurance and pension products, the role of intermediaries may have a greater impact on engagement and up-take. In the case of pensions, the design of distribution varies significantly by country, as we discuss this in section

2.2 Implications for the distribution of retail financial services

Retail customers have cognitive limitations and are subject to inertia. Inertia can, in turn, be reinforced by social norms and information overload. Consumers are subject to behavioural biases, and many have low financial literacy, which can explain why so many do not engage with financial products and therefore do not ask for them.

In sum, in the absence of financial advice, consumers are likely to behave differently (such as being inert), potentially leading to suboptimal outcomes. Consumers may also not prioritise their future financial wellbeing, are likely to make suboptimal decisions, and may lack the capability to even engage with financial services.

Further, in the absence of advice, consumers may be mistaken in their perceptions of financial products and services. We also note that a customer's decision not to engage in financial markets may be rational, given the time and effort involved in engagement.

All these factors are hard to change (we cannot educate ourselves out of our cognitive limitations) and likely to be persistent. Therefore, actual consumer behaviour and decision-making processes should be considered when designing regulation of financial services.

Just because a consumer chooses not to receive regulated financial advice does not mean that they do not look for similar types of guidance and information from unregulated sources (such as on social media, where the information is of variable quality and accuracy). Moreover, unregulated advice provides no safeguards for consumers.

Box 2.2 Value of financial advice

The study by the International Longevity Centre used data from the Wealth and Assets Survey, a longitudinal survey that interviews individuals and households across the United Kingdom. Between 2012 and 2014, the study collected data by conducting 20,000 household interviews to gather information on households' economic well-being.[36]

The authors investigated the socioeconomic characteristics of people who receive advice using a series of discrete choice models. To determine a causal impact, the researchers employed a discrete choice model to estimate the likelihood of being treated (i.e., receiving advice) while controlling for relevant factors. The propensity score was then utilised in the analysis to estimate the treatment effect, simulating a natural experiment. The study also produced descriptive statistics on financial advice use, trust levels, and other factors.

According to the findings of the study, seeking financial advice has a significant positive impact on individuals' financial and pension wealth. Individuals who seek financial advice are more likely to save and invest

[36] International Longevity Centre (2017), 'The value of financial advice: a research report from ICL-UK', July

in equity assets (accounting for underlying demographic factors), resulting in greater financial and pension wealth. The study also discovered that retirees who receive financial advice have more income, especially as they age.

Source: Oxera

2.3 Institutional set-up and systems for the provision and distribution of pensions

Pensions are vital to consumers' long-term financial wellbeing as well as for (European) capital markets. To assess the impact of a potential ban on commissions and the pros and cons of different remuneration systems, it is useful to understand the current set-up and way in which pensions products are distributed.

Over the last two decades, pension funds within the euro area have almost doubled in size as well as in percentage of GDP. Their total assets currently amount to approximately €3 trillion and the percentage of GDP nearly doubled, from 13% in 2008 to 25% in 2019.[37] However, there are large differences between the euro countries, ranging from 0–1% of GDP in Greece to over 200% in the Netherlands.[38]

The numbers underline the relevance of pensions both for the retirement of each investing retail customer and for the economy as a whole.

Pensions

Pension products enable households to make provisions for retirement and contribute to the efficient allocation of long-term capital. Pension-related assets play a major role among household assets. They represent around 20% of households' net financial wealth in the euro area. [39] However, there are large differences between the euro countries.

The pension system is based on three pillars.

1. First pillar (public) pensions: state pensions are administered by the state and are typically funded by social insurance contributions and/or tax revenue. Statutory mandatory funded individual plans (pillar 1b) were introduced mainly in Central and Eastern European countries.
2. Second pillar (occupational) pensions: a private supplementary insurance linked to an employment relationship. Contributions are made by employers and/or employees, usually in conjunction with tax benefits granted by the state.

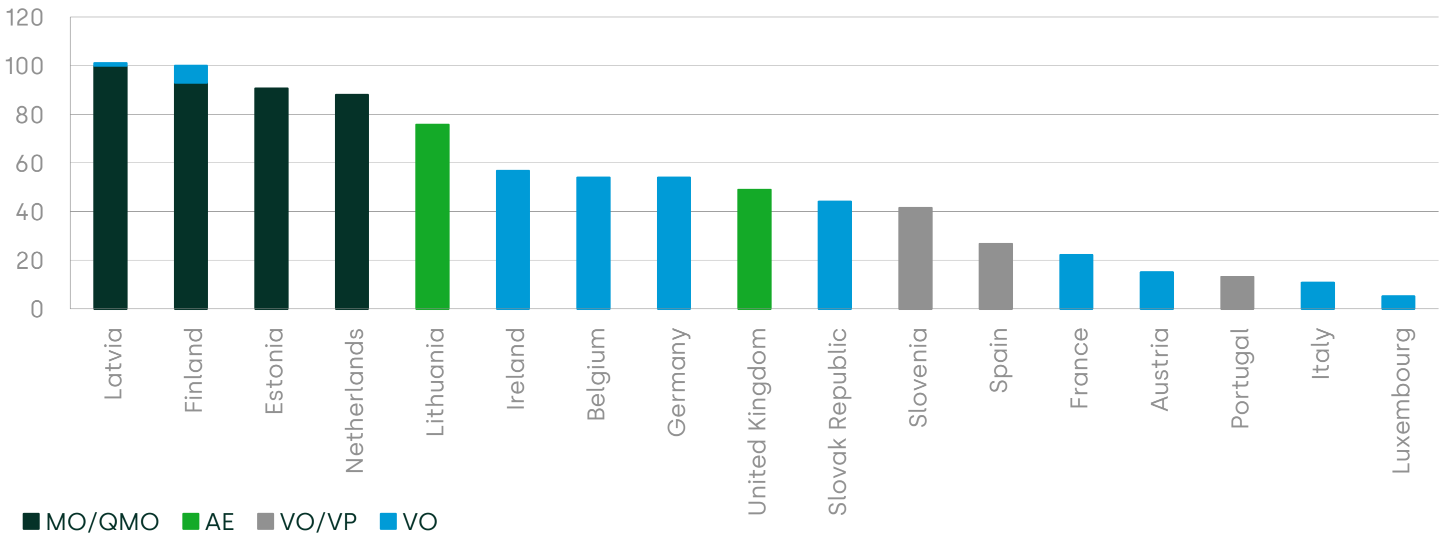
[37] European Central Bank (2020), 'Economic Bulletin, Issue 7/2020'. As the European Central Bank has noted, and according to OECD data, by comparison private pension fund assets in the USA account for 140% of GDP.
[38] OECD (2023), 'Pension Markets in Focus 2022'.
[39] European Central Bank (2020), 'An Economic Bulletin, Issue 7/2020. Another source estimates that pensions and insurance make-up 33% of household assets in the EU (2015-21). https://www.ecmi.eu/sites/default/files/enhancing_investment_funds_and_capital_markets_in_the_eu.pdf.

3. Third pillar (private) pensions: voluntarily pre-financed private pension plans. Contributions are invested into an individual account and managed by a pension fund, insurer, or financial institution. These can also be incentivised by for example tax or other mechanisms.

Differences in pension schemes across Europe

There are major differences in pension systems within Europe. In some countries, pillar 2 of the pension system plays an important role. In Figure 2.4, the following elements are considered as part of an occupational pension plan: mandatory/quasi-mandatory occupational (where the decision for the plan is made at the industry or branch level through collective bargaining agreements), automatic enrolment, voluntary personal and voluntary occupational.

Figure 2.4 Coverage of occupational pensions plans (as a percentage of the working-age population, 2021)

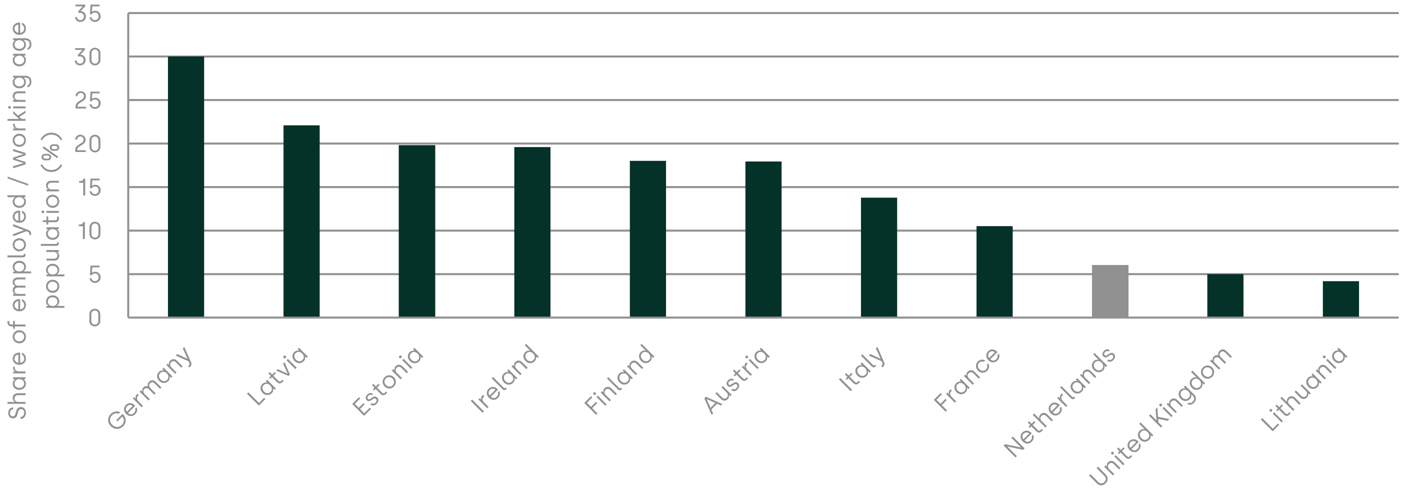


Note: MO = mandatory occupational; QMO = quasi-mandatory occupational; VO = voluntary occupational; VP = voluntary personal; AE = automatic enrolment. It was not possible to separate the data for Slovenia, Spain and Portugal according to VO/VP. They were assigned to the second pillar.
Source: Oxera analysis based on OECD (2021), 'Pension Markets in Focus 2021'.

Latvia, Finland, Estonia and the Netherlands, where a mandatory (or quasi-mandatory) contribution to an occupational pension has been imposed, have a very strong second pillar. (Almost) 100% of the working-age population pays into the occupational pension scheme. In the countries where auto-enrolment has been introduced (Lithuania and the UK), the occupational pension covers 49–76% of the working population. Voluntary contributions to an occupational pension have a high coverage in Ireland, Belgium and Germany. However, in half of the countries considered here, less than 50% of the working population contribute to an occupational pension.

The way in which the third pillar of the pension system has developed in the European countries also shows great differences, as shown in Figure 2.5 below.

Figure 2.5 Coverage of voluntary personal pensions plans



Notes: (i) OECD data refer to 2020 or to the latest year available, (ii) Coverage rates are provided with respect to the total working-age population (i.e. individuals aged 15 to 64 years old), except for Germany (employees aged 25 to 64 subject to social insurance contributions), Ireland (workers aged between 20 and 69), and the Netherlands (employed and self-employed aged from 21 to 66) (iii) OECD data for the Netherlands is outdated (2010), and thus updated with latest data from Dutch Authorities on voluntary pillar 3 pension coverage (see source below); (iv) It is not possible to separate the data for Slovenia, Spain and Portugal according to VO/VP. They were assigned to the second pillar.
Source: Oxera analysis based on OECD (2021), 'Pension Markets in Focus 2021' and AFM (2023), 'Fiscaal-gefaciliteerde opbouw van individueel pensioenvermogen in de derde pijler: Een analyse van de afnemerskant op basis van CBS-microdata', for the Netherlands.

Germany has a very high contribution to voluntary personal pensions, with almost a third (30%) of the employed and working age population making voluntarily private pension provision. In Latvia, Estonia, Ireland, Finland, Austria, Italy, and France, there is also a considerable contribution to the third pillar. However, the figure also makes it clear that in half of the EU and the UK either a negligible proportion of the working population (6% in the Netherlands and 5% in the UK) or none at all pays into the voluntary private pension schemes. This underlines the extent to which the third pillar has developed very differently in the countries.

In the Netherlands (213%), more than twice as many assets were invested as the country's GDP in 2021. In the UK, assets are invested in pillar 2 and 3 pension schemes, which accounted for 120% of GDP in 2021. This is followed only by Finland as the country considered here, which has pension assets of more than half of its current GDP. All other countries have less than 40% of their country's current economic output invested in occupational or private pension schemes.

Implications of variation in pension systems across countries

Pension systems based on the first pillar are implemented in all euro countries and in the UK. The previous evaluations show that Latvia, Finland and the Netherlands have a strong (quasi-)binding pension system for the second pillar. Other countries (Germany, Austria, Italy, and Luxembourg) have only a voluntary second pillar scheme and people do not participate comprehensively.

The pension plans that affect the first two stages in the four A's framework (Attend and Access) already address the issue of participation. People automatically contribute money to these plans and therefore do not necessarily require financial advice in order to benefit from them.

There are also variations with regard to the second pillar. Some countries have group personal pensions (private group pensions are a type of defined contribution pension that some employers offer to their employees), employers that are required to contribute, and auto-enrolment initiative**Error! Reference source not found.**).

The situation is different with the third pillar. This relies on people's own initiative to save for private old-age provision. To do this, people must be motivated to engage with the topic in the first place. Even where they do, they have a large selection of investment options available to make provisions for their private pension. This requires accessible financial advice.

In other words, in some countries with more voluntary pension systems, access to financial advice may have more of an impact on retirement savings than in other countries where pension systems and mandatory and/or employers play an active role.

2.4 The advantages and disadvantages of remuneration systems for financial intermediaries

2.4.1 Payment for the distribution of products and services

Organisations distribute the products and services of producers to consumers in all sectors of the economy, and in all cases their distribution services need to be paid for. Supermarkets and many other types of retailer tend to recover their distribution costs by charging a retail price that covers the wholesale price plus a mark-up. Similarly, a producer selling products directly to consumers will typically charge a mark-up on the wholesale price that they charge to other businesses. In other markets, retailers may receive payments from the provider. A travel agent may receive commissions from a tour operator (e.g. a cruise liner), or it may charge service fees directly to the consumer (as is often the case with booking flights). Similarly, a mobile phone shop that sets up contracts between consumers and mobile network operators (MNOs) could take a commission payment from the MNO for arranging the transaction. Distribution services are paid for in a wide range of ways.

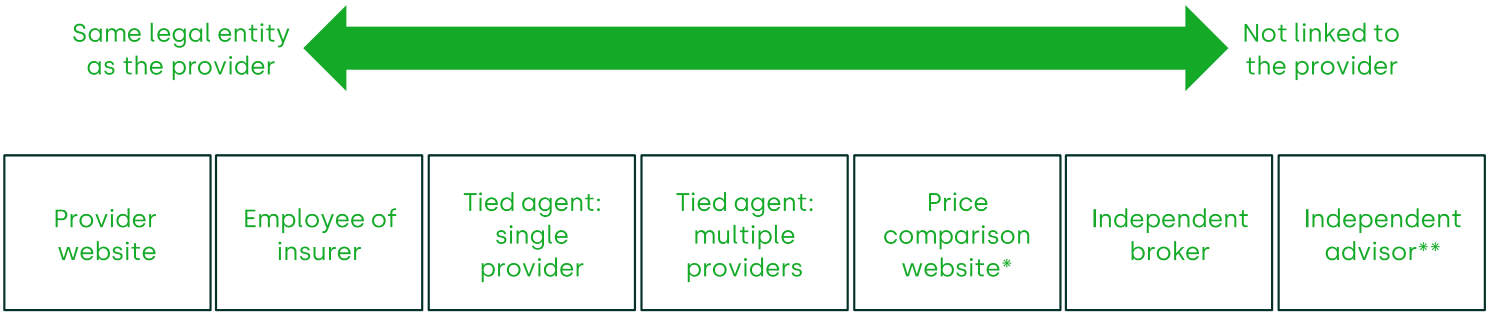
The situation is no different in financial services. Financial intermediaries, such as agents and brokers, facilitate transactions between retail consumers and the providers of financial products. The intermediaries' services range from simply providing access to products to giving consumers advice about which product may be the best option for them (including possibly advising not to buy any products).[40] Intermediaries may also undertake the administration and claims handling activities. The nature of the service will depend on the circumstances of the consumer, the product and the distribution channel.

There are also many types of distribution channel, depending on the nature of the relationship between the provider and the distributor. The spectrum of options is illustrated in Figure 2.6, from 'in-house' sales by the provider to brokers acting on behalf of their clients.

Under the Insurance Distribution Directive, insurance distribution must be accompanied by a 'demands and needs test', based on the information provided by the customer.[41] This is to ensure that the products are 'suitable' for the customer.

There are various definitions of whether an intermediary is 'independent' of providers. One legal definition is that an intermediary is independent of the provider as the intermediary represents the interests of the client, acting on behalf of the client in the relationship with the provider (whereas an agent acts on behalf of the provider). An independent intermediary may offer consumers whatever services they wish, often providing the consumer with access to the whole of the market (i.e. the full range of products). Some regulators have argued that an intermediary is independent only if that intermediary receives no commission payments from providers. These various interpretations are shown in Figure 2.6.

Figure 2.6 Spectrum of types of financial distributor



Note: * Price comparison websites may have different relationships with providers, and in some countries may be classed as insurance brokers. ** In some countries, independent advisors may be seen as a type of broker, in other countries there may be a separate legal class for advisors (separate to brokers).

[40] Insurance distribution is defined in the Insurance Distribution Directive (IDD), as: 'the activities of advising on, proposing, or carrying out other work preparatory to the conclusion of contracts of insurance, of concluding such contracts, or of assisting in the administration and performance of such contracts, in particular in the event of a claim, including the provision of information concerning one or more insurance contracts in accordance with criteria selected by customers through a website or other media and the compilation of an insurance product ranking list, including price and product comparison, or a discount on the price of an insurance contract, when the customer is able to directly or indirectly conclude an insurance contract using a website or other media'.
[41] Insurance Distribution Directive, recital 44.

Source: Oxera.

As distributors facilitate transactions between consumers and providers, they can receive payment from either party, although ultimately all payments come from the consumer. As defined in Insurance Distribution Directive, remuneration of insurance distribution activities includes 'any commission, fee, charge or other payment, including an economic benefit of any kind or any other financial or non-financial advantage or incentive'.[42]

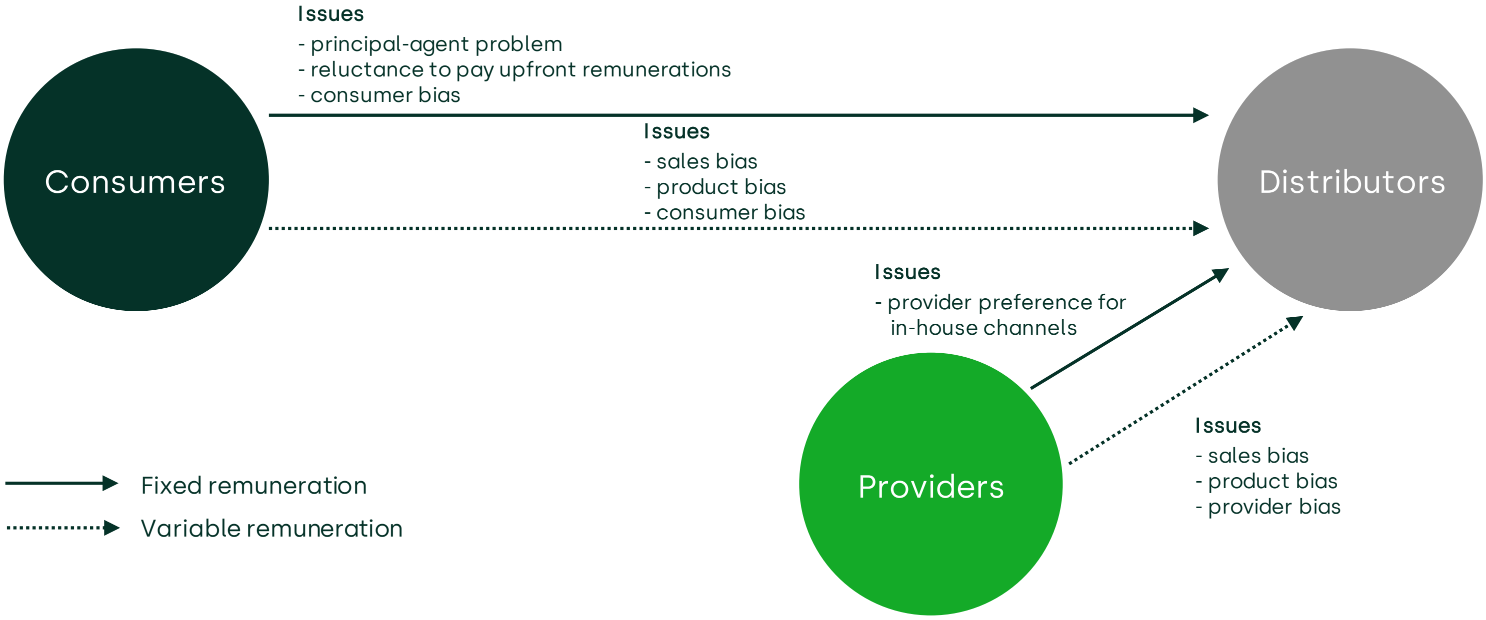
Thus, the remuneration can come in several forms:

- as a fixed amount that is unrelated to the value or frequency of transactions (e.g. a fixed fee to hire the services of an insurance broker);
- as a fixed amount that depends on the completion of the transaction (e.g. a fixed commission paid to an insurance broker or the price comparison website by the insurance company for each sale);
- as a one-off amount that is linked to the value of the transaction (e.g. a commission paid by a provider of non-life insurance that is a percentage of the value of the premiums);
- as an ongoing amount that is paid for as long as the consumer maintains the contract with the provider of the product (e.g. ongoing commissions paid by an insurer to the broker for as long as the customer continues to pay for the policy).

The form of remuneration can be expected to have an impact on both consumer demand for financial products and the intermediary's incentive to offer different services and advice. The payment structure could also affect the behaviour of providers. The various impacts are summarised in Figure 2.7, and discussed in detail below.

[42] Insurance Distribution Directive, Article 2, para. 9.

Figure 2.7 Potential impacts of different types of payments



Source: Oxera.

2.4.2 Impact of commissions and alternative regulatory approaches

Commissions can be characterised as payments from the provider of the financial products to the distributor of those products, with the commission generally depending on the completion of a transaction.

Traditionally, regulation of commissions would often focus on the potential impact of payments on the behaviour of distributors, but it is also important to take account of the impact on the behaviour of providers and customers. Regulators are increasingly considering the findings of behavioural studies with regard to how consumers respond to different situations, and the analysis in this report has been informed by behavioural economics (see section 2.1).

To assess the need for regulation of different forms of payment to distributors, it is vital to have a suitable economic framework for understanding the impacts on the behaviour of the parties involved. The forms of consumer bias were discussed in detail in section 2.1. We now examine the economics of payment methods with regard to the other parties: distributors and providers.

The analysis indicates that no single method of payment for the distribution of financial products can be considered to be ideal (or not ideal) in all circumstances—the pros and cons vary according to the situation.

A range of regulatory options can be considered depending on the circumstances of the market in question, including 'smart' disclosure, financial education and company supervision (such as Product Oversight and Governance ('POG') and value-for-money assessments), as well as restrictions on specific types of inducement and commission payment (e.g. banning volume-related bonuses).

2.4.3 Impact on the behaviour of distributors

The type of payment may affect the behaviour of the distributor of financial products. Any salesperson in any sector may be influenced by the way in which they are paid, which is why it is important to understand the range of impacts that can arise from different forms of payment. In particular, the following are key considerations.

- payments that do not depend on completion of the transaction may fail to incentivise the intermediary (the 'agent') to achieve the aim of the consumer or the provider (the 'principal')—which is to complete the transaction (for example, the consumer wants to buy insurance). This is often referred to as the 'principal–agent problem'. Also, inducements that may depend on the hours/effort spent on providing the advice could incentivise the agent to give more advice than needed or to stretch out the advisory process.
- any payment that depends on the transaction being completed, from either the consumer or the provider, will incentivise the intermediary to achieve a successful transaction. Although this is their primary economic function, there may be concern in some situations that intermediaries are incentivised to complete more transactions than may be in the interests of either the consumer or the provider ('sales bias').
- The different balance of payments from consumers and providers will affect the incentives of the intermediary. For example, higher commission payments from a particular provider can be expected to incentivise the intermediary to favour achieving transactions involving that provider ('provider bias').
- Any difference in payments, from either the consumer or the provider, with regard to different products, can be expected to incentivise the intermediary to favour achieving transactions involving that particular product ('product bias'). This applies equally to differential margins on products (i.e. payments from the consumer to the distributor) and differential commission payments (i.e. payments from the provider to the distributor).

These different forms of payments need to be considered from the consumer's perspective, as the impact on the final outcomes depends on their situation. For example, if a consumer has to buy motor insurance, and the choice of product features is fairly straightforward, the extent to which the distributor can affect the outcome is relatively limited and the service it provides to the consumer will mainly be around obtaining a competitive price. In this case, the impacts of the payment methods described above are unlikely to be important. On the other hand, a consumer looking for investment advice may be more reliant on the distributor, and there may be a risk of consumer detriment if these impacts arise. Furthermore, the impact may depend on how aware consumers are about potential conflicts of interest in financial advice (e.g. if more sophisticated customers are more aware of potential conflicts of interest such that there is less impact arising from them). The presence and effects of these impacts are a matter of degree. This is ultimately an empirical question, as it depends on the circumstances of the situation, as discussed further in section 3. Payments do not necessarily affect consumer outcomes.[43]

2.4.4 Impact on the behaviour of providers

As well as affecting the behaviour of distributors, payment methods can be expected to affect the behaviour of providers. This impact is likely to affect the nature of competition in the market, which will have consequences for consumers. Potential impacts include:

- changes in relative bargaining power, as distributors may have more bargaining power than customers in relation to providers;
- the choice of distribution channel, depending on how much influence the provider wishes to have over how products are sold.

Changes in relative bargaining power

Another impact that could arise, in principle, from how distributors interact with providers concerns bargaining power. Distributors that receive commissions from providers will be incentivised to maximise those commissions, while minimising the final price to the end-consumer in order to attract more consumers, especially if those consumers are price-sensitive. This means that distributors are incentivised to minimise the net price charged by the provider (the factory gate price (FGP), which is the price charged to the consumer minus commission payments to the intermediary).

This is also the situation if the intermediary is paid only by the consumer, as the consumer will be incentivised to drive down the FGP. However, the intermediary may have greater bargaining power with the provider than the individual consumer has, in which case the broker may be able to negotiate a lower FGP than the individual consumer can.

Ultimately, this could mean that commission payments to intermediaries strengthen the competitive pressure on providers.

Choice of distribution channel

Providers will have an interest in how their products are sold, which in turn will have implications for consumers. Providers often have a choice over distribution channels, and can choose to sell products

[43] The debate about regulating commissions appears in the academic literature as well as in policymaking. Two of the more recent papers are Inderst, R. and Ottaviani, M. (2012), 'How (not) to pay for advice: A framework for consumer financial protection', *Journal of Financial Economics*, 105:2, pp. 393–411; and Gorter, J. (2012), 'Commission Bans and the Source and Quality of Financial Advice', Dutch Central Bank Working Paper no. 350, September. The analysis in Indest and Ottaviani (2012) suggests that the policy decision about whether to impose a ban would depend partly on the proportions of more or less sophisticated customers. When more customers are more aware of incentives, the negative side effects of intervention are likely to be greater and could outweigh any benefits. Gorter (2012) concludes that, in practice, the welfare benefits of a ban on commissions may be limited. Gorter extends Inderst and Ottaviani's framework by allowing for both direct and intermediary advice (rather than just intermediary advice). Gorter's model suggests that, in equilibrium, customers who are less aware about conflicts of interests tend to prefer direct advice (i.e. advice offered by a direct sales force of a provider) over intermediary advice, even though the latter may be of better quality. Sophisticated customers rationally prefer intermediary advice.

through their own in-house distribution channels (e.g. their own website) as well as through tied agents (distributors that sell the products of only one or a few providers), or via independent brokers (who may provide products from across the market to consumers, without any restrictions from providers). Providers may choose to favour distribution through in-house channels and tied agents (or own employees).

Under the Product, Oversight and Governance requirements, providers must define their distribution strategy for each product (and ensure that this is consistent with the product's target market).[44] This is to impose limits on providers' ability to select inappropriate distribution channels.

2.4.5 Conflict of interest

The relationship between a financial intermediary and consumer can be described as a principal-agent relationship. A principal-agent problem exists when one person (i.e. the agent) is able to make decisions on behalf of another person (i.e. the principal), but the principal is unable to adequately supervise the agent. This can result in the agent acting in his/her own best interests rather than the interests of the principal.

When applying this concept to the relationship between the consumer and distributor of financial products, there are three important points to consider:

First, economic theory tells us that any principal–agent relationship can result in conflicts of interest. That is because the principal and the agent have differing incentives. Whether the distributor is paid by the provider or directly by a consumer with imperfect knowledge, incentives will not be aligned and a conflict of interest may arise and lead to higher costs for the consumer.

Second, there is no simple remedy that can remove all material conflicts of interest. Economic theory tells us that any financial distributor or advisor will ultimately act in their own interest. Thus an advisor has an incentive to recommend a needless transaction when there is a fee to be justified, as this will maximise the expected value they receive. Similarly, an advisor under pressure to justify a fee might direct customers to suboptimal complex products just because they were not easily accessible to the public.

Third, the presence of a theoretical potential conflict of interest does not necessarily result in consumer harm, compared to the counterfactual. This depends on whether the conflict of interest is material enough to change the behaviour of the economic agents. For example, does the inducement change the behaviour of the financial intermediary, and does this changed behaviour result in worse consumer outcomes compared to the counterfactual (where other conflicts of interest arise)? This is an empirical question. For example, if there are sufficient clawback mechanisms for commissions, this will incentivise intermediaries not to sell products that the customer later

[44] Insurance Distribution Directive, article 25.

cancels. This reduces the impact of any conflicts of interest associated with commissions. Further, due to Product Oversight and Governance regulation, a financial intermediary may not incentivise customer-facing staff to prioritise the firm's interests over the consumer's interests. In this context, the incremental benefit of banning commissions is likely to be small. Indeed, in the case of a compliant firm, there might be no effect while, if a firm has a weak compliance culture, we should not expect a ban to result in the delivery of high-quality advice.

Therefore, it is important to consider the extent to which a possible conflict of interest (as a result of commission payments) actually results in harm relative to the harm that would arise under other forms of remuneration.

In any event, it is important to acknowledge that, absent an commission-based compensation regime, distributors and advisors can be subject to their own misperceptions and biases about the products they advise on.

In summary, the mere identification of a conflict of interest arising from inducements to financial intermediaries is insufficient evidence that a ban on inducements would benefit consumers overall. This is a more complex and nuanced question and, importantly, there are significant trade-offs to consider.

On the one hand, a ban on commission[45] may remove one specific financial reason for advisers to recommend products that have attractive commissions. But then again, whether the commission is a strong driver of an adviser's behaviour is an empirical question and also depends for example on other regulation that is in place to manage possible conflicts of interest and the principal-agent problem and the extent to which compliance is indeed supervised. Furthermore, there are various other factors that affect the behaviour of a distributor which may result in negative outcomes for consumers. Irrespective of whether there is a commission payment, regulation and supervision is required to address the principle-agent problem.[46]

Importantly, in the UK, where a commission ban was introduced in 2013 for certain complex products, a general Consumer Duty is being introduced.[47] This Duty requires firms to act to deliver good outcomes for retail customers and, most importantly, applies to situations with and without commission payments. This is happening because of serious concerns that distributors and providers (irrespective of how they are paid) were not sufficiently focused on delivering good outcomes for consumers.

A ban on commissions may also come with a significant trade-off. Insights from behavioural economics indicate that for a variety of

[45] This could be an outright ban on all types of commission across all channels, a partial ban focusing on specific channels, or a de-facto ban where, for example, the conditions under which a commission could be paid are so stringent that in practice it would have the same or a similar effect as a commission ban.
[46] The IDD requires distributors to act honestly, fairly and in the best interest of customers (Article 17). MiFID II contains similar requirements (Article 24).
[47] FCA (2022), 'PS22/9: A new Consumer Duty', July.

reasons many consumers insufficiently engage with financial planning and products, and are not willing to pay for financial advice. One of the benefits of a commission-based system is that it helps overcome consumer inertia. A ban is likely to affect the use of advice and engagement with financial products resulting in insufficient use of in particular insurance and pension products. This would affect people's financial well-being in the longer-term; the costs of not taking certain insurance and/or pension products can be substantial in the long term.

We now turn to the empirical evidence on how introducing a ban on inducements changed consumer outcomes in the Netherlands (section 3), and then the UK (section 4).

3 Analysis of the impact of a commission ban in the Netherlands and the lessons for the EU policy debate

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The Netherlands has introduced perhaps the widest-ranging regulation of commission payments to advisors among all EU member states. The ban on commissions, implemented in 2013, was the final significant piece of regulation forming part in a series of regulatory interventions introduced from 2009. These measures were introduced against the backdrop of high-profile mis-selling cases in the market for mortgages and related life insurance products (so called 'complex products'). Many of these regulations applied across the industry, but others were specific to individual product markets (e.g. mortgages).

Box 3.1 Key takeaways

- As recognised by the Dutch Minister of Finance in their report to Parliament, i**t is impossible to disentangle the impact of the ban from the broader series of regulatory interventions** that preceded and accompanied it. The Dutch authorities introduced a package of regulatory measures and increased regulatory scrutiny, with the aim of removing from the market problematic complex products, and related steering behaviour on the part of advisors.
- **Changing trends in some of the main outcomes of interest, and across the products of concern, were observed *prior* to the ban** on commissions, and in large part due to market-specific regulations and developments outside the ban. For example, changes in tax incentives and regulations allowing new competitors to enter the market seems to have the main driver in removing complex mortgage- and life insurance products from the market.
- **There is no robust evidence that consumers are receiving better financial advice and making better financial decisions.** While the government's evaluation seems to conclude that the quality of advice has improved, this relates primarily to procedural compliance considerations rather than a rigorous assessment of the changes in the quality of advice itself.
- **There is cautionary evidence to suggest that advice may have become less comprehensive and less customised** to individual needs (at least for the majority of people who cannot afford personal portfolio management).[48]
- **There has been a meaningful decrease in both the demand and supply of traditional financial advice.** Academic and consumer research shows that this *is* indeed likely driven by the ban: consumers are more price-sensitive under the new advice cost

[48] As discussed in further detail below, there is evidence that advisors (i) provide advice within the narrower scope of products brought to them (and play it safe by only providing advice on those products enquired about, given the new strict fee-per-service environment); (ii) that they are no more likely to shop around on behalf of consumers; and (iii) consumers are increasingly reliant on online services and/or non-advice, execution-only products to make investments or take out insurance products. The current lack of ongoing aftercare services is a particular concern.

regime and are thus more likely to avoid paying for advice. This has been accompanied by the increased use- and supply of execution-only, non-advice products. The government's evaluation of consumer behaviour shows that when consumers are made aware of the costs of advice, this markedly shifts their preference from taking out financial products through personal advisors to doing so via execution-only platforms.

- **There is evidence to suggest that those who avoid seeking financial advice are those in most need of it, and that traditional advice from a financial advisor is increasingly reserved for wealthy clients**. Non-wealthy consumers are generally redirected to online and execution-only services.[49]
- **Compensatory measures were required to ensure that the ban on commissions did not create an unlevel playing field** between direct providers and independent advisors/intermediaries. This has remained on ongoing area of concern for Dutch authorities.
- **For some product markets, the ban has been less of a concern**.
  - **For mortgages**, demand is driven primarily by the desire to own a house and advice fees are a relatively minor part of the homebuyer s total expenditure
  - The impact on **pension savings** is also of less concern in the Netherlands. Unlike most of its EU peers, the country has a mandatory public and semi-mandatory occupational group pension (so-called pillar 1 and 2 pensions). In countries with for example voluntary pension systems, a commission ban is likely to have more impact on retirement savings.
- **While there has been a notable increase in the uptake of passive index fund investments and ETFs since 2017, this is in line with the general trend across well-developed capital markets**.[50] These products have been increasing in popularity in well-developed capital markets, including countries where no commission ban is in place (like the USA[51]).

3.1 Source: OxeraBackground, rationale and overview of the ban

One of the main drivers of the commission ban and related regulations on the distribution of financial products were concerns arising from a number of high-profile mis-selling cases. [52] The *woekerpolisaffaire* ('profiteering policy affair'), uncovered in 2006, related specifically to the sale of savings-based mortgages and insurance based investments products (IBIPs)—see discussion in the box below.

[49] For example, mystery shopper studies conducted for the European Commission show that independent advisors would provide advice only to investors with substantial capital to invest—requiring minimum investment amounts ranging from €250,000 to €500,000. The alternative for non-wealthy investors is to be steered towards digital and/or execution-only products. European Commission (2018), 'Distribution systems of retail investment products across the European Union.', p. 23.

[50] See EU-level index fund and ETF investments trends in ESMA (2021), 'Performance and Costs of EU Retail Investment Products', April, p. 20; and Refinitiv (2022), 'Monday Morning Memo: Review of the European ETF Market 2021', https://lipperalpha.refinitiv.com/reports/2022/03/monday-morning-memo-review-of-the-european-etf-market-2021-2/#

[51] See FT article here

[52] These concerns were compounded by the subsequent broader stress on the Dutch housing market, and mortgage repayments in particular, and the more general loss in financial service providers and advisors, as the Netherlands dealt with the fallout from the global financial crisis in 2008/09.

Box 3.2 The *woekerpolisaffaire* (Dutch mortgages and life insurance mis-selling scandal)

The *woekerpolisaffaire*, or 'profiteering policy affair', which was uncovered in 2006, was seen to be one of the motivations for the regulation of the distribution of financial products and, more specifically, the ban on commissions. The affair related to the sale of mortgage and investment insurance products, whose value was linked to investments. For example, the payments of mortgage holders would be invested rather than used to pay the interest and principal on the mortgage directly.

The value of these multifaceted products was linked to investments, and they were complex in that they had both a mortgage and/or insurance component, as well as an investment component. A consumer's premiums would thus go towards both mortgage interest and/or insurance coverage, while the remaining portion would be pooled with assets from other policyholders and be invested in either equities or bonds, or a combination of the two. These products form part of what have since become known in subsequent Dutch regulations as 'complex products'. They have since mostly been removed from, and are generally discouraged in, the Dutch financial services market.

For example, in a savings-based mortgage (which has since been phased out of production[53]), while part of the premiums would be used for interest payments, the other part of the payments of mortgage holders would be invested (rather than making capital/principal repayments). At the end of the mortgage term, the principal would then be repaid from this linked savings account.

The rise of these policies coincided with the equity boom of the late 1990s, which made them look attractive. These mortgages also had the advantage of smoothing out real mortgage payments in the higher-inflation environment of the 1980s and early 1990s.[54]

However, following an investigation by the Dutch Authority for Financial Markets (AFM), these policies turned out to be complex, unclear and relatively expensive.[55] The concern was that due to the commissions they were receiving, distributors were incentivised to advise consumers to take these products.

[53] De Nederland Bank (2016), 'Vision for the future of the Dutch insurance sector', p. 12. Similar 'complex' mortgage products (life insurance mortgages or investment mortgages) have also since been phased out of production.
[54] With a standard repayment mortgage, the monthly repayments are fixed in nominal terms. Thus, in a high-inflation environment, the repayments are high in real terms at the start of the mortgage, and low in real terms at the end. With an endowment mortgage, it was possible to smooth out payments in real terms to a greater extent, although this might be feasible in practice only if the value of the house was also rising.
[55] See Minister of Finance, The Netherlands (2010), 'Betreft evaluatie provisieregelgeving en vervolg met kenmerk FM/2010/17247 M', Letter to Dutch Parliament, 12 October.

These policies were similar to endowment mortgages in the UK and a similar concern arose in the UK, but the UK regulator did not conclude that the solution would be to restrict commission payments to mortgage intermediaries. In the UK, the policies were also mostly sold by the providers' own inhouse distribution arms, and so the regulator instead chose to regulate the products of the mortgage provider rather than the activities of the distributor. The nature of the chosen regulation was different, as the market operated in a different way in the UK.

Source: Oxera.

The specific target of the measures was thus to prevent mis-selling and 'hit-and-run' advice, whereby intermediaries would advise customers on investment-linked policies and receive large commission payments at the outset of the transaction.

A related concern for regulators was that consumers were not sufficiently informed to identify and counteract such advice from conflicted advisors.[56] Prior to the ban on commissions in 2013, payments to advisors were typically part of total payments for financial products. This made it difficult for customers to learn how much they were paying for advice, and how much they were paying for the product. In addition, it was believed that this lack of transparency made it more difficult for consumers to compare across products, providers and advisors.

At the time, there was a general acceptance by the Dutch government, the regulator, and representatives of the financial services industry (both providers and distributors) that there was a need to reform the model of distribution and remuneration for advice and intermediation. There was also a general lack of trust in the insurance sector, and the types of complex products that were at the heart of the mis-selling cases (mostly savings-based mortgages and unit-lined life insurance).[57] This was augmented by the untenable position most homeowners found themselves in as the house market and mortgages came under pressure following the financial crisis in 2008/09. The reforms were thus perceived to be in the best interest of both consumers and industry.

A series of regulatory interventions, reviews and amendments then followed over the 2009–14 period.[58] Several measures were gradually introduced and tightened over time, culminating in the eventual ban of commissions ('*provisieverbod*') for complex products in January 2013.

The regulations introduced reflected the regulator's preference to move from product-driven sales towards client-centred advice (often

[56] Minister of Finance, The Netherlands (2010), 'Betreft evaluatie provisieregelgeving en vervolg met kenmerk FM/2010/17247 M', Letter to Dutch Parliament, 12 October.
[57] See, for example, De Nederland Bank (2016), 'Vision for the future of the Dutch insurance sector'.
[58] An overview and timeline of all the relevant AFM regulations over the period, and amendments and new regulations since then, is provided by Adfiz (2019), 'Adfiz in Cijfers', pp. 28–29.

referred to as a 'culture change').[59] The aim was to ensure a clear separation of the payment streams between customer to advisor, and customer to provider. Already from 2009 there were significant changes in the levels and structure of advisor fees: advisors were prohibited from accepting inducements (such as turnover-related bonuses), and rules were introduced to cap the level of commission that could be charged and limit the share of the total commission payments that an advisor could receive upfront (to disincentivise hit-and-run selling practices).[60] From 2013 onwards, alongside the introduction of the ban, advisors were also increasingly restricted in their right and ability to take payments for financial products (e.g. premiums) from their customers and transfer them to providers.

The Dutch Minister of Finance recognised that the creation of a level playing field was also an important objective for the ban on commissions. In particular, this concerned the terms of competition between independent advisors and advisors working for banks, insurers, or other direct providers of products.

The Dutch authorities have also been careful to consider potential unintended consequences and trade-offs that may result from the ban. This is reflected in the fact that: (i) there is a range of products not covered by the ban (and there are circumstance-specific exemptions for products to which the ban applies); and (ii) the scope of the ban and related regulations remains subject to amendments as or when evidence of detrimental impacts come to light.[61]

3.2 Scope of the ban (and additional measures)

The scope of the ban initially covered complex products,[62] which in the first instance targeted products that formed part of the mis-selling cases (investment-linked mortgages and life insurance products[63]). It also included all other forms of investment-based insurance, general mortgage loans, term life insurance, income insurance products (e.g. payment protection and individual disability insurance), and

[59] Minister of Finance, The Netherlands (2011), 'Uitwerking regelgeving provisieverbod', Letter to Dutch Parliament, 13 April; and Minister of Finance, The Netherlands (2018), 'Government letter; Evaluation of commission ban - Laws and regulations financial markets', Letter no. 74 from the Minister of Finance, 23 January.
[60] The regulator first introduced a cap on commissions in 2009, alongside a range of complementary measures (some of which are discussed below). For example, this included a cap for mortgage advisors of approximately €5,000. See Adfiz (2019), 'Adfiz in Cijfers', pp. 28–29; and Van der Linden, R. (2014), 'Banning protection commissions – the Netherlands Experience', *Cover*, 18 March, http://www.covermagazine.co.uk/cover/feature/2333037/banning-protection-commissions-the-netherlands-experience.
[61] To this end, the Dutch Minister of Finance highlighted a non-exhaustive list of remaining issues that 'deserve attention', and which are the subject of follow-on consultation between the government and market parties. See Minister of Finance, The Netherlands (2018), 'Government letter; Evaluation of commission ban - Laws and regulations financial markets', Letter no. 74 from the Minister of Finance, 23 January.
[62] The relevant legislation defines complex products as those that are a combination of two or more financial products, and where at least one of these product's value depends on developments in financial markets or other markets. See Article 1 of the Besluit Gedragstoezicht Financiële ondernemingen Wft ('Decree on the Supervision of the Conduct of Financial Enterprises Wft'). The commission ban is stated in Article 86c.
[63] This includes life insurance mortgages, products that combined a mortgage loan with a life insurance policy.

funeral insurance.[64] In January 2014 the commission ban was extended to other investment products (not just participation in investment funds), which means that the ban covers advice for both discretionary individual pensions[65] and retail investment products (e.g. equity stocks or bonds and related investment vehicles such as mutual funds or ETFs). The scope of products covered is summarised in Table 3.1.

Table 3.1 Scope of commission ban

Product	Covered
Mortgages *(investment-linked and standard loans)*	☒
Life insurance *(investment and non-investment)*	☒
Other investment-based insurance	☒
Discretionary private pension products *	☒
Retail investment products	☒
Income insurance *(e.g. payment protection and disability insurance)*	☒
Funeral insurance	☒
Non-life insurance *(property, motor, etc.)*	☐
Consumer credit	☐

Note: Discretionary private pension products in the Netherlands relates to both fiscally facilitated (i) life-insurance and (ii) annuity-type bank savings products – referred to as pillar 3 pension products (discussed below).
Source: AFM website and underlying legislation: 'Besluit Gedragstoezicht Financiële ondernemingen Wft', Articles 1 and 86c.

The eventual scope of the ban thus covers the selection of products that the Minister of Finance had identified as complex and/or having a potential material impact on consumers.[66] Funeral and disability insurance products are examples of the latter (i.e. having a material impact), rather than the former (they are not necessarily complex). For example, funeral insurance was included on the basis of an AFM review, which considered that the interests of customers were not central to the sale of these products.[67]

[64] 'Besluit Gedragstoezicht Financiële ondernemingen Wft', Articles 1 and 86c. See also summary provided on the AFM website: https://www.rijksoverheid.nl/onderwerpen/financiele-sector/vraag-en-antwoord/wat-betekent-het-provisieverbod-voor-mij-als-consument.
[65] This covers pillar three, supplementary annuity and blocked bank saving products for persons who accumulate insufficient pensions under the second pillar or are not in employment (e.g. the self-employed—discussed below). Pension funds are not allowed to provide these kinds of products as their field of operations is strictly limited (to occupational/group pensions, pillar 2 activities). However, uncertainty remains regarding the extent to which this applies equally to financial services (and advice) by a general pension fund provided to employers. See Minister of Finance, The Netherlands (2018), 'Government letter; Evaluation of commission ban - Laws and regulations financial markets', Letter no. 74 from the Minister of Finance, 23 January; and AFM (2015), 'Naleving provisieverbod financiële dienstverlening'.
[66] Minister of Finance, The Netherlands (2011), 'Uitwerking regelgeving provisieverbod', Letter to Dutch Parliament, 13 April.
[67] AFM (2011), 'Onderzoek naar de distributie van uitvaartverzekeringen', marktstudie, December.

Certain product categories were also specifically excluded from the ban (given differences in prevailing market conditions and/or other regulatory priorities), while even for the products that are covered, exemptions are possible in certain cases.

- **Non-life insurance** this includes property and casualty insurance (e.g. for vehicles, home contents, general liability and legal aid). These products were excluded based on the existence of strong competition among providers and the view that consumers have a good understanding of these products and an awareness of the various providers.[68]
- **Consumer credit** was excluded given the over-representation of vulnerable consumers, which pointed to a greater risk of abuse and consumer harm. Recognising this risk of abuse, the AFM considered it to be more appropriate to directly regulate the prices of advice relating to consumer credit, applying the principle that the price has to be proportional to the advice given (the '*kennelijke onredelijkheidsnorm*').[69]
- **Exemptions**—a specific exemption was introduced for mortgage takers who are in financial distress (having either current or foreseeable problems in making their mortgage payments). In this special case, advisors may receive a payment (i.e. a commission) from the provider for the specific activities performed to resolve the actual (or foreseeable) mortgage payment arrears, subject to certain conditions.[70] In select cases the AFM has also exempted companies from the ban where the company has shown that it: (i) cannot reasonably comply with the ban; and (ii) has put sufficient alternative measures in place to meet the objectives of the ban.[71]

The Dutch authorities thus had a specific problem they wanted to address in introducing the ban on commissions (alongside the suite of complementary regulations). The Dutch government thus seems to have deemed that, considered as a whole and given its context-specific policy objectives with the ban, the benefits of the ban have outweighed any potential trade-offs.[72]

[68] Note, however, that bonus commissions (fees that encourage the sales of certain products) on non-life insurance policies were already banned as of 1 January 2012.
[69] Minister of Finance, The Netherlands (2011), 'Uitwerking regelgeving provisieverbod', Letter to Dutch Parliament, 13 April.
[70] Including that the fee is proportionate for the scope and nature of the service, and that the customer is informed about the fee and the amount thereof. See AFM website: https://www.afm.nl/nl-nl/sector/adviseurs-bemiddelaars-en-gevolmachtigde-agenten/beloning/provisieverbod/uitzondering.
[71] These often relate to outsourced provider activities. See the overview of exemptions granted by the AFM to date: https://www.afm.nl/nl-nl/sector/adviseurs-bemiddelaars-en-gevolmachtigde-agenten/beloning/provisieverbod.
[72] For example, in assessing the necessary follow-up discussions and potential measures required in light of the government-commissioned evaluation of the impact of the ban and related measures, the Dutch Minister of Finance noted: 'All in all, the evaluation gives no reason to question the commission ban. However, a number of issues deserve attention. […] These subjects will be discussed with the parties involved in the near future in order to develop broad support for possible follow-up steps.' Minister of Finance, The Netherlands (2018), 'Government letter; Evaluation of commission ban - Laws and regulations financial markets', Letter no. 74 from the Minister of Finance.

However, the implementation of the ban has not been challenge-free, and the Dutch authorities have been careful to consider the potential unintended consequences and trade-offs involved (and where relevant, introduce potential compensatory measures). For example, the application of the regulation across all sales channels has created difficulties, in particular since regulating distribution costs for in-house sales channels is not straightforward. Nevertheless, despite best efforts from the regulator (see Box 3.3 below), there are still residual concerns about an unlevel playing field (discussed below)

Box 3.3 Dutch case study: the regulatory challenge of ensuring a distribution channel-neutral ban on commissions

The concern in this regard is that vertically integrated providers (those who also provide advice services as part of one product offering) may have an incentive to treat some of their distribution costs (e.g. advice) as product costs. This would result in an artificially low cost for advice, which could potentially price independent advisors out of the market.

Compensatory measures were thus required to ensure that the ban on commissions did not create an unlevel playing field between direct providers and independent advisors/intermediaries, and included the following.

- As a first step, the ban covers all sales channels (i.e. it is a channel-neutral approach). However, this alone would not be sufficient and measures were required in addition to this.
- Providers of financial products who are also advisors (direct sales) are also required to ensure that fees for advice/intermediation are cost-reflective, and that they do not fall below the direct cost of providing the advice/arranging the implementation.[73]
- Furthermore, the tax regimes for independent advisors and those acting on behalf of direct providers have also been equalised.[74]

Source: Oxera.

Given the broader suite of additional measures introduced either before or alongside the ban on commissions, one must first consider how the ban fits within the broader set of regulations and market developments. This, in turn, informs what can reliably be concluded about the impact of the ban on the relevant Dutch policy objectives (and any lessons for the broader EU policy debate).

[73] Details on the cost model, to ensure cost-effective pricing, are provided on the AFM's dedicated page to the commission ban, under frequently asked questions: https://www.afm.nl/nl-nl/sector/adviseurs-bemiddelaars-en-gevolmachtigde-agenten/beloning/provisieverbod.
[74] Decisio (2017), 'Zakelijker verhoudingen – de markteffecten van het provisieverbod', p. 17 (from here, referred to as Decisio (2017) Report).

3.3 Disentangling the impact of the commission ban from a broader suite of regulations

It is important to note that disentangling the impact of the ban on commissions, as a stand-alone intervention, is not possible. None of the various studies and government commissioned evaluations to date allows one to make a firm causal conclusion on its effects. Rather, the research on the real-world effects of the ban (discussed below) has necessarily been descriptive in nature. This leaves scope for interpretation and subjectivity in the broader policy debate, depending on the weight given to different data points.

First and foremost, because the ban was introduced as (the last) part of a series of targeted regulatory interventions, it is not possible to consider its impact in isolation. The Dutch Minister of Finance also noted as much in his report to Parliament, caveating the certainty with which results and conclusions can be drawn from the government-commissioned evaluations of the ban [75]:

> 'it is virtually impossible to consider the effects of the ban on commissions in isolation. Simultaneously with the entry into force of the commission ban, other measures have also been taken to improve the quality of the service, such as the rules regarding the product development process and a tightening of the professional competence requirements'[76]

More specifically, in addition to the ban on commissions, several preceding and/or complementary measures were introduced over 2008–14. In most instances these measures also directly targeted these same complex financial products and were also designed to have an impact on the exact same policy concerns and objectives (such as improving the quality of advice, improving fee transparency, removing information asymmetries and potential conflicts of interests, and lowering advice costs).

The broader suite of complementary measures of which the ban on commissions formed part included the following.

- **Information disclosure measures**. Since 2009, Dutch legislation has required that potential clients be entitled to upfront information from financial advisors and intermediaries on both (i) the way in which they are remunerated and (ii) the amount of remuneration they receive when advising on complex products and mortgages.[77] An important accompanying instrument in this regard is the *dienstverleningsdocument* (DVD), or service document, required

[75] The other main caveat was that 'good data is not always available' for the purposes of making causal inferences about the impact of the ban, specifically. The research conducted used a combination of descriptive methods, and triangulated across the results from a descriptive analysis of industry trends before and after the ban, lab experiments, and industry stakeholder interviews and survey. Minister of Finance, The Netherlands (2018), 'Government letter; Evaluation of commission ban - Laws and regulations financial markets', Letter no. 74 from the Minister of Finance, 23 January.
[76] Ibid.
[77] See summary of legislation in De Jong, F. (2010), 'Marktfalen bij tussenpersonen', Uitgeverij Paris, p. 68; and SEO (2010), 'Evaluatie provisieregels complexe producten', p. 11.

from 1 July 2013. For the DVD, advisors were obliged to draft a summary disclosure document presenting information on the fees they charge,[78] the nature and range of services, the costs they incur, and whether they were acting on behalf of specific providers (i.e. whether the advisor is independent, tied to a specific provider, a subset of providers, etc.). The aim of the DVD was to empower consumers with the information necessary to make decisions on which advice (and products) to use, enabling them to compare service offerings and costs across different advisors.[79]

- **Tighter requirements and oversight on advice quality** This included requirements that an advisor has sufficient knowledge of the consumer's specific financial situation and needs.[80] The aim was to ensure that advisors cover what are outlined as the necessary steps to provide quality advice. The AFM has also closely monitored the state of the advisory practice[81] and handed out fines where applicable, ensuring that these measures are enforced.[82]
- **Tighter competence requirements for advisors and intermediaries**, to ensure that they are sufficiently qualified.
- **A knowledge and experience test for consumers** who wish to make use of execution-only products (i.e. those not involving advisors and advice fees).[83]
- **General increase in monitoring, public information provision and intensity of regulatory oversight.** Over the same period, there was also an uptick in the regulator's scrutiny of activities relating to the same underlying objectives of the suite of regulatory measures introduced over the period. This included reports on the costs of investment services,[84] ongoing consumer and market participant monitoring surveys,[85] and subsequently making information on the costs and fees of different financial products publicly available to consumers. Other efforts included a series of guidelines to, and interactions with, market participants about the regulator's expectations for advice quality, advice payment incentive structures, and the acceptable level of advice charges.[86]

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[78] These are given for an average customer, as the precise fee for each individual customer will depend on the services they choose. See Minister of Finance, The Netherlands (2011), 'Verdere uitwerking beleid provisieverbod complexe producten', Letter to Dutch Parliament, 13 December.
[79] Article 4:23 of De Wet op het financieel toezicht (Wft), or Financial Supervision Act, concerning know-your-client requirements.
[80] Ibid.
[81] See, for example, AFM (2015), 'Naleving provisieverbod financiële dienstverlening', Report.
[82] See appendix report to Minister of Finance, The Netherlands (2018), 'Government letter; Evaluation of commission ban - Laws and regulations financial markets', 23 January: Decisio (2017), Report. p. 21.
[83] This test is required for all products covered by the commission ban, except funeral- and life insurance (unless these qualify as payment protection, in which case the test is again mandatory), See [Decisio (2017), p. 17.
[84] AFM (2012), 'Research into the costs of investment services: Findings and Recommendations', November.
[85] With reference to the AFM's half-yearly Consumentenmonitors and annual Marktmonitor surveys of consumers and financial advisors and intermediaries, respectively.
[86] See summary of guidelines introduced since 2009, in Adfiz (2019), 'Adfiz in Cijfers', pp. 28–29.

Second, given that the ban formed the final part of a series of related measures gradually introduced over the period, an evaluation of the impact of the ban must also account for the fact that many of the changes to industry structures and practices may have already occurred prior to the commission ban taking effect in 2013. Despite the 2010 government investigation into these early measures finding that the most important perverse incentives and hit-and-run practices had been removed from the market and that market parties were adhering to new cost- and service transparency rules, the Minister of Finance concluded that further measures were still required. This was based on the view that consumers were still inadequately informed and the envisioned 'cultural change' on the part of advisors had not yet been achieved.[87]

For example, as early as 2008, tighter regulations on the structure and level of advisor commissions were introduced (including regulations in the share of fees payable upfront versus trail commissions and caps on aggregate commissions). Thereafter, over 2009 and 2010, requirements around remuneration transparency, caps on commission fees, and the inducement standard were introduced (the latter prohibiting any form of remuneration seen to be perverse – like volume-based bonuses or in-kind remuneration – between the provider and distributor).[88] A subsequent government evaluation in 2010 found that (i) the main perverse incentives and hit-and-run practices had already been removed from the market and that (ii) market parties generally adhere to the newly introduced rules regarding advice costs and transparency therein.[89]

It is also important to consider how these regulatory measures relate to other industry regulations and general market developments that occurred over the period, which may also be conflated with the effect of the commission ban. The most pertinent examples include the following (discussed further below).

- **Mortgages**, where, over the period preceding and overlapping with the implementation of the ban, there has been: (i) an increase in competition in the provision of mortgages (with low interest rates seeing insurers and pension funds enter the market, thus competing with traditional bank providers); (ii) more stringent requirements introduced (over 2008–12)with regard to obtaining a mortgage loan, and the maximum value thereof; and (iii) a change in tax relief incentives (introduced at the same time as the ban, in 2013). The introduction of these mortgage-market specific measures has been credited with the removal of the more complex, more expensive

[87] Minister of Finance, The Netherlands (2010), 'Betreft evaluatie provisieregelgeving en vervolg met kenmerk FM/2010/17247 M', Letter to Dutch Parliament, 12 October.
[88] Ibid. A full summary of the series of regulations introduced over this preceding period can be found in De Jong, F. (2010), 'Marktfalen bij tussenpersonen', Uitgeverij Paris; and SEO (2010), 'Evaluatie provisieregels complexe producten', pp. 9 – 11.
[89] Minister of Finance, The Netherlands (2010), 'Betreft evaluatie provisieregelgeving en vervolg met kenmerk FM/2010/17247 M', Letter to Dutch Parliament, 12 October, with reference to the study by SEO (2010), 'Evaluatie provisieregels complexe producten'.

products and the increased uptake of simpler, more cost-effective alternatives in their place.[90]
- **Life insurance products**, which have been affected by similar (and related) developments to mortgage products. Here too a change in tax incentives, an increase in competition from new types of products and providers,[91] as well as a loss of confidence in the type of product after the earlier mis-selling scandals saw a general decline in the uptake of life insurance products after 2008 (that is, prior to the ban on commissions in 2013).

The change in market outcomes observed for these main products of concern were thus in large part due to market-specific regulations and developments, and in the main *prior to* the ban on commissions in 2013.[92] Below we discuss what can reasonably be concluded from existing studies on the impact of the ban, cognisant of these broader market regulations and industry trends over the period.

3.4 Assessing the evidence on the impact of the ban

The Dutch Ministry of Finance commissioned an evaluation of the ban and accompanying measures, which was conducted over 2017.[93] The main outcomes of interest of the evaluation (as it related to the ban, specifically)—as outlined in the letter from the Minister of Finance on the scope of the evaluation[94] and the categories subsequently captured in the eventual evaluation[95]—can be summarised as follows:

- **removing conflicts of interest**;
- **the quality of advice;**
- **the impact on competition** (i.e. ensuring a level playing field);
- **the accessibility** of advice and the cost thereof.

Below we discuss the outcomes of the Dutch government's evaluation, as well as other academic and/or independent studies conducted over the period, in each outcome area.

3.4.1 Removing conflicts of interest

Given the context in which the ban was introduced, removing the incentives that facilitated the earlier mis-selling cases was clearly one

[90] Decisio (2017), Report, p. 20; De Nederland Bank (2016), 'Vision for the future of the Dutch insurance sector', pp. 28–29; and Knop, K. (2019), 'Mortgage Interest Tax Deduction in the Netherlands: A Welcome Relief', speech at the Macroprudential Policy Conference, 'Real estate taxation and macroprudential policy', 2 July, pp. 5–6.
[91] In this case referring to private bank savings products competing with traditional life insurance and annuity products sold by insurers, which was facilitated by a change to regulations on whom may offer the relevant fiscally facilitated savings products (discussed further below).
[92] The Dutch government also announced the ban on commissions in 2011, such that further anticipatory industry changes may have occurred over the two-year period before it took effect.
[93] The evaluation consisted of two reports, one by research agency Decisio on the market effects of the commission ban, and the other by Centerdata (at Tilburg University) on the impact on consumer behaviour as a result of the ban and accompanying DVD service documents.
[94] Minister of Finance, The Netherlands (2016), 'Recht op premie-incasso bemiddelaars en voorgenomen evaluatie Provisieverbod met kenmerk 016-0000058524', Letter to Dutch Parliament, 13 June.
[95] See themes in the executive summary, Decisio (2017), Report, pp. 6–10.

of the main objectives of the ban and broader package of regulatory interventions introduced since 2009. The focus here was whether these measures removed undesired steering towards certain products and/or providers on the part of advisors.

On the whole, the Dutch authorities have considered that these interventions were successful. The Minister of Finance noted in his conclusions from the 2017 evaluation that 'direct steering in the market towards certain products and providers has ended'.[96] As support for this, the underlying evaluation report concludes that:

- the complex products of initial concern, where there was a flow of commission from provider to distributor, are no longer offered. The financial links between intermediaries and providers that can result in steering behaviour have thus been removed;
- there is also evidence of more formalised, arm's-length business relations between advisors and providers.[97]

Empirically, it is not clear to what extent the ban in itself has added further value in this regard. As alluded to above, trends of reduced steering behaviour and the phasing-out of complex products were already evident in the years *prior to* the ban's introduction in 2013. A government-commissioned report in 2010 had already indicated that the main perverse incentives and hit-and-run practices had been removed from the market by prior regulatory interventions.[98] Furthermore, research by De Nederland Bank also shows that complex savings-based mortgages and life insurance products were being phased out in the years preceding the ban, primarily driven by other sector-specific regulations and market developments[99] (as echoed in the government's evaluation).[100]

3.4.2 Quality of advice

The government's evaluation seems to conclude that the quality of advice has improved. This is attributed primarily to stricter professional competence requirements and closer oversight by the AFM (and resulting internal company audits) of procedural requirements on how advisors provide advice.[101] The increased use of advice-supporting technologies are also cited as a tool that has improved the advice-giving process. However, both increased

[96] Minister of Finance, The Netherlands (2018), 'Government letter; Evaluation of commission ban - Laws and regulations financial markets', Letter no. 74 from the Minister of Finance, 23 January.
[97] For example, as reflected in account management and the content of cooperation agreements. See Minister of Finance, The Netherlands (2018), 'Government letter; Evaluation of commission ban - Laws and regulations financial markets', Letter no. 74 from the Minister of Finance, 23 January.
[98] Minister of Finance, The Netherlands (2010), 'Betreft evaluatie provisieregelgeving en vervolg met kenmerk FM/2010/17247 M', Letter to Dutch Parliament, 12 October.
[99] The main drivers identified by De Nederland Bank include low interest rates (seeing new providers enter the market) and tax changes. De Nederland Bank (2016), 'Vision for the future of the Dutch insurance sector', pp. 4, 12 and 27–29.
[100] Discussed in the government's 2018 evaluation, especially as it relates to mortgage pricing regulations and related tax incentives. See Decisio (2017), Report, p. 20.
[101] Minister of Finance, The Netherlands (2018), 'Government letter; Evaluation of commission ban - Laws and regulations financial markets', Letter no. 74 from the Minister of Finance, 23 January.

procedural compliance and technology improvements would not seem to be directly related to the ban.

In addition to the general caveat around disentangling the impact of the ban from among a broader set of regulations, the government evaluation on quality is also limited by the data it has available to measure the impact on advice quality, which does not directly relate to the quality of advice actually received by consumers. First, the evaluation relies on the views of advisors and other market participants, as reported in surveys and stakeholder discussions. Not only are the results of this investigation fairly mixed, but they are at best indirectly related to actual consumer outcomes (and thus inherently limited). Second, these discussions and surveys of market participants, and thus the findings of the evaluation, were predominantly focused on procedural compliance aspects (e.g. on AFM reporting requirements and oversight, professional competency requirements, and company's own internal reporting processes), not on consumer outcome per se.

We are not aware of any study that has rigorously evaluated (i) how the content of advice given to consumers has changed since the implementation of the ban, and (ii) what this has meant for their investment and/insurance decisions and eventual financial outcomes.[102] It is thus not possible to draw any firm conclusions on how the ban has affected the quality of advice given to consumers as it relates to the main outcome of interest: their financial outcomes.

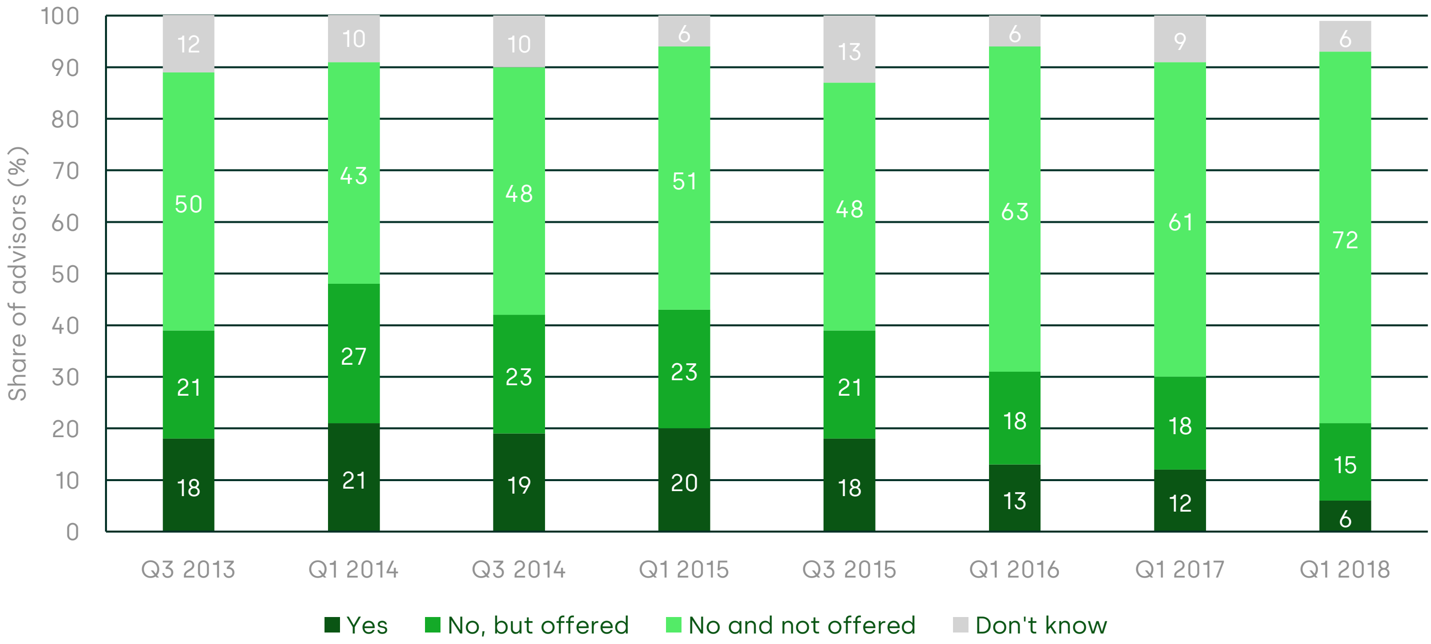
That said, there is at least some cautionary evidence from the government's evaluation as it relates to the impacts of the ban, specifically. There are suggestions that advisors are more likely to focus only on the narrow scope of products (with the lack of aftercare services a particular concern), while advisors suggest that consumers are also less likely to shop around for advice and second opinions.

- The evaluation's survey of advisors suggests that they are reportedly cautious to offer consumers broader, potentially more holistic and/or customised financial advice, beyond the scope of the specific products enquired about.[103] The government's evaluation concludes that, at least in part, this seems to be due to the commission ban: there is uncertainty as to when information provision becomes advice,[104] which consumers may not want if unsolicited (out of fear of incurring additional fees), and which providers are in turn hesitant to provide.[105]
- The evaluation's survey of market participants also suggests that consumers may be less likely to shop around for advice, in part because they fear they would have to pay upfront advice fees.[106]

[102] That is, beyond advisor surveys and stakeholder interviews, studies seeking to measure the impact of the ban on consumers' actual financial decision-making (given the type and quality of advice they receive).
[103] Decisio (2017), Report, pp. 8–9, 27–28 & 67.
[104] Ibid., p. 67
[105] Ibid., pp. 32–33.
[106] Ibid., p. 6.

- Aftercare services, in particular, are less likely to be offered (and accepted) in the wake of the ban (see Figure 3.1 below).[107] The evaluation notes with concern that this may see products not being sufficiently updated and adapted to consumer needs over time.[108] This too would seem to stem from the change in fee structure: aftercare services are less likely to be provided to new customers (those not covered by legacy commission contracts)[109] and those who cannot afford broader portfolio management services.[110] The lack of aftercare services has since been highlighted, by both the evaluation[111] and the Minister of Finance[112], as a specific priority area to be addressed post the implementation of the ban.
- The lack of aftercare services has since been highlighted, by both the evaluation[113] and the Minister of Finance[114], as a specific priority area to be addressed post the implementation of the ban.

Figure 3.1 Decline in offers for (and uptake of) aftercare services



Source: AFM (2018), 'Consumentenmonitor.'

More broadly, the government's overarching objective for the regulations was to bring about 'cultural change in financial services from product-driven sales to customer-oriented advice'.[115] This implies that a holistic, client-centred approach, where the suite of products

[107] Ibid., pp. 39–41.
[108] Ibid., p. 10.
[109] Ibid., pp. 39–40.
[110] Ibid., p. 41.
[111] Ibid., p. 10.
[112] Minister of Finance, The Netherlands (2018), 'Government letter; Evaluation of commission ban - Laws and regulations financial markets', Letter no. 74 from the Minister of Finance, 23 January.
[113] Decisio (2017) Report, p. 10.
[114] Minister of Finance, The Netherlands (2018), 'Government letter; Evaluation of commission ban - Laws and regulations financial markets', Letter no. 74 from the Minister of Finance, 23 January.
[115] Ibid.

offered is tailored and customised to the consumer based on their specific needs and means, is the ideal market outcome.

In this regard, it is worth noting that the evaluation finds no evidence that the broader suite of measures introduced has made advisors more likely to shop around for products and services that best suit consumer needs.[116] To the contrary, neither the scope of products offered nor the range of providers' products advised on by independent advisors seems to have increased (with the potential exception of mortgages[117]). This may be because independent advisors are still limited by costly relationship-specific investments and knowledge required to expand their suite of product offerings and/or provider set.[118]

If anything, the government's evaluation suggests that advisors' propensity to customise advice and incentives to increase their efforts to search across product offerings (and providers) may have decreased due to (i) increased specialisation (to meet tighter competence and compliance requirements) and (ii) a hesitancy to provide advice broader than the specific products enquired about (thus playing it safe so as not to provide unsolicited advice, which could attract fees, on products not inquired about).[119]

3.4.3 Competition

Notionally, the ban could affect competition at two levels, at least: (i) competition between types of advisors, as the distributors of the relevant products (especially between advisors tied to specific providers and independent advisors), and (ii) competition between providers of the various investment and insurance products. Consumers' propensity to shop around, in turn, affects both these outcomes. While the government's evaluation focuses primarily on (i), under the theme of concerns about ensuring a level playing field, it also provides some evidence on an ad hoc basis on (ii).

With respect to competition between types of advisor channels, the main concern is that in light of an inability to incentivise third-party sellers of their products, providers may choose to favour in-house distribution channels and tied agents.[120] The concern is that this may reduce the range of products on offer to consumers and/or drive independent distributors out of the markets (as vertically integrated providers could, absent regulation, undercut independent advisors by offering advisory services without explicitly charging advice fees and embedding the costs thereof in the product price). Indeed, a summary

[116] Decisio (2017), Report, p. 67.
[117] This is due to the increase in the number of providers, as insurance companies and pension funds entered the market in the context of low interest rates, and is thus unrelated to the commission ban. See discussion on mortgage use below and Decisio (2017), Report, p. 20 and De Nederland Bank (2016), 'Vision for the future of the Dutch insurance sector', pp. 28-29.
[118] Decisio (2017), Report, p. 7.
[119] Decisio (2017), Report, pp. 8–9.
[120] This follows from the fact that providers generally have a choice over distribution channels, and can choose to sell products through their own in-house distribution channels (e.g. their own website), through tied agents (distributors that sell the products of only one or a few providers) and/or via independent brokers (who may provide products from across the market to consumers, without any restrictions from providers).

by the European Commission notes this as one of the primary concerns, across stakeholders, in the EU-level debate on commission bans:

'The limitation of the offer of third-party products to investors has been noted as a negative trend by both opponents and supporters of a ban, industry and authorities alike. It is noted that the ban on inducements would certainly encourage more manufacturers that are also distributors to only sell their in-house products in a closed market architecture. This would be detrimental for the consumers as it would curtail their options at each distributor and impede their capacity to shop around.'[121]

In this respect, it is important to note a significant difference in the pre-existing distribution landscape in the Netherlands (vis-à-vis many other EU markets where no commission bans are in place): there was already an extensive network of independent advisors before the ban on commissions. For example, in 2010, more than three-quarters of insurance companies' revenue came through third parties such as independent advisors (see Table 3.2 below). One should thus be wary to extrapolate from the impact of the ban in the Netherlands to other EU countries where similar initial conditions do not exist. That is, even if other jurisdictions were to be as careful to implement compensatory measures to ensure a level playing field across sales channels, it is not clear that the independent advisor would be able to compete to the same extent if it were still in its infancy and up against established direct providers (who may compete on a preferential basis, as they can generally offer lower advice costs).

Table 3.2 Size of direct versus third-party distribution channels in insurance provider revenue

	2010	2011	2012	2013	2014
Direct	23%	21%	23%	25%	27%
Through third parties	77%	79%	77%	75%	73%

Source: De Nederland Bank (2016), 'Vision for the future of the Dutch insurance sector'.

That said, the compensatory measures to ensure a level playing field introduced alongside the ban seem to have been largely successful in the context of the Netherlands. For the majority of products covered by the ban, independent advisors generally maintained their combined market share in the distribution of new production relative to advisors acting directly on behalf of, or tied to, providers.[122] The only market where there is meaningful concern in this regard is funeral insurance, where there is evidence that, directly following the ban, the distribution of products shifted meaningfully from the intermediary channel to direct insurance provider channels.[123]

[121] European Commission (2022), 'Disclosure, inducements, and suitability rules for retail investors study', Annexes to the Final Report, p. 147.
[122] Minister of Finance, The Netherlands (2018), 'Government letter; Evaluation of commission ban - Laws and regulations financial markets', Letter no. 74 from the Minister of Finance, 23 January.
[123] Decisio (2017), Report, p. 7.

These compensatory measures have however created practical enforcement difficulties. For example, there are concerns about whether some advice costs from advisors acting on behalf of direct providers remain embedded in the product price (e.g. for aftercare services). Despite the cost reporting and obligations for cost-reflective pricing introduced by the AFM to combat this, the government evaluation in 2018 notes that 'it is impossible to determine objectively whether providers have completely removed the commission from the product prices.'[124] Furthermore, unlevel playing field concerns have also been raised for pension advice, between pension funds and independent advisors/intermediaries.[125]

Another means by which competition can be enhanced is by increasing fee transparency and salience (thus reducing information asymmetries), and thereby increasing consumers' propensity to shop around across different distributors, providers and products. In this respect, the ban and related fee disclosure and fee transparency measures (like the DVD service document) have seemingly not had the desired effect. That is, despite the range of measures introduced to date, the evaluations do not suggest that consumers are more likely to shop around, and so create additional competitive pressure on both distributors and providers.[126] The Dutch government has subsequently also taken steps to update and replace the DVD disclosure document,[127] while the evaluation notes other measures that may be more promising.[128]

Information asymmetry and a lack of informed decision-making on the part of consumers thus remains a challenge, as the Dutch Minister of Finance noted in his summary to parliament:

> 'Consumers hardly compare the different forms of service and different service providers and have a limited insight into the quality of the service.'[129]

With respect to the competition between providers, the evaluation does not present evidence to suggest that advisors are on the whole more likely to shop around on behalf of consumers, due to the ban. That is, there is no evidence that advisors are considering a broader array of products (or providers) as a result of a break in financial ties

[124] Decisio (2017), Report, p. 9 See discussion to same effect on pp. 71–72.
[125] When considering remaining issues created by the ban with respect to a potential unlevel playing field for pension advice, the Dutch Minister of Finance noted that '[t]he evaluation gives no reason to reconsider the ban on commissions, so it is necessary to consider how this playing field can be levelled.' Minister of Finance, The Netherlands (2018), 'Government letter; Evaluation of commission ban - Laws and regulations financial markets', Letter no. 74 from the Minister of Finance, 23 January.
[126] Minister of Finance, The Netherlands (2018), 'Government letter; Evaluation of commission ban - Laws and regulations financial markets', Letter no. 74 from the Minister of Finance, 23 January.
[127] The Minister of Finance has since announced that the DVD was set for replacement by a new comparison map from the start of 2023, as an updated tool serving the same ends. See https://www.adfiz.nl/nieuws/adfiz-berichten/dienstverleningsdocument-per-begin-2023-vervangen-door-vergelijkingskaart/.
[128] More specifically, the evaluation cites the potential role of the increased use of technology (e.g. advisory software and comparison sites) in driving competition between providers. Decisio (2017), Report, p. 20.
[129] Ibid.

resulting from the ban on commissions, and so increasing the competitive pressure on providers.

This seems to be because the binding constraint to offering a wider array of products lies outside of financial ties with providers: independent advisors have limited capacity for the array of relationship-specific investments required to provide a range of products from a range of providers.[130]

On broader competition trends, the evaluation notes that there has been a consolidation in the number of providers across the different product markets. In line with the common theme noted above, this consolidation is attributed to factors outside of the ban, as they are in line with industry trends observed before its implementation. The one exception is for mortgages, where there has been an increase in the number of non-traditional mortgage providers entering the mortgage market (in the form of pension funds and insurance companies). However, both the increased competition in mortgage provision[131] and the general increase in provider concentration in other markets is attributed to factors outside of the ban, and is in line with industry trends observed prior to its implementation.[132]

3.4.4 Accessibility

Maintaining high levels of access to advice, so as not to unintentionally create an advice gap, was another priority area for the government's 2018 evaluation. This is in a context where various studies have shown that (i) Dutch consumers have very limited prior knowledge of the levels of advisors' fees, which they consistently underestimate,[133] and (ii) thus have an expectation gap—they have to pay more for advice than they would have expected in advance.

The concern is that this incorrect anchor may have a disproportionate impact on advice-seeking, especially for non-mortgage products, given the change in the advice cost regime (where advice costs are now presented more explicitly and more often require upfront payment). If consumers are less likely to seek financial advice as a result, it may be to both their own and society's detriment if this in turn leads to underinsurance (especially against acute risks such as death and disability), inadequate provision for old age, and/or costly and ill-informed investments, or simply the purchase of products that are not suited to the consumer's needs or objectives.

A ban on commissions can thus affect advice-seeking via two channels: (i) the total cost of advice (and whether consumers can afford it), and (ii) the salience of advice costs (potentially affecting consumers price-sensitivity and their willingness to seek advice, independent of whether it is in their best interest to do so). Replacing commissions with more salient fees also affects the distributors'

[130] Ibid., pp. 7, 22 and 64.
[131] Ibid., pp. 7 and 47.
[132] Ibid., pp. 7, 47 and 52–53.
[133] Decisio (2017), Report, p. 32, echoed in various studies such as the accompanying government evaluation report, Elsen, M., van Giesen, R., Elshout M. and Leenheer, J. (2017), 'Consumenten en financieel advies', Tilburg: CentERdata, and independent survey research by Nibud (2017), 'Keuzeproces bij financieel advies', Utrecht: Nibud.

incentives to make consumers aware of the broader suite of products and/or aftercare services that may be relevant to them.

As we discuss below, the Dutch government's evaluation (and policy conclusions) focuses on affordability. However, given that the ultimate outcome of intertest is whether there is sufficient and appropriate uptake of financial products (across different consumer groups), we also consider the impact of the ban on the willingness to seek advice, the supply by producers, and the eventual use of products.

Affordability (advice costs)

The government evaluation seems to have focused primarily on this aspect. It concludes that while there is a reluctance among consumers to pay the now direct (and generally upfront) fees for advice, this is not due to them not being able to afford the fees. Rather, it seems that consumers are no longer willing to pay for advice.[134]

We are not aware of any studies that have isolated and compared the cost of advice between the Netherlands and other EU countries, on a like-for-like basis. The lack of comparability of cost data across countries and product types are a significant hurdle in this regard.[135] The various studies often cited in the debate compare some level of aggregate product- and/or management fees across countries, instead. [136]

These studies have shown that consumers in the Netherlands today enjoy some of (if not the) lowest ongoing aggregate product and management fees in Europe. This generally holds across the various financial products covered by the ban, be they private pension products, life insurance or investment products (e.g. investment funds, equities, bonds, ETFs, etc).[137]

[134] Minister of Finance, The Netherlands (2018), 'Government letter; Evaluation of commission ban - Laws and regulations financial markets', Letter no. 74 from the Minister of Finance, 23 January.
[135] Also discussed in ESMA') (2021), 'Performance and Costs of EU Retail Investment Products', April, p. 25 for comparing the management fees across difference investment products, and by the European Commission (2022), 'Disclosure, inducements, and suitability rules for retail investors study', pp. 169-170 regarding the comparability of indirect distribution fees (as a proxy for advice costs) specifically.
[136] See, for example, recent studies by the European Securities and Markets Authority ('ESMA') (2021), 'Performance and Costs of EU Retail Investment Products', April; European Commission (2022), 'Disclosure, inducements, and suitability rules for retail investors study', pp. 161-170, Morningstar (2021), 'European Fee Study', Morningstar (2019), 'Global Investor Experience Study: Fees and Expenses', September and European Commission (2018), 'Distribution systems of retail investment products across the European Union.', section 4.
[137] Ibid. The one exception in this regard is a study by the European Commission in 2022, which shows that the unweighted average total product costs in the Netherlands lies at the median of the 15 country sample considered. This is based on a comparison of a similar basket of products across the countries considered. The study notes, however, that this comparison *'do not necessarily reflect the actual average costs investors in these countries face as the composition of the investments may differ from the one assumed in this study.'* European Commission (2022), 'Disclosure, inducements, and suitability rules for retail investors study', pp. 165-166.

However, the fact that broader product fees are lower does not imply that financial advice, as a subcomponent thereof, necessarily costs less in the Netherlands. Ongoing product fees refer to all ongoing product or management fees (depending on the metric used). This would, for example, also including fees for the management of investment funds, fund performance fees, transaction and registration fees, etc.[138] In some cases, the metric used for comparison may not even include third party fees incurred by the providers (like advisor fees), and thus excludes the costs of advice in those cases where it is charged outside of the product provider's own fees (most pertinently, the advice fees of independent advisors in the Netherlands are excluded from such a metric). This is the case, for example, for a Morningstar study that compares what it refers to as the 'representative costs' charged by investment funds, which does not include any '*cost charged by third parties such as advisers or platforms*'.[139]

It is also not clear to what extent the ban on commissions is the driver of the lower aggregate product costs observed in the Netherlands. Lower ongoing costs can be the result of various factors, which would need to be investigated as potential drivers of the low product fees observed (and distinguished from the impact of the commission ban). For example, other drivers of lower product fees that could be equally (if not more) important in this context include:

- **The Dutch are more likely to buy products without advice (i.e. execution only)**: Lower aggregate product fees may thus simply reflect the relatively greater prevalence of execution only products in the Netherlands.[140] If one compares a sample of products where advice fees included, to one without advice fees, the latter would by definition have lower costs (all else equal).
- **The relative levels of competition in different financial product markets and the economies of scale** achieved by financial product providers also differ between EU jurisdictions. These factors are the key determinants of product fees. If levels of competition are relatively greater and/or providers are achieving greater economies of scale (and/or some other efficiencies) in a well-developed capital market like Netherlands, one would also expect lower product fees than what is observed in other EU markets.

It is not clear to what extent, if any, low financial product fees are attributable to the commission ban. The ban could notionally lower prices by creating an increased price-sensitivity among consumers, thus putting downward pressure on advice fees if consumers have sufficient bargaining power.

[138] See summary of the various charges included in ongoing costs provided in ESMA (2021), 'Performance and Costs of EU Retail Investment Products', April, p. 65, European Commission (2022), 'Disclosure, inducements, and suitability rules for retail investors study', pp. 162-163 and European Commission (2018), 'Distribution systems of retail investment products across the European Union.', p. 45.
[139] The representative cost methodology laid out in Morningstar (2018), 'Representative cost methodology', August.as used in the Morningstar (2019), 'Global Investor Experience Study: Fees and Expenses', September report.
[140] Also noted in European Commission (2018), 'Distribution systems of retail investment products across the European Union.', p. 79.

However, we are not aware of any rigorous studies to date that have attempted to isolate and quantify the impact of the ban on advice costs, specifically. As discussed above, various other relevant regulatory measures were introduced over the period (many of which were introduced prior to the ban). Some of these measures (such as price caps on advice and information disclosure requirements) also had the explicit objectives of lowering advice costs and/or making them more transparent and salient to consumers.

As discussed above, various other relevant regulatory measures were introduced over the period (many of which were introduced prior to the ban). Some of these measures also had the explicit objectives of lower advice costs and/or making them more transparent and salient to consumers (like price caps on advice and information disclosure requirements).

Willingness to seek advice

While the government's evaluation notes a decrease in consumers' propensity to seek advice and a decrease in the supply and uptake of certain products (e.g. life insurance, funeral insurance and payment protection for mortgages)[141], it is cautious not to draw any concrete conclusions on whether the ban has resulted in a suboptimal use of financial advice and products. Instead, it notes that it is beyond the scope of the evaluation to assess whether this decrease in production has led to underconsumption, and ultimately undesirable social consequences.[142]

There is, however, a significant amount of cautionary evidence from both within the studies forming part of the government evaluation itself, as well as broader independent academic and industry research, to suggest that the ban may have had an adverse impact on the extent to which consumers make use of financial advice.

The government evaluation notes that the ban has resulted in a decreased willingness among consumers to pay for advice, which has in turn shifted a greater share of consumers to execution-only (i.e. no advice, 'do it yourself', generally online) products.[143] Although less prevalent in mortgage markets, execution-only products have increased as a share of total new policies taken out across life, disability and funeral insurance markets.[144]

The increased use of execution-only products due to the ban is similarly supported by the findings from various consumer behaviour studies (including the one forming part of the government evaluation), as well as empirical market trends. These studies confirm that certain financial products (e.g. life and disability insurance) are more vulnerable than mortgages to seeing consumers opt out of seeking advice in light of the change in the advice cost regime.

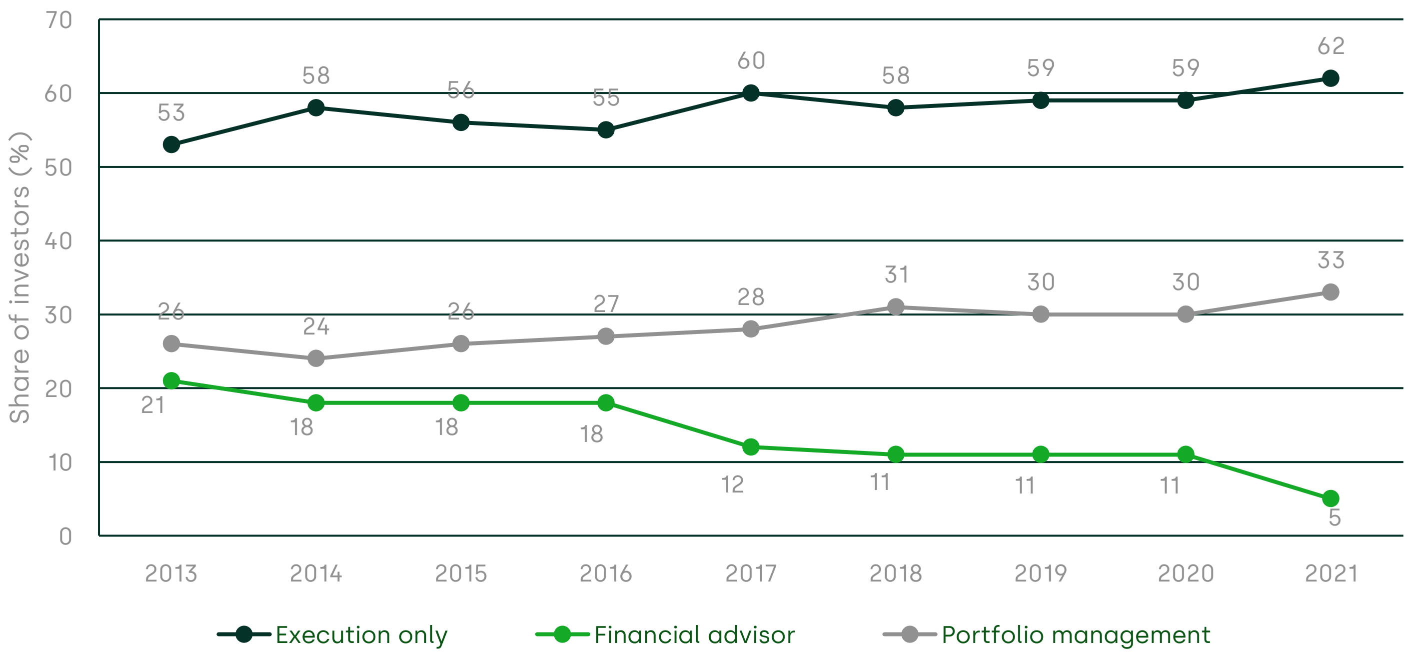
The research also suggests that the decrease in advice is due to the change in the way in which consumers have to pay for advice (as

[141] Decisio (2017), Report, pp. 6–7.
[142] Decisio (2017), Report, pp. 10, 74 and 78.
[143] Ibid.
[144] Decisio (2017), Report, pp. 41–44.

opposed to changes in its relative cost), with consumers more price-sensitive under the new fee-based regime. The most pertinent findings from these studies are summarised in Box 3.4 below.

These lab- and survey-based research findings are also consistent with empirical industry trends. The AFM's Consumer Monitor survey shows that the share of retail investors choosing to invest via financial advisors decreased immediately by 3% with the implementation of the ban on commissions, and has been on a downward trend since. In turn, the share of investors investing without making use of advice (i.e. execution only) has increased markedly. Despite the initial drop after the ban's implementation, there has, however, been an uptake in the use of financial advice through portfolio management, a service that is generally available to wealthier consumers (with more assets to manage).

Figure 3.2 Main investment channel, over time



Source: AFM Consumer Monitor (2021).

Box 3.4 **Research summary: the ban increases price sensitivity (reducing advice-seeking)**

Study 1: Elsen et al. (2017)

Findings from an advice-choice experiment in the evaluation's consumer research study suggest that if potential consumers are made aware of the costs of advice, this markedly shifts their preference from taking out financial products through personal advisors to doing so via execution-only platforms. [145] The study compared impacts across three financial products: mortgages, life

[145] Elsen et al. (2017), 'Consumenten en financieel advies', Tilburg: CentERdata, section 3.

insurance and disability insurance. The impact on the propensity to move to execution-only products is greater for disability and life insurance relative to mortgages (where participants predominantly opt to use advisors). For three in ten participants, knowledge of advice costs was sufficient to discourage taking out the relevant financial product completely (again with a relatively greater effect on disability and life insurance).

Note that an often (mis)quoted statistic from the evaluation's consumer behaviour research is the finding that only 2% of consumers surveyed saw high advice costs as a deterrent to getting advice when purchasing a product.[146] It would be misleading to conclude on this basis that consumers are making sufficient use of financial advice. This figure only considers the particular subset that already chose to take out the specific financial products considered, and thus suffers from **selection bias, for the following reasons**:

- First, this statistic is not representative of what one could expect for the Dutch population on average, as it samples only from the population who had purchased one of the three products considered. It does not take into account those who did not take out one of these products, perhaps exactly because the upfront advice fees act as a deterrent.
- Second, the sample is constructed predominantly of mortgage takers, a product for which there are arguably the fewest concerns around a potential advice gap. Demand for mortgages is generally driven by consumer demand for homes, such that consumers would tend to approach advisors for assistance to get a mortgage (as something required by most homebuyers). In contrast, an advice gap, if present, would more likely be present for products which consumers are less likely to seek out on their own volition. These are exactly the products a consumer would traditionally need to be made aware of and/or educated on – products like life and disability insurance[147] – and where an advisor could notionally play an important role in raising consumer awareness and unlocking otherwise latent, or 'concealed', demand.

Study 2: Nibud (2017)

The findings in Elsen et al. (2017) are consistent with the findings from independent survey research conducted by the industry think-tank, Nibud, in 2017. The Nibud survey indicates that most consumers (66%) will avoid advice costs as far as possible by seeking information elsewhere (e.g. the internet), and even avoid making use of financial advisors completely on this basis (as was the case for 46% of the sample).[148]

Study 3: Kramer (2018)

[146] The exact sample includes consumer who had taken out either a mortgage, term life insurance or disability insurance over 2015–17.
[147] The researchers also note that caution should be exercised when extrapolating from the results for disability insurance, in particular, given the small sample size. Elsen et al. (2017), 'Consumenten en financieel advies', Tilburg: CentERdata, p. 49, footnote 65.
[148] Nationaal Instituut voor Budgetvoorlichting, Nibud (2017), 'Keuzeproces bij financieel advies', Utrecht: Nibud. p. 22.

A randomised survey experiment by Kramer (2018), which is specifically designed to test causality, also finds that willingness to take financial advice is considerably lower under the new, fee-based advice payment regime. Importantly, Kramer finds that the reduced advice-seeking is driven not so much by the absolute level of the advice costs, as by the change in payment regime (with consumers more price-sensitive to advisor costs under the new fee-based regime).[149]

Source: Oxera.

There is also some suggestive evidence that those choosing not to make use of advice, due to increased price sensitivity under the new advice payment regime, may be those in the greatest need of it. For example, the government's consumer behaviour study finds that those who are less financially literate are most likely to opt for execution-only products when made aware of the costs of advice (as occurs in practice in the new fee-based regime).[150] Consumer survey research similarly indicates that low-income consumers are less likely to seek advice because they want to avoid the associated costs.[151]

Advisor incentives

The clearest impact of the ban is on advisors' sales incentive, which can reduce the over-provision of certain products, but also the under-provision of others. The government's evaluation found that advisors are more hesitant to provide broader advice and cross-sell other products that may be of use to the consumer. [152] This hesitancy to advise beyond the specific products enquired about seems to be a direct consequence of the ban: faced with a consumer who has to pay more for advice than they expected beforehand, and an unwillingness to be further informed or advised on possible additional products, advisors (both independent and tied) report that they would rather 'play it safe' and refrain from providing further information or advice beyond the narrow product (e.g. a mortgage) enquired about.

Furthermore, mystery shopper studies suggest that traditional financial advice is reserved for wealthy clients, with other customers generally being directed to execution-only products. Under the current fee regime, providers and independent advisors are incentivised to redirect advice-fee-sensitive consumers to execution-only products. For example, the Netherlands was an outlier in an EU-wide mystery shopper study commissioned by the European Commission, in that both a young professional with €10,000 to invest and a 50-year old with €100,000 were systematically redirected to execution-only products (and to a lesser extent portfolio management services) when seeking advice, be it directly from financial institutions or from

[149] Kramer, M. (2018), 'The impact of the commission ban on financial advice seeking', Groningen: University of Groningen.
[150] Financial literacy was assessed on the basis of four questions. If participants answered all four questions incorrectly, they were classified as 'low financially literate'.
[151] Nibud (2017), 'Keuzeproces bij financieel advies', Utrecht: Nibud. p. 14.
[152] Decisio (2017), Report, pp. 8–9.

independent financial advisors.[153] Independent advisors would only provide advice to investors with substantial capital to invest, requiring minimum investment amounts from €250,000 to €500,000. The only channel by which investors of the two profiles above could receive advice was by making use of robo-advice, but these exclusively offered ETFs[154] (which may, in turn, result in a product bias and see disproportionately more EFTs sold in the Dutch market).

The state of the accessibility of advice in the Netherlands is therefore best summarised in the conclusions of a recent study commissioned by the European Commission.[155] This notes that independent advice for retail investors is increasingly limited to wealthier consumers (while other investors are redirected to execution-only and/or online channels). The report notes that:

> 'The Netherlands, where inducements are banned, is an exception where independent advice is indeed more common. This does not yet mean that independent advice is easily accessible in the Netherlands. It is often reserved for more wealthy clients or is subject to a fee that not everyone is willing to pay. The majority of clients are not served through independent advice but are rather directed towards execution-only products sold through digital platforms.'[156]

The question thus turns to whether the decrease in advice-seeking has led to a suboptimal use and allocation of products. It is not straightforward to determine whether there is indeed an under-provision (or uptake) of financial products due to the ban. Besides disentangling the effects of the ban from other regulations over the period, one must also consider the impact at a product level (as market dynamics and the drivers of demand differ by product).

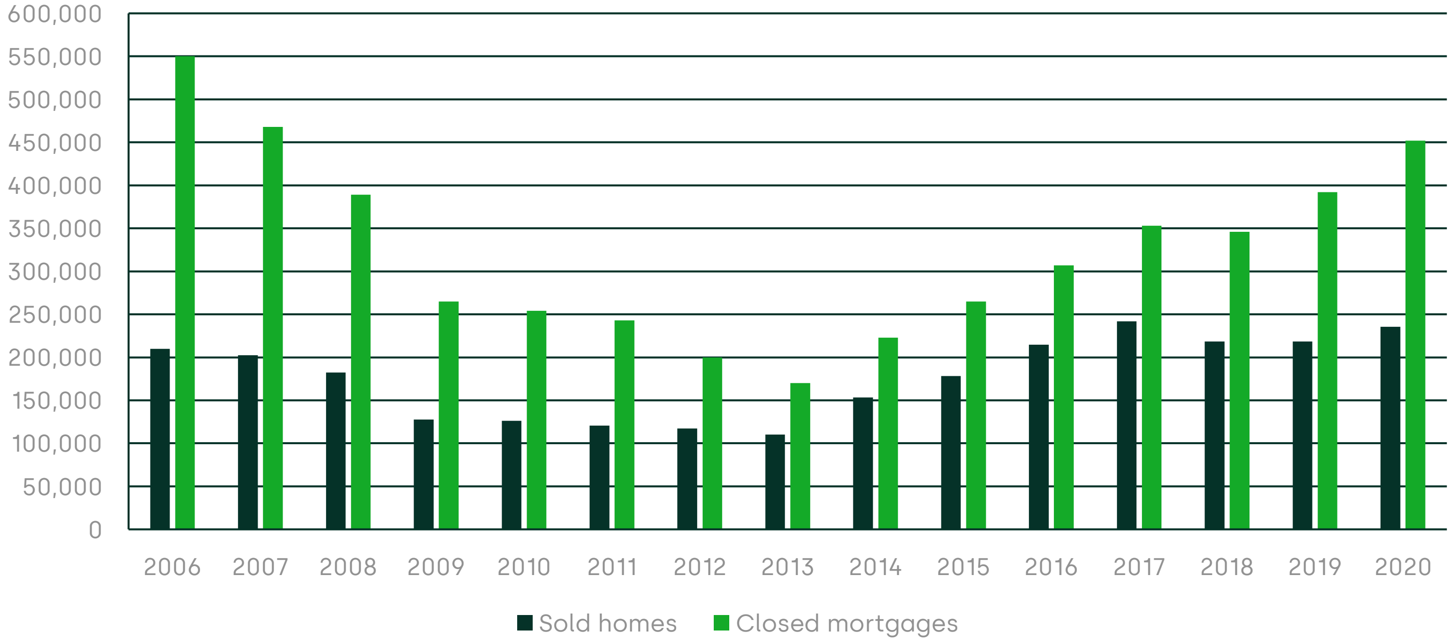
Below we consider each of the most prominent products of interest, and the likely impact of the ban on product uptake relative to the other main drivers of demand.

3.4.5 Use of products

For mortgages, demand is driven primarily by the housing market, such that the impact of the commission ban is unlikely to have a major effect on product uptake. Given that a mortgage is necessary for most homebuyers, consumers tend to approach advisors or banks directly for what is an immediately obvious, necessary product. In this sense, mortgages are not like other long-term insurance and investment products, where consumers often have to be educated and/or nudged to make the necessary provision. Advice fees are also generally minor relative to the overall costs of buying a home, and are thus unlikely to be a meaningful consideration.[157]

[153] European Commission (2018), 'Distribution systems of retail investment products across the European Union.', pp. 20–23.
[154] Ibid, p.23.
[155] The study focuses on disclosure and inducement measures across 15 EU jurisdictions and their impact on retail investor decision-making. European Commission (2022), 'Disclosure, inducements, and suitability rules for retail investors study'.
[156] Ibid., p. 327.
[157] As echoed in the results of the government evaluation – See Decisio (2019) Report, p. 29.

Figure 3.3 Number of homes sold versus mortgages closed, over time



Source: Dutch Central Bureau for Statistics (CBS).

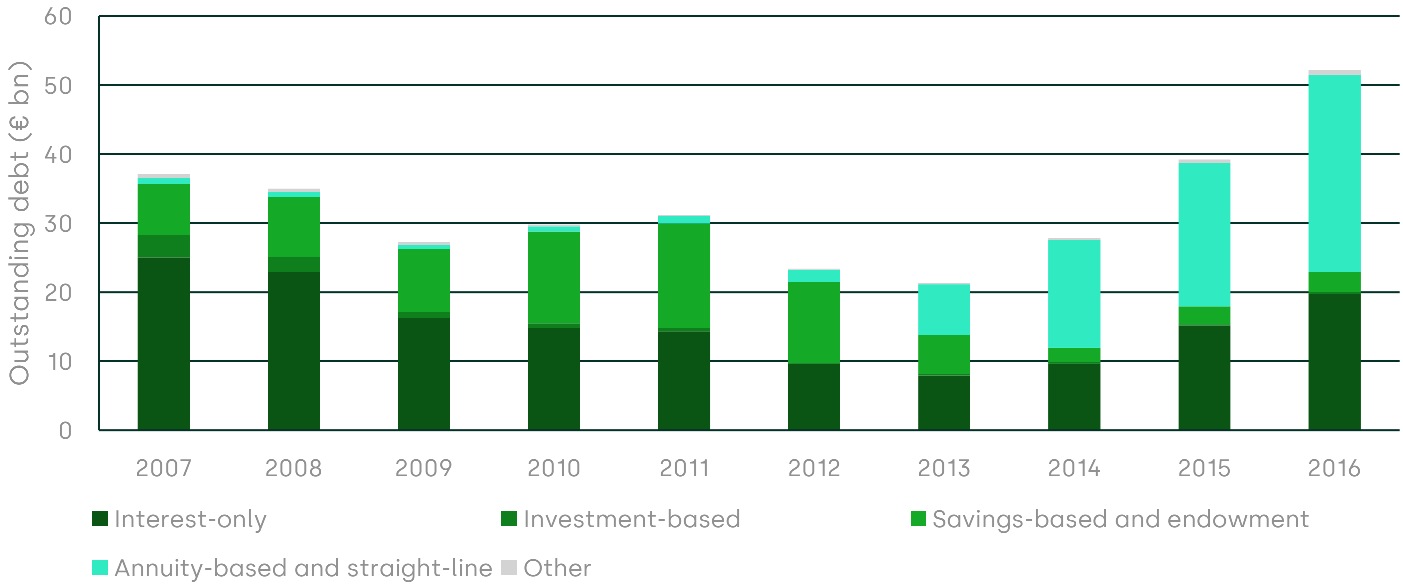
Other regulations specific to the Dutch mortgage market have also affected the type (and potentially volume) of mortgages taken out before and after 2013. This primarily relates to a change in tax relief incentives, introduced in 2013, that have seen complex, more expensive products being replaced by simpler, more cost-effective alternatives. However, more stringent criteria regarding who qualifies for mortgages loans (and the maximum value they qualify for) has likely further contributed to the decrease in mortgage loans relative to homes sold before and after the introduction of the ban in 2013.

- **Change in tax incentives**: Prior to 2013, all types of mortgage products were eligible for tax deductions on interest payments, tax incentives that were comparatively generous by EU (and international) standards.[158] Mortgage takers were thus incentivised to maximise interest repayments. Providers, in turn, sold products that allowed consumers to maximise tax advantages, including products that combined interest-only mortgages with savings or investment accounts (e.g. life insurance products), thus allowing for maximum upfront interest repayments (and with deferred payment on the loan principal).[159] Some households would reportedly also take out more than one mortgage in order to take maximum advantage of these incentives.[160] Following regulatory changes in 2013,[161] only linear and annuity mortgages repaid within a 30-year

[158] See discussion by the President of the Dutch Central Bank, Knop, K. (2019), 'Mortgage Interest Tax Deduction in the Netherlands: A Welcome Relief', Speech at the Macroprudential Policy Conference, 'Real estate taxation and macroprudential policy', 2 July, pp. 1–7.
[159] Ibid, p. 3.
[160] Ibid, p. 4.
[161] Ibid pp. 5–6 and De Nederland Bank (2016), 'Vision for the future of the Dutch insurance sector', pp. 12 and 29.

period were still eligible for these interest payment tax deductions. As illustrated in Figure 3.4, these products (which were a minute share of mortgages sold pre 2013) have since displaced savings-based (or endowment) and interest-only mortgages.[162]

Figure 3.4 Outstanding debt per mortgage product type, over time (€bn)



Notes: Annual debt values per product measured by year of origination. The remaining interest-only and savings-based mortgages in the market post 2013 mainly reflect pre-existing mortgages being rolled over.
Source: De Nederland Bank (2018), 'Financial Stability Report'.

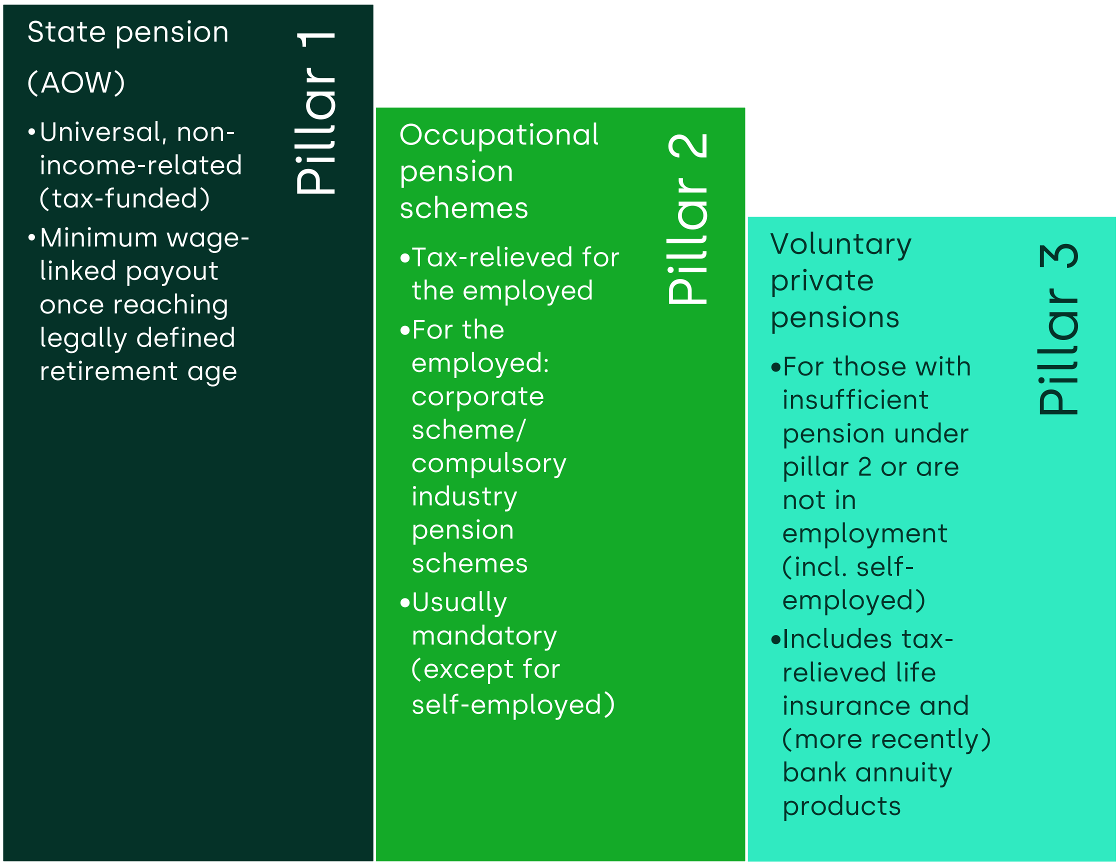
- **More stringent loan criteria**: prior to the introduction of the commission ban, the government also introduced more stringent requirements on the value of the loan relative to the potential mortgage taker's income and home value. From 2012, a binding loan-to-value (LTV) cap of 106% was introduced for new mortgages, decreasing by 1% annually until reaching 100% by 2018 (the ratio still applicable today).[163] Loan-to-income ratios (or debt service-to-income ratios (DSTIs) were similarly tightened after the financial crisis of 2008/09 (and its impact on the Dutch housing market).[164] These regulations have made it more difficult to qualify for a mortgage (especially among those with less savings and/or financial reserves), and may thus also have contributed to the reduction in 'excess' mortgages over homes bought up to 2013 (as evident in Figure 3.3).

For pension savings, the Netherlands has a well-developed pension system. In this system, a universal state pension benefit (pillar 1) is supplemented primarily by semi-mandatory occupational pension schemes that cover the vast majority of the employed workforce

[162] Decisio (2017), Report, p. 20; De Nederland Bank (2016), 'Vision for the future of the Dutch insurance sector', pp. 28–29; and Knop, K. (2019), 'Mortgage Interest Tax Deduction in the Netherlands: A Welcome Relief', speech at the Macroprudential Policy Conference, 'Real estate taxation and macroprudential policy', 2 July, pp. 3–6.
[163] Knop, K. (2019), 'Mortgage Interest Tax Deduction in the Netherlands: A Welcome Relief', speech at the Macroprudential Policy Conference, 'Real estate taxation and macroprudential policy', 2 July, p. 6.
[164] Ibid.

(pillar 2), as well as additional, tax-facilitated discretionary private pension savings under the 3rd pillar—see Figure 3.5.

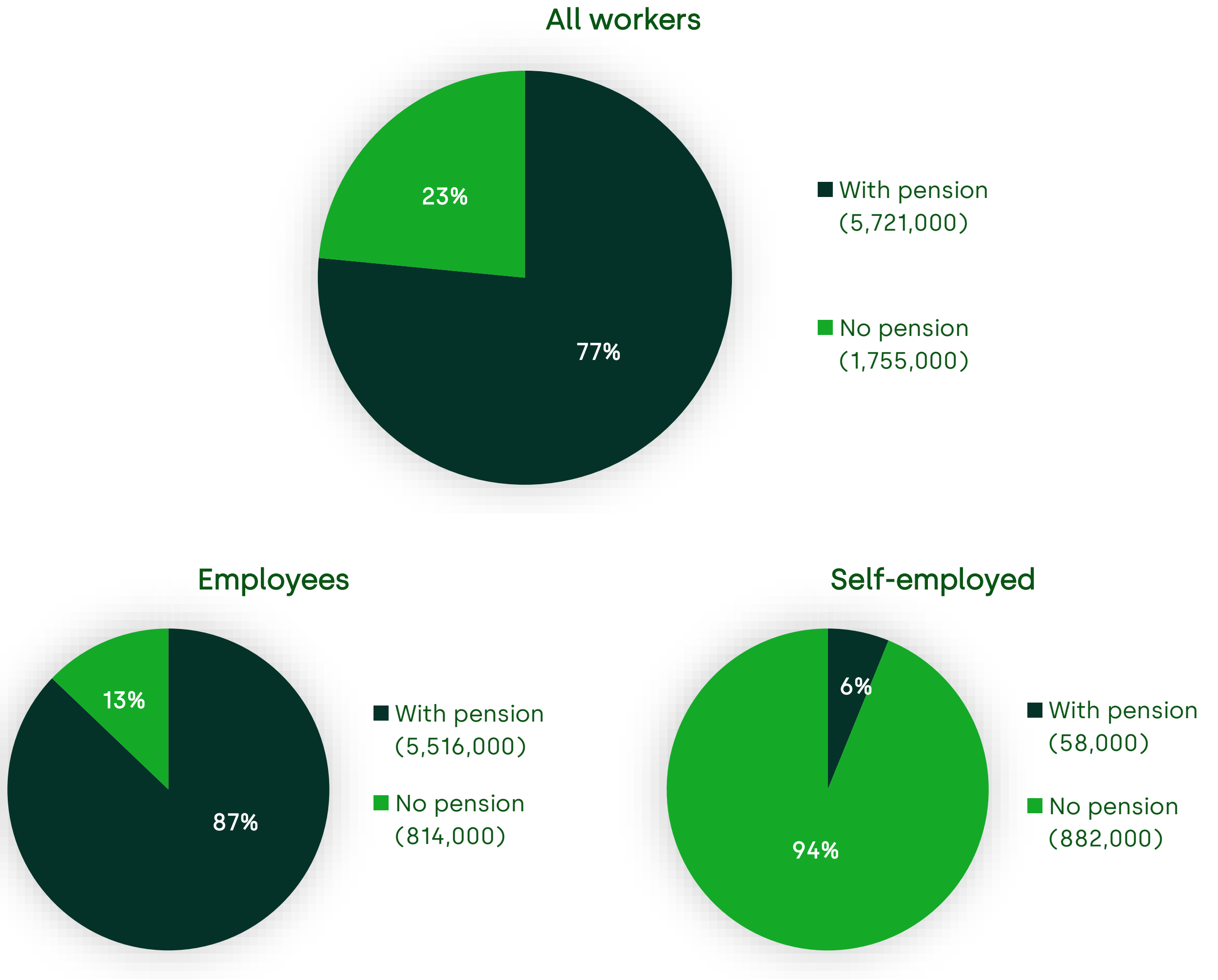
Figure 3.5 Structure of the Dutch pension system



Note: Other forms of wealth accumulation that can be used for retirement saving are sometimes characterised as an additional, '4th' pillar. This would include all other discretionary savings deposits, capital accumulated in the form of an owner-occupied home, and discretionary investments in securities.
Source: Oxera.

Most of the working population is covered by occupational, pillar 2 pensions (77% of all workers in 2020)—see Figure 3.6. While almost nine out of ten are covered among the employed (the majority of the workforce), a very small share of the self-employed are covered (only 6%).

Figure 3.6 Coverage of occupational, pillar 2 pensions (2020)



Source: De Nederland Bank (2020), 'Werkenden zonder pensionopbouw'.

The Dutch thus have much broader mandatory and semi-mandatory pension coverage, and also more extensive pension entitlements, than their EU peers. Compared to the 15 other member states covered in a 2018 European Commission study, pension entitlements account for the largest share of households' wealth in the Netherlands (62%). This compares to the EU average of 16%. The next-highest contribution to household wealth is in the UK (52%), followed by much lower figures in continental Europe: Sweden at 30% and Germany at 15%.[165] Given the nature of the Netherlands' pension system, there is thus much less scope for a negative impact on household savings for retirement than in other EU countries.

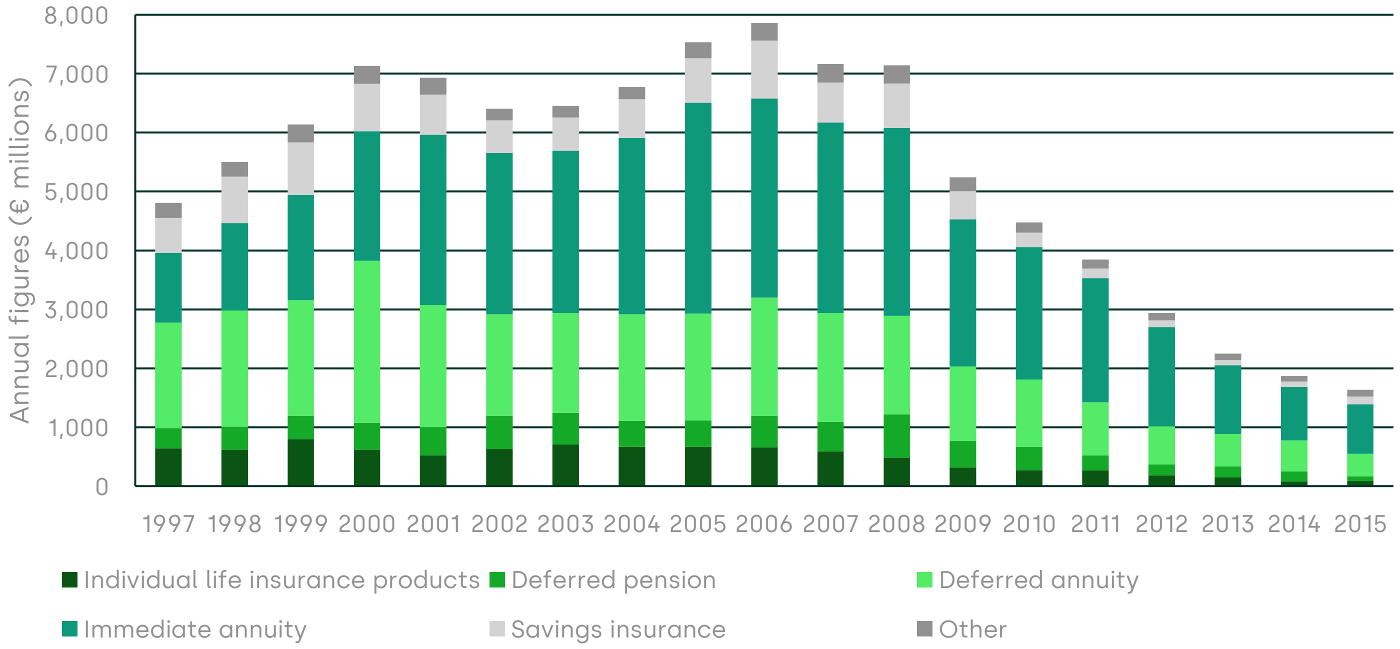
However, this does not mean that there are no areas of concern for potential under-provision of private pension products in the Netherlands. There is considerable policy concern for the lack of pension build-up under pillar 3 by the self-employed, given that 94% of this group is not covered by pillar 2 occupational pensions.[166] Research by the Dutch Central Bank indicates that the self-employed are also

[165] European Commission (2018), 'Distribution systems of retail investment products across the European Union.', p. 14.
[166] De Nederland Bank (2020), 'Werkenden zonder pensioenopbouw', Occasional Studies Volume 20 – 3.

not compensating for the lack of occupational pension build-up with discretionary private pensions (with only 11% of this group having pension savings in pillar 3 products), nor by other means (e.g. property assets, etc).[167]

For life insurance: compared with the rest of the EU, the Dutch life insurance sector is fairly small.[168] The market for individual life insurance products has long been on the decline, halving in size between 2008 and 2015 (both in absolute terms and as a share of GDP, as shown in Figure 3.7).[169] The same trend has been evident across the different life-insurance product segments, driven by market developments outside of the ban on commissions.

Figure 3.7 New production of life insurance, by product type



Source: De Nederland Bank (2016), 'Vision for the future of the Dutch insurance sector'.

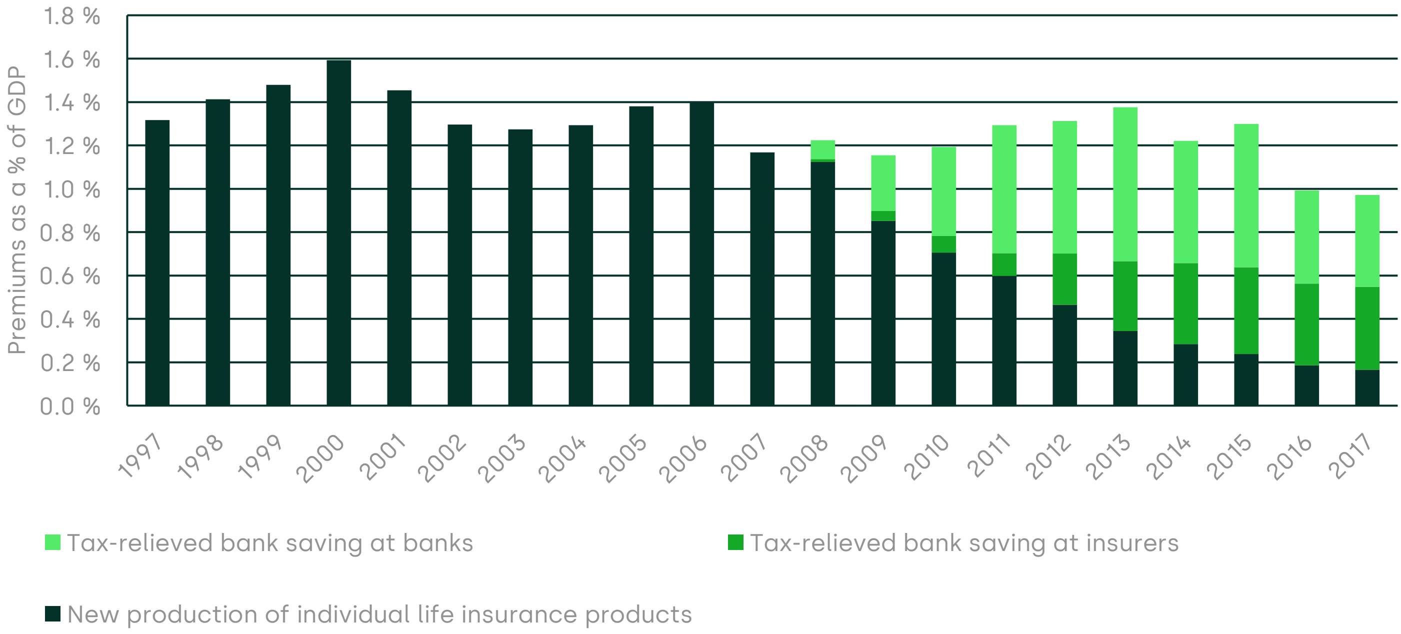
According to the De Nederland Bank, the main drivers of the decreased uptake of life insurance products from 2008 include the following.

- **Broadening tax-advantaged saving beyond life-insurance**: prior to 2008, tax-advantaged private saving for mortgage repayment and/or retirement was possible only through life-insurance policies. The adoption of the Bank Saving Act in 2008 extended the same fiscal benefits to bank annuities ('*banksparen*'). With new providers (banks) and products entering the market, there was a substitution away from traditional life insurance products (see figure 3.8 below). Today these simpler bank annuity products are the main product used for discretionary mortgage- and pillar 3 pension-related saving.

[167] Ibid., pp. 40–47.
[168] For example, in 2020, life insurance premiums as a share of GDP was 1.5% in the Netherlands, compared to the EU average of 3.6%. This is particularly low when compared to other developed financial markets: 7.6% in Finland, 6.1% in Sweden, 5.3% in the UK, 4.9% in France and 3.1% in Germany. Source: Insurance Europe, https://www.insuranceeurope.eu/statistics.
[169] De Nederland Bank (2016), 'Vision for the future of the Dutch insurance sector', pp. 11–12.

- **Related mortgage market regulations**: besides discretionary pension saving, the other important driver of demand for life-insurance policies historically was saving or investment-based mortgages. As discussed above, the 2013 change in interest-deductibility rules made mortgagees linked to savings products such as life insurance less attractive. Life insurers have thus phased these types of product out of production. (In Figure 3.7 above, savings-based mortgages are included under 'savings insurance').
- **Loss of confidence in this type of product:** following the high-profile mis-selling cases, regulatory and tax incentive changes were likely to have been augmented by a general decrease in confidence in complex products such as unit-linked life insurance policies and those linked to savings-based mortgages.

Figure 3.8 New production of individual life insurance policies and bank savings products



Source: De Nederland Bank (2017), 'Financial Stability Report'.

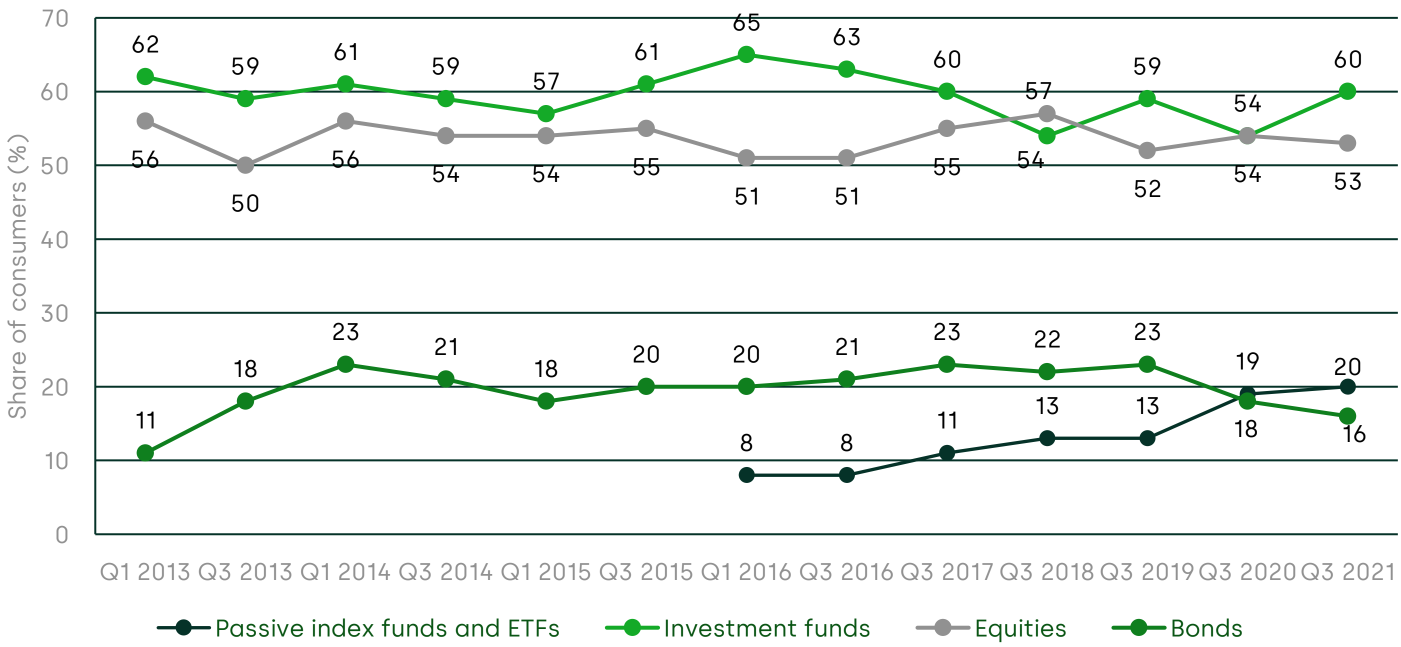
For retail investments products, it is important to note that compared to the rest of the EU, the Netherlands has a longer tradition of retail investor participation in capital markets.[170] Investors here have a relatively greater propensity to opt for non-traditional products (e.g. index funds, ETFs and cryptocurrencies), and have a comparatively greater appetite for execution-only products.[171] The recent trends the increased uptake of non-traditional products (e.g. passive investment funds) are thus in line with what one would expect from a mature retail investment market, where a greater share of consumers may be accustomed to different financial products (and how to make use of them independently). This does not mean that the ban on commissions could not have an impact on product use (if fact, the shift to execution-only products may well in large part be due to

[170] European Commission (2022), 'Disclosure, inducements, and suitability rules for retail investors study', p. 65.
[171] Ibid, pp. 11 and 65.

it). However, one should be careful to conflate broader market trends and developments with the impact of the ban.

A high-level analysis of trends in the uptake of various products does not suggest that the ban has had a clear and meaningful impact on the types of investment product used by private investors in the Netherlands (see Figure 3.9 below). There has been an notable increase in the uptake of EFTs and other passive investment products since 2016/17—products that generally carry little to no management or advice fees. However, from the data available, it would seem that the meaningful increase in uptake of these products occurred only a few years after them implementation of the ban. The recent increase in ETF and passive fund investments is also not much different from similar trends at the broader EU level over recent years[172], and in particular, the higher levels of uptake in other countries with high levels of capital market participation (e.g. Germany, Sweden and Finland).[173]

Figure 3.9 Share of investors per financial product category over time



Source: AFM (2021), Consumer Monitor.

Compared to the rest of Europe, the Netherlands is an outlier with respect to the share of people indicating that they have residual savings, but that they are not actively looking to invest and are not interested in financial products (see Figure 3.10 below).[174] Note that this phenomenon may also be affected by factors other than the ban

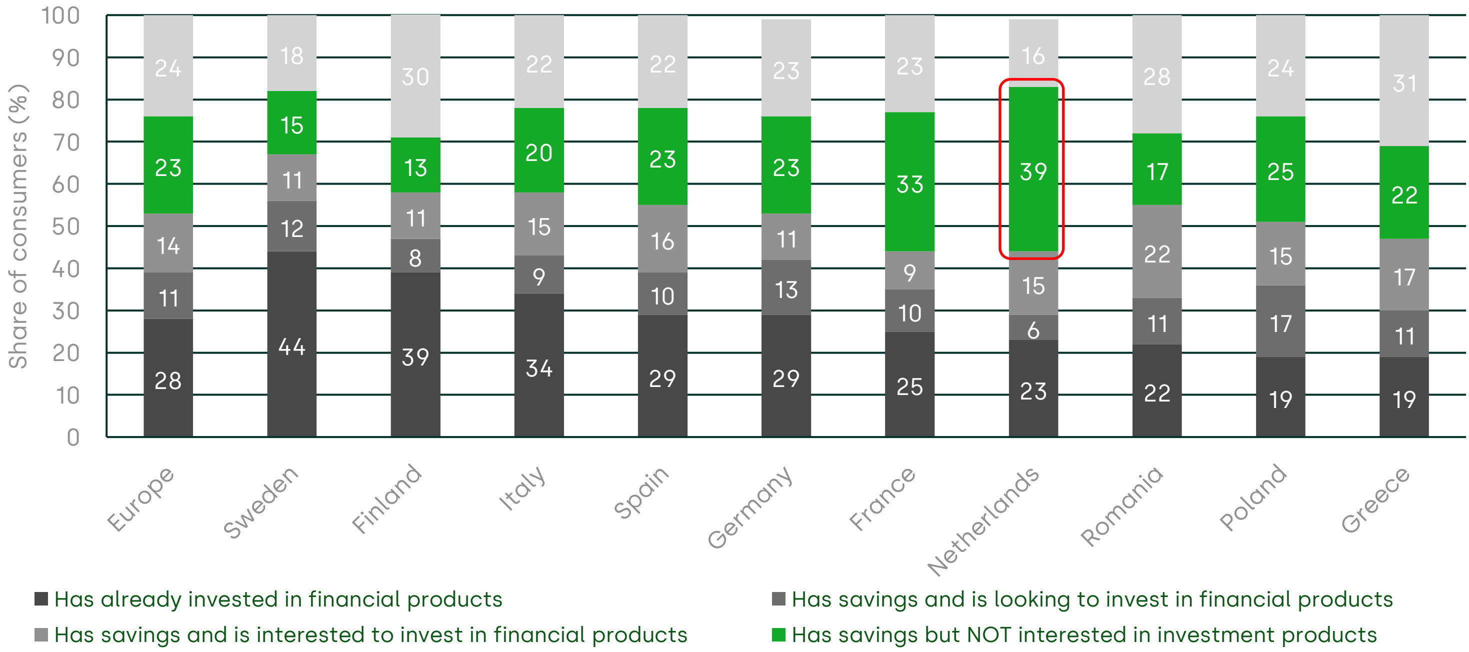
[172] See EU-level index fund and ETF investments trends in ESMA (2021), 'Performance and Costs of EU Retail Investment Products', April, p. 20; and Refinitiv (2022), 'Monday Morning Memo: Review of the European ETF Market 2021', https://lipperalpha.refinitiv.com/reports/2022/03/monday-morning-memo-review-of-the-european-etf-market-2021-2/#.

[173] European Commission (2022), 'Disclosure, inducements, and suitability rules for retail investors study', p. 11.

[174] European Commission (2022), 'Disclosure, inducements, and suitability rules for retail investors study', p.10. See findings to the same effect in European Commission (2018), 'Distribution systems of retail investment products across the European Union', p. 6.

on commissions (such as the extent of pension coverage already provided through a well-developed, semi-mandatory pension system). Nevertheless, this is consistent with the research findings in the Netherlands that potential consumers are less likely to seek advice (and potentially thus also less likely to make use of investment products). It also serves as cautionary evidence for contexts where pension coverage is not as extensive as in the Netherlands.

Figure 3.10 Share of consumers who have savings and are (not) interested in investment products



Note: 'Europe' is the average figure from the ten countries in the sample. The sample considers people who already have bank accounts in the ten countries covered by the consumer survey.
Source: European Commission (2022). 'Disclosure, inducements, and suitability rules for retail investors study.'

3.5 Lessons for the EU policy debate

One should be careful not to extrapolate from current market conditions in the Netherlands on the assumption that these are as a result of the ban, nor that similar conditions would take root in other markets if they were simply to impose a similar ban on commissions.

First and foremost, it is not possible to disentangle the impact of the commission ban from the broader series of regulatory interventions that preceded and accompanied it in the Netherlands. As we discuss above, the changing trends in the main outcomes of interest across the primary products of concern (especially complex mortgage and related life insurance products) were observed *prior to* the ban on commissions, and in large part due to market-specific regulations and developments unrelated to the ban.

Financial markets also vary significantly across EU member states, and the impact of the ban would differ according to the pre-existing conditions in the markets where it was introduced.[175] For example, the

[175] See, for example, the summary on the extent to which consumers in different EU member states rely on different financial products, in European Commission (2022), 'Disclosure, inducements, and suitability rules for retail investors study', pp. 56–57.

incentives offered by commissions are viewed in a positive light by both industry players and public authorities alike in some eastern European jurisdictions (where markets are smaller and generally less well-developed).[176] In these contexts there is greater concern that a ban on commissions might reduce the range of products on offer, the number of distribution channels and/or result in the suboptimal uptake of products.[177]

For some product markets, such as the mortgage market, a commission ban may be of less concern in general, as demand is driven primarily by the demand for houses and advice fees are a relatively minor part of the homebuyer's total expenditure.

However, there is a greater risk for other insurance and investment products, especially as these relate to pension savings. This proved less of a concern in the Netherlands, given that a mix of state and semi-mandatory occupational pensions provides coverage to a much greater share of the population than their EU peers (where pension saving is more often left more to consumer discretion and initiative).

Unlike the prevailing conditions in most other EU markets, the Netherlands also had an extensive network of independent advisors prior to the imposition of the ban on commissions. Therefore, while Dutch authorities have to a large extent averted causing large-scale competition distortions, a ban on commission could place at risk the development of the independent advisor channel in other contexts.

Dutch authorities were (and continue to be) careful to introduce a range of compensatory measures to avoid the unintended consequences of creating an unlevel playing field between independent advisors and those tied to vertically integrated providers. However, this has come at the cost of non-negligible practical enforcement difficulties. Despite best efforts, some concerns remain about an unlevel playing field.

[176] Ibid., Annexes to the Final Report, pp. 147–148.
[177] Ibid, p. 147.

4 Analysis of the impact of a commission ban in the United Kingdom and the lessons for the EU policy debate

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This section presents an analysis of why a commission ban was introduced in the UK, the impact of the ban on the financial advice market, and the subsequent lessons for the current EU debate on commission bans.

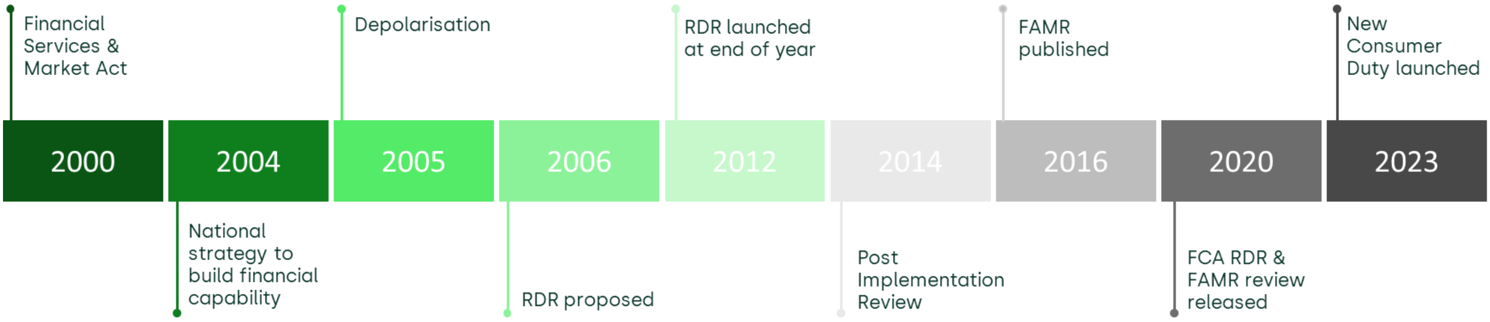
Box 4.1 Key takeaways

- The Retail Distribution Review (RDR) was implemented to ensure that, among other things, financial advice was available to all consumers who required it, but there is growing concern (and evidence) in the UK about a **financial advice gap**, particularly for those who cannot afford it.
- **Lower-income customers may be at a disadvantage** because they are less likely to receive financial advice, which may result in poor investment decisions or falling victim to financial scams, eroding their savings and worsening their financial situation.
- The RDR has led to **lower product costs** but **higher advisory fees**, resulting in a disproportionate impact on individuals with lower incomes and an uneven playing field that can have negative consequences.
- The **elimination of product bias** in adviser recommendations has resulted in an increase in the sale of retail investment products that previously paid low or no commission.
- There are still instances where the quality of advice is questionable, and a **sizable portion of the population lacks access to financial advice** due to accessibility and affordability issues, which has a negative impact on the overall quality of financial advice.
- Despite the potential benefits of seeking financial advice, **engagement** in the financial advice market remains low, with **trust** continuing to be a major barrier to engagement.
- The **unsatisfactory** outcome of competition in the market for financial investment advice is largely attributable to fee-induced decreased competition. Investors' criteria are less stringent than those of commission rate setters, resulting in a **less competitive environment**.
- RDR caused a **shift towards lower-cost products**, such as ETFs, which are simpler – cheaper to sell – but may be **less suitable**.

RDR had **minimal impact on life insurance products**, which account for 77% of insurance premiums, but non-life insurance take-up remained stable.

Source: Oxera

Figure 4.1 Timeline of key initiatives and changes in the financial advice market in the UK



Note: Financial Advice Market Review (FAMR)
Source: Oxera.

4.1 Background, rationale and overview of the ban

In 2006, the UK FSA launched the RDR to examine whether commission-based advice involved misaligned incentives leading to high levels of mis-selling.[178] Such mis-selling was indeed found in particular in connection with payment protection insurance (PPI) (see **Error! Reference source not found.**).[179] The FSA identified several types of distortion that resulted in sales that were not in customers' best interests. Even disclosing any conflicts of interest did not, according to the FSA, adequately protect investors.[180] Furthermore, it was believed that investors did not fully comprehend the commission-based remuneration model and its inherent potential for conflicts of interest. Moreover, the FSA discovered that consumers' limited understanding of the financial products they purchased aided mis-selling.[181] Sales bias was another critical concern raised by the FSA.

The FSA aimed to prevent financial product mis-selling by improving the quality and transparency of financial advice. Moreover, unlike other geographies, particularly in other European countries, the UK was deemed amenable to a commission ban because it has an established, mature market with actively investing consumers, for example through mandatory occupational pension schemes.[182]

Box 4.2 Payment protection insurance mis-selling

In 2009, UK regulatory authorities discovered that payment protection insurance (PPI) had been widely mis-sold, resulting in a large number of compensation claims. PPI was mis-sold for a variety of reasons, most notably because customers were pressured into purchasing the

[178] The initial development of the RDR is explained in the FSA Consultation Paper: Financial Services Authority (2009), 'Distribution of retail investments: Delivering the RDR', CP09/18, June.
[179] Oxera (2015), 'Regulating remuneration systems: effective distribution of financial products', p. 20.
[180] European Commission (2022a), p. 294.
[181] FSA (2007), 'A Review of Retail Distribution', para 3
[182] EFAMA, EBF, EAPB, EACB, Insurance Europe, EUSIPA (2022), 'Joint letter on EC Retail Investment Strategy and the importance of financial advice', 16 December.

product (despite the fact that the product was optional) or were sold the product when they would not be eligible to claim.

A market investigation by the Competition Commission (now the CMA) into PPI found that: [183]

> *each distributor and intermediary faces little competition for the sale of PPI when it is sold in combination with the credit it insures.*[184]

The Competition Commission proposed addressing this issue by prohibiting distributors from selling PPI within seven days of a credit sale - a 'point of sale prohibition'. This addressed the underlying issue, which was that consumers were not putting enough competitive pressure on distributors at the time because they were focused on the associated credit product (the loan) that they wanted. Consumers were frequently unaware of the true value of the insurance or the price for the insurance if they shopped around at the point of sale of the credit product.

The Competition Commission's case study on the PPI market is notable for addressing the underlying cause of the problem rather than changing payments from providers to distributors. The issue arose as a result of distributors making excessive profits on PPI sales, which was facilitated by companies' market power at the point of sale of credit products such as loans, with consumers unable to accurately judge the cost of PPI. The Commission concluded that measures such as commission payment disclosure would not suffice to address the issue, leading to the prohibition of point-of-sale PPI. The findings indicate that the problem would persist regardless of the distribution model used and that the underlying cause needed to be addressed.

Source: Oxera.

New RDR regulation, which came into effect on 31 December 2012, prohibited intermediaries from receiving commission from product providers on retail investment products, even if the commission was intended to be returned to the client in the form of a rebate. Instead, advisers can only be compensated by, or on behalf of, the client, thus increasing transparency and aligning advisers' interests with those of their clients.[185] The FSA hoped that lowering the risk of significant bias from commission-based remuneration structures would reduce the potential for mis-selling.

The FSA did, however, permit 'provider facilitation' of payments, in which the customer agrees to payments with the intermediary but the provider delivers the payment to the intermediary, for example, from premiums paid. This might be considered a hybrid arrangement between fees and commissions (the charge is not as salient as a normal fee when the consumer does not pay it).

[183] Competition Commission (2009), 'Market investigation into payment protection insurance', January, para. 1.
[184] Competition Commission (2009), ' Market investigation into payment protection insurance', January, para 1.
[185] Conduct of Business Sourcebook (COBS) 6.1A.

Under the RDR, financial advisers are required to charge customers two sets of fees: one for the financial product and another for advisory services. The total amount payable to the adviser must be agreed upon and disclosed to the client. Firms with direct sales forces were required to establish advice charges that are reasonably representative of the costs incurred in relation to the services provided, preventing distributors from cross-subsidizing advice charges with profits from other parts of the business. This obviously involves problematic judgements about allocation of fixed and common cost and could result in distortions in competition between different distribution channels.

To determine whether the charges are reasonable, a value-for-money assessment must be made.[186] The long-term costs of providing personal investment advice and distributing the investment product are calculated in this assessment, but the costs of manufacturing and administering the product are not included. The purpose of this evaluation is to determine whether the adviser's fees are reasonable and provide value to the client. Furthermore, any cross-subsidisation from product charges to advice charges must be minimal in the long run.[187] Due to of the allocation of fixed costs, this assessment, to some extent, is open to interpretation. Box 4.2 provides an overview of recent developments in UK regulation.

Box 4.3 A short overview of developments in UK regulation of the distribution of financial products

Regulation of retail distribution of financial products:

In December 2020, the FCA assessed the success and wider impact of the RDR and the Financial Advice Market Review (FAMR). Despite fears that the RDR would reduce access to financial advice, the FCA found that the market had adapted and was working well for the majority of consumers. Despite that assessment, the FCA admitted that many consumers keep their money in cash rather than investing it, and as a result are missing out on the potential opportunity to make their money work better for them in the long run; many consumers do not seek or receive the type of financial help that would equip them to make better investment decisions.[188]

On the supply side, the FCA highlighted that there had been some innovation in the advice market, but that the market has not yet been able to attract large numbers of consumers. The industry does offer a range of services—from automated or robo-advice, to one-off specific advice—but there is significant clustering around a few service types. As a result, advice firms appear to face little competitive pressure to

[186] Conduct of Business Sourcebook (COBS) 6.1A.10G.
[187] This does not refer to cross-subsidisation between different types of customer, but rather from product charges to advice charges.
[188] FCA (2020), 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review', December, p. 3.

innovate and offer new, more affordable services, or to try to attract less wealthy consumers. Ultimately, competition does not appear to be operating effectively in the interests of consumers.[189]

The FCA also stated that the RDR had resulted in higher professional standards for advisers and less product bias. Despite all this, because outcomes for consumers in retail financial markets in the UK are considered to be unacceptably poor, the FCA decided that it had to introduce a major new regulatory requirement, in the form of the Consumer Duty.

It is hard to reconcile the FCA's action and the still significant concerns about affordability and access to advice, especially for those with smaller investment portfolios, with the optimistic findings of the FCA's assessment of the impacts of the RDR and FAMR. The assessment [?] appears to emphasise the 'policy' benefits of the RDR rather than to examine its full range of market impacts. The FCA pays little attention to the concerns raised above or to other concerns. For example, 'unintended consequences of the RDR' are reduced to 'regulatory barriers', which the FCA considers 'are not linked to *specific* RDR provisions' (our emphasis). Perhaps they are linked to the overall impact of the RDR?

The assessment relies a lot on a consumer survey without properly accounting for the severe information problems affecting consumers in the market for retail investments. It discusses industry developments but with no rigorous analysis of how these were or were not changed by the RDR or FAMR. This is not surprising as, again, the industry section of the report is based on a survey.

The detailed findings in Annex 1 of the report are said to be stated against a 'Baseline', but in fact there is no rigorous counterfactual that seeks to capture the market as it would have developed over several years of technological change if the RDR and FAMR had not been in place. Most of the evidence in Annex 1 is reportage or a loose aggregation of comforting observations organised around the (vaguely worded) 'outcomes' that the regulator hoped would be generated by the RDR and FAMR. Potentially disturbing data, such as that relating to complaints, is not discussed or explained.

The European Commission, the UK government and the FCA itself have all set out standards for impact assessments, and these broadly align with each other. It is hard to identify many elements of these standards that are met by the FCA's assessment of the impacts of the RDR and FAMR.

Savings and protection gap

The savings and protection gap has long been a source of contention in the UK. According to research, a significant proportion of people do

[189] Financial Conduct Authority (2020), 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review', p. 6, December.

not save enough for retirement and do not have adequate protection against unforeseen events such as illness, death, or unemployment.[190]

Several initiatives have been proposed to address this. Simple products have been developed that consumers can buy without seeking financial advice, such as the stakeholder suite of pension and savings products introduced in response to the Sandler Review of Long-Term Savings in 2002.[191] The Sergeant Review of 2013 aimed to increase consumer confidence and help individuals make more informed financial decisions by simplifying financial products and promoting transparency. It also recommended a new suite of simple financial products (SFPs) to help consumers navigate the financial marketplace.[192] This again demonstrates a lack of belief in what the RDR could achieve. To be eligible for the SFP label, products had to meet a set of standardised features, such as a clear explanation of fees, simple terms and conditions, and a simple pricing structure. The review proposed a suite of SFPs for savings, insurance and credit products aimed at a diverse range of consumers.

SFP products included easy-access savings accounts, term life insurance policies, and credit cards with simple interest rates and no hidden fees. These products were created to be simple to understand and compare, allowing consumers to choose the best product for their needs.[193]

The Sergeant Review also suggested creating a dedicated organisation to oversee the development and promotion of SFPs, as well as implementing measures to encourage consumer engagement with financial products, such as financial education initiatives and improved access to advice and guidance. Also note that the ban on commission occurred prior to the implementation of the IDD measures (e.g. to operate honestly, fairly and professionally), implying that the restriction may not have been necessary if the IDD had been adopted sooner.[194]

Despite efforts to increase access to financial advice for mainstream investments, the outcomes have been unsatisfactory. As a result, the FCA has considered other ways to achieve its aim, including lowering regulatory standards by establishing a less-demanding regime for 'streamlined advice' or 'financial guidance'. This 'advice-light' strategy intends to allow businesses to deliver offerings to a broad audience, including less affluent clients. This new strategy is designed to increase access to financial advice and assist a broader spectrum of customers in making informed investment decisions.[195]The assessment relies a lot on a consumer survey without properly accounting for the

[190] The Money Advice Service (2016), 'Closing the savings gap – Insights from Money Advice Service research', September.
[191] HM Treasury (2002), 'Medium and Long Term Retail Savings in the UK: A Review' (The Sandler Review).
[192] See HM Treasury (2013), 'Sergeant Review of Simple Financial Products, Final report', March.
[193] HM Treasury (2013), 'Sergeant Review of Simple Financial Products, Final report', March, p. 9
[194] Financial Conduct Authority (2018), 'Insurance Distribution Directive', May.
[195] Financial Conduct Authority (2022), 'Broadening access to financial advice for mainstream investments – consultation paper', November.

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The Sergeant Review also suggested creating a dedicated organisation to oversee the development and promotion of SFPs, as well as implementing measures to encourage consumer engagement with financial products, such as financial education initiatives and improved access to advice and guidance. The Sergeant Review aimed to increase consumer confidence and help individuals make more informed financial decisions by simplifying financial products and promoting transparency.

Source: Oxera.

4.2 Scope of the ban (and exemptions)

The commission ban in the UK applies to all retail investment product distributors, including single- and multi-tied agents, and independent financial advisers (IFAs).[200] **Retail investment products** covered by the ban include pension policies, investment trusts, savings schemes, securities, equities, and structured capital-at-risk products.

Financial advisers were required to meet updated and more stringent qualification thresholds in addition to the ban on commission payments for retail investment products. The qualifications required vary depending on the type of advice provided, but in general, advisers are now required to hold higher levels of qualifications than previously required. Furthermore, advisers must maintain their knowledge and skills through continuous professional development. This was done to ensure that advisers could provide high-quality advice that met the needs of their clients.

Certain products were also explicitly exempted from the ban, discussed in turn below.

4.2.1 Pure protection products

The FSA decided to exempt pure protection products from the commission ban, such as **critical illness insurance**, **non-investment life insurance**, and **income protection**.[201] This decision was influenced by the lower incidence of complaints and mis-selling episodes in the pure protection market, as well as the inherent differences between pure protection and investment products. Furthermore, the absence large-scale mis-selling episodes, like the PPI scandal, identified by the regulator in the context of investment advice (in addition, the PPI mis-selling case was not directly linked to commission payments by the UK's Competition Commission and the FSA, as explained in Box 4.1 above) provided additional justification that a commission ban was not required. Ultimately, while PPI was a major scandal in the UK, as explained above, banning commission was not considered to be the right solution to it.

The customer's cost transparency was viewed as a key differentiator between pure protection and investment products. The cost of pure protection products was thought to be relatively transparent, whereas the cost of investment products can vary depending on the fund's value. Customers purchasing pure protection products are also cost-

[200] COBS 6.1A.
[201] See FSA (2009), 'Distribution of retail investments: Delivering the RDR', Consultation Paper CP09/18, June.

conscious and interested in lowering their premium because they are purchasing insurance to cover something they hope will not happen.

In addition, pure protection products are considered "distress purchases," whereas investment products are purchased with the expectation of a financial return. This disparity may indicate that customers who purchase pure protection insurance are more concerned with cost minimization than customers who purchase investment products, which place a greater emphasis on potential investment returns.

While the FSA convinced itself that it would be useful to try to remove the subset of biases in the investment adviser and consumer relationship associated with commissions while ignoring the biases that arise from the charging of fees in this relationship, it could not convince itself that it would be worthwhile to take this approach in other retail financial markets.

Note that, household expenditure on pure protection life insurance products in the UK has remained fairly constant over the past 20 years, with slight annual variability (as seen in Figure 4.1 below).

Figure 4.2 Household spending on life insurance in the UK (seasonally adjusted)

Source: Consumer Trends, Q1 2022, table 12CS (ONS).

4.2.2 Mortgages

In October 2009, the FSA issued a Discussion Paper outlining the case for mortgage market regulatory reform.[202] Since there was no evidence that the commission-based remuneration model for mortgages caused the same level of consumer harm as investment products, the FSA decided not to include mortgages in the commission ban. It should be noted that the Netherlands chose a different strategy in this case, incorporating mortgage products inside their commission prohibition. This demonstrates how different solutions have been utilised. According to the FSA's analysis, while the wrong mortgage could be purchased, the mortgage market was characterised by a relatively high level of switching, which meant that

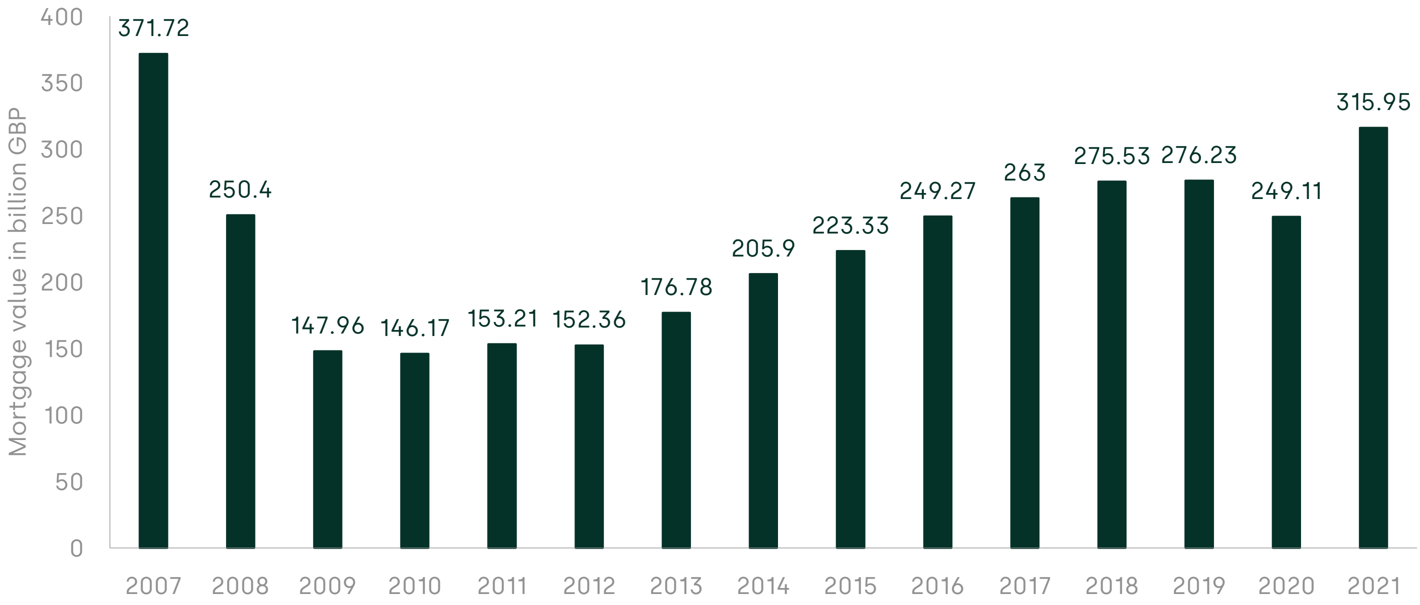
[202] Financial Services Authority (2009), 'DP09/03: Mortgage Market Review'.

consumers had the opportunity to correct any mistakes they may have made.[203]

Furthermore, the FSA found no other countries that prohibited commission payments in mortgage markets.[204] As a result, the regulator concluded that prohibiting mortgage commission payments was unnecessary at the time.

Since 2012, the total value of gross mortgage lending in the UK has been steadily increasing (see Figure 4.2 below).

Figure 4.3 Total value of gross mortgage lending in the United Kingdom from 2007 to 2021



Source: Statista Research Department, 2022.

4.2.3 Group pensions

The prohibition on commission payments does not apply to **group pensions** (group stakeholder pensions and group self-invested personal pensions). Group pensions are employer-sponsored plans that provide a pension to a group of employees. The fees paid to financial advisers for setting up and managing these plans are typically paid by the employer rather than the individual employees. As a result, group pensions are exempt from the RDR commission ban.

Group personal pensions (GPPs), on the other hand, are a specific type of group pension scheme that is based on a defined contribution model and are subject to the commission ban. Employers establish them and allow employees to contribute to a personal pension plan managed by an insurance company or a fund manager.[205]

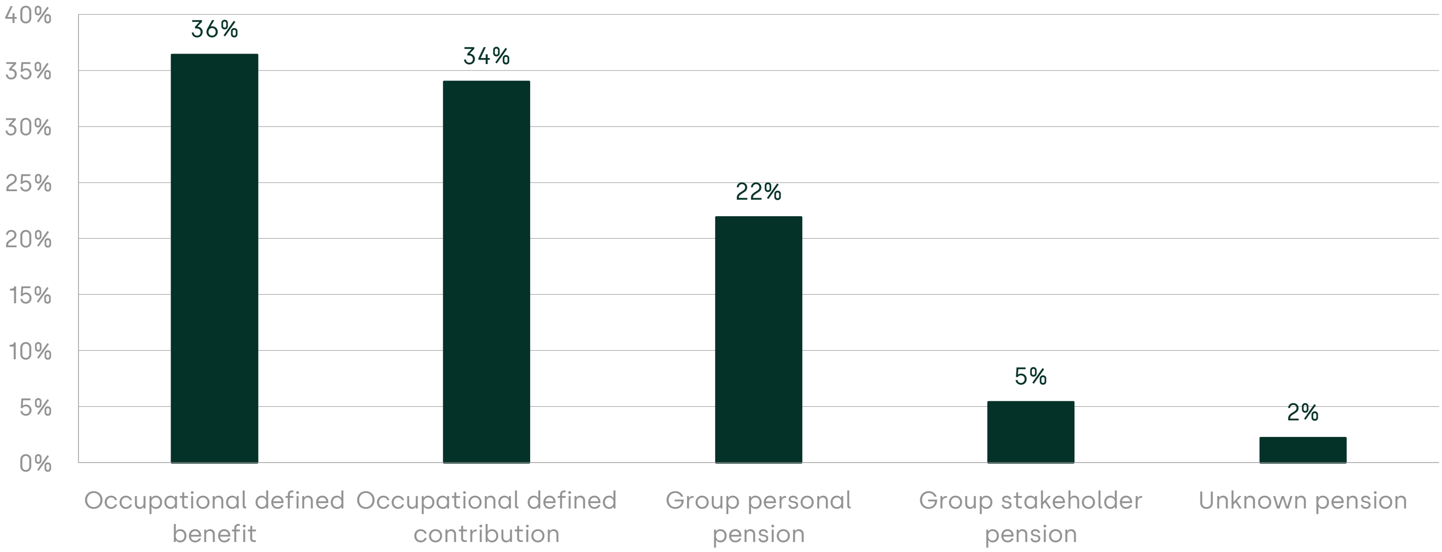
The inclusion of GPPs in the commission ban is explained by the fact that they are essentially individual pension plans arranged through an employer rather than a collective arrangement for all employees. As a

[203] Financial Services Authority (2009), 'DP09/03: Mortgage Market Review', para. 5.42.
[204] Financial Services Authority (2009), 'DP09/03: Mortgage Market Review', para. 5.41. This analysis was conducted before the Netherlands introduced a ban on commission payments for mortgage brokers.
[205] Money Helper, 'What is a group personal pension'.

result, they were perceived as more akin to personal pensions than traditional occupational pensions, which were not subject to the commission ban.

Box 4.3 provides an overview of the mis-selling of self-certified mortgages in the UK.

Figure 4.4 Distribution of employees with workplace pensions in the UK in 2018, by pension type



Source: ONS (2019) Annual Survey of Hours and Earnings, 2018, table 1.

Box 4.4 Self-certified mortgages

Self-certified mortgages are another product which was widely mis-sold in the UK (and, notably, also in the US). Mortgage distributors were accused in this case of advising applicants to take out so-called self-certification mortgages and of advising applicants to overstate their true income in order to obtain a larger mortgage, which they might have had difficulty servicing later.

These intermediaries were encouraged to help applicants obtain larger mortgages for two reasons: first, they were paid on the basis of a successful transaction (creating sales bias);[206] and second, they did not face the consequences of the customer defaulting at a later date (which is a type of principal–agent problem, as the mortgage provider has not incentivised the intermediary to avoid high-risk situations).

As part of the Mortgage Market Review, the FCA tightened regulation on self-certified mortgages in response to these concerns (MMR).[207] The MMR required mortgage lenders to collect much more information (and evidence) about borrowers (e.g., income, regular expenditure) in

[206] In this case, the intermediary was paid in the form of commissions. However, intermediaries would also have been subject to a sales bias if they had not been paid in the form of commissions but in the form of a fee by the consumers. There is a sales bias irrespective of the form of payment.
[207] FCA (2010), 'Mortgage Market Review' – available here.

order to assess 'affordability'. This review, however, did not attempted to address the issue by limiting commission payments. Indeed, as previously stated, the regulator recommended that commission payments for this type of product not be prohibited; but rather that specific problems be addressed specifically. The problems with self-certification mortgages were caused by the separation of brokers and providers, not by commission payments. Brokers were unconcerned about the risk of arranging a mortgage for a customer who might not be able to afford it.

In banking more broadly, these types of 'principal-agent' problems have sometimes been addressed by deferring commission payments or analogous payments, forcing intermediaries or employees to consider longer-term outcomes—for example, deferred bonus payments to bankers.

Source: Oxera.

4.3 Assessing the evidence on the impact of the ban

The ban on commission in retail investment products (as outlined above) represented a significant shift in the UK financial advice market, with far-reaching consequences for both advisers and consumers. In this section, we will look at how the commission ban has – and continues to - affect various aspects of the market, such as accessibility, affordability, advice quality, customer engagement, market competition, and product usage.

It is critical to consider the ban's impact in the context of the FSA's **RDR objectives**. These objectives include:[208]

- Standards of professionalism that inspire consumer confidence and trust.
- An industry that engages with consumers in a way that delivers more clarity on products and services.
- Remuneration arrangements that allow competitive forces to work in favour of consumers.
- An industry where firms are sufficiently able to deliver one their longer-term commitments and where they treat customers fairly.
- A market which allows more consumers to have their needs and wants addressed.
- A regulatory framework that can support the delivery of all aspirations and does not inhibit future innovation where this benefits consumers.

Furthermore, we must acknowledge that determining the impact of the ban is a nuanced exercise, given that it was implemented alongside a slew of other policies (to be discussed in further detail below).

[208] Europe Economics (2014), ' Retail Distribution Review Post Implementation Review', December, p. 4.

4.3.1 Disentangling the impact of the commission ban from other measures introduced through RDR

It is critical to recognise that isolating the effects of the commission ban as a separate intervention is impossible (similar to the corresponding discussions in section 3 on the Netherlands). Despite numerous studies and evaluations commissioned by the government, no definitive causal conclusions about the ban's impact can be drawn. As a result, there is room for subjective interpretation within the larger policy debate, depending on the importance assigned to various data points.

Importantly, because the ban was implemented as part of a series of targeted regulatory interventions (including increased qualification requirements), its impact cannot be considered in isolation.

In addition to the commission ban, several complementary measures were implemented in the years preceding RDR; these measures had a significant impact on the UK financial advice market.

The preceding and broader suite of complementary measures (see Figure 4.1), of which the commission ban was one component, included, among other things, the following:

- The **Financial Services and Markets Act** (2000) – aimed at improving retail markets for financial products and services to provide fairer outcomes for consumers.[209]
- From 2004, the FSA focused on **building financial capability** in the UK.[210]
- The FSA introduced a third-type of distributor in 2005, known as **multi-tied agents**.
- Also in 2005, the FSA **depolarisation regime** required distributors to provide an **initial disclosure document** describing their services and remuneration scheme to reduce commission bias and confusion.

4.3.2 Overview of major studies on the impact of the commission ban

Before exploring the impact of the commission ban on the UK financial advice market, it is necessary to provide an overview of the three major studies on the subject. These studies include Europe Economics' **RDR Post Implementation Review** in 2014; HM Treasury and the FCA's **Financial Advice Market Review** (FAMR) in 2016, and the FCA's **Evaluation of the Impact of the RDR and the FAMR** report in 2020.

RDR Post Implementation Review[211]

The FCA commissioned this study less than two years after the Retail Distribution Review (RDR) regulations went into effect. The purpose of the study was to assess the impact of the RDR regulations on the financial advice market and consumers. It investigated the effects of

[209] See UK government Financial Services and Market Act 2000 – available here.
[210] For more detail, see the Committee on Treasury report on financial capability – available here.
[211] FCA, (2014), 'Retail Distribution Review Post Implementation Review', Europe Economics, December.

the commission ban, the implementation of adviser charging, and changes to financial adviser qualifications and professional standards.

The study provides an early assessment of the impact of the RDR regulations and the commission ban, which were major changes in the financial advice market. The report provides a detailed analysis of the impact on consumers, advisers, and firms, as well as insights into the industry's key drivers of change. The study found encouraging signs about increased shopping around, reductions in product prices that might have exceeded the commissions previously paid by the product providers, although the report notes that this might have been due to the rise of platforms, and a change in product sales mix away from high commission products. It is important to note, however, that the study was conducted only two years after the RDR regulations were implemented, which was insufficient time to assess the long-term impact of the changes.

HM Treasury and the FCA – the FAMR[212]

Commissioned by the UK government and the FCA in March 2016 (three years after the RDR regulations were implemented), the FAMR sought to identify ways to improve consumer access to affordable financial advice, particularly for those with smaller investment portfolios. The review was a comprehensive review of the financial advice market that took into account the impact of RDR regulations on consumers and firms. It recommended reforms to improve consumer access to financial advice, which have since been implemented.

Unfortunately, because it focused on the broader financial advice market, the FAMR review did not provide a detailed evaluation of the impact of the commission ban specifically.

FCA – the Evaluation of the impact of RDR and the FAMR[213]

The FCA commissioned this study in 2020, eight years after the RDR regulations were implemented and four years after the FAMR review. The purpose of the study was to assess the impact of the RDR and FAMR on the financial advice market and consumers, with a particular emphasis on the impact of the commission ban and other regulatory changes.

The study provides a longer-term assessment of the impact of the RDR regulations and commission ban, which were significant changes in the financial advice market. The study compared the impact of the regulations to the pre-RDR market and considered the impact on consumers, advisers, and firms.

Some industry observers have criticised the report for not adequately capturing the experiences of smaller advisory firms and failing to consider the impact of recent market developments, such as technological advancements and changes in investor behaviour. Others have argued that the report is overly optimistic in its

[212] HM Treasury & FCA (2016), 'Financial Advice Market Review', March.
[213] FCA (2020), 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review', December.

assessment of the impact of the regulatory changes, particularly in terms of potential consumer benefits.

Furthermore, some stakeholders have expressed concern that the report's findings may not accurately reflect the experiences of consumers, particularly those who may have been harmed by regulatory changes or face barriers to accessing financial advice.

Indeed, the Association of Investment Companies (AIC) issued a response to the FCA's 2020 report highlighting that *"important questions [remain] unanswered"*.[214]

Our detailed comments on this report, which does not meet the standards required of governmental impact assessments, are in Box 4.2 above.

FCA – Consumer Investments Strategy[215]

In 2021 the FCA unveiled a new Consumer Investments Strategy,[216] with the goal of strengthening investor protection and increasing access to appropriate and affordable financial advice. The strategy was built on three major pillars.

- **Addressing the advice gap:** the FCA's goal was to encourage more people to seek financial advice by highlighting the benefits of help and experimenting with innovative advising models, particularly for underrepresented populations.
- **Improving consumer protection:** the FCA's goal was to safeguard investors from firms and products that are unsuitable for their needs. This included raising standards for firms that provide investing products and services, boosting transparency and disclosure, and promoting market competition.
- **Ensuring that innovation and competition benefit consumers:** the FCA sought to establish a competitive and innovative investment market that benefits consumers while also ensuring that risks are effectively managed. This involved encouraging the use of technology to increase access to advice and investing, as well as striving to combat fraud and scams in the industry.

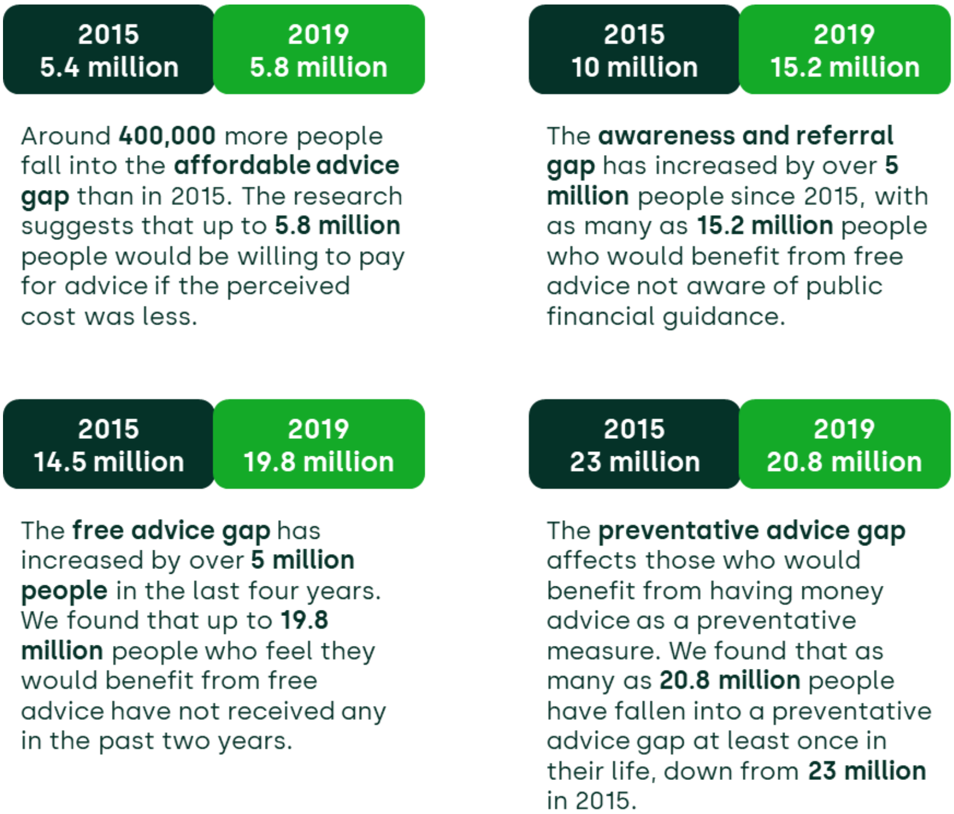
4.3.3 Accessibility

The FSA's primary goal in designing and ultimately implementing the RDR was to ensure that financial advice remained available to all consumers who needed it. Indeed, the FSA wished to ensure that any regulation enabled a market in which more consumers' needs and preferences could be met. Following the implementation of the RDR, there has been rising concern in the UK about a financial advice gap, which refers to some categories of people not having access to financial advice and guidance. These groups may include those who actively seek but do not receive advice, those who would benefit from advice but do not seek it, those who cannot afford it, or those who are unaware that advice or assistance is available. It is crucial to highlight

[214] AIC (2020), 'AIC responds to the FCA's FAMR and RDR review', December.
[215] FCA (2021), 'Consumer Investments: Strategy and Feedback Statement', October.
[216] Financial Conduct Authority (2021), 'Consumer Investments: Strategy and Feedback Statement', October.

that the term 'advice gap' incorporates a wide range of issues other than affordability.

Figure 4.5 The advice gap in the UK



Source: reproduced from OpenMoney (2019), 'The UK advice gap: are consumer needs for advice and guidance being met?'.

Advice is not reaching all parts of the market. The FCA has found that only 8% of UK adults have received financial advice. Robo advice is failing to fill this gap, with only 1.3% of adults having used this in 2020. The majority (54%) have received no support in making investment decisions. Few consumers have considered the benefits of advice. With 67% of consumers believing they can make investment decisions themselves and a further 22% had simply not thought about it.[217]

According the FCA, 54% of UK adults with £10,000 or more in investible assets did not receive any formal support to help them make investment decisions in the previous year.[218] Wealthier customers seem to fare better. In fact, only 17% of UK adults with more than £100,000 in investible assets received regulated financial advice in the last 12 months, compared to 25% between £100,000 and £250,000 and 38% for more than £250,000.[219]

Another indicator of the RDR's negative impact on financial advice availability is that the advisory rate for investment funds has dropped

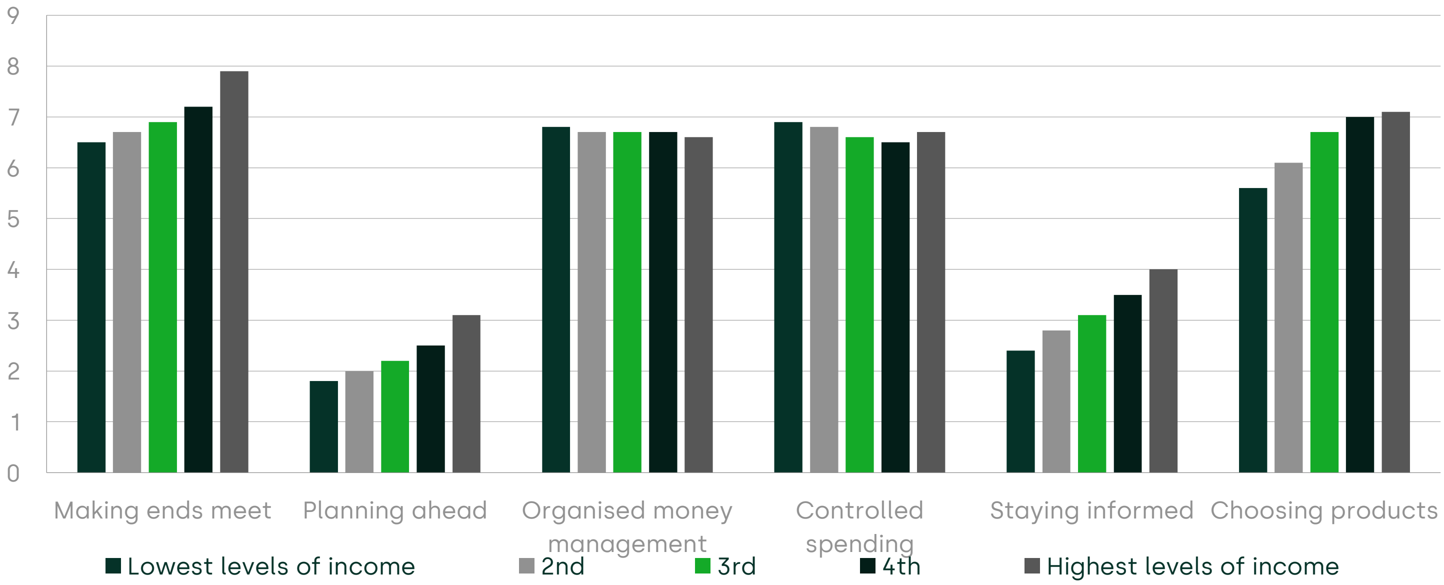
[217] https://www.fca.org.uk/publications/corporate-documents/consumer-investments-strategy.
[218] FCA (2020): 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review' report.
[219] FCA (2020): 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review' report.

significantly, from approximately 67% in 2009 to only 12% in 2022. The market for private pension products has also been heavily affected, with a 66 percentage point drop in the advisory ratio since the commission ban.[220]

Worryingly, post the implementation of RDR, there is evidence that suggests financial advisers have introduced restrictive'' assets under management'' requirements – thus focusing efforts on high-net worth individuals at the expense of those with more limited financial assets. A survey by Citizens Advice (a UK organisation that offers free legal, financial, and other advice and support to individuals in need) found that the proportion of advisory firms who asked for a minimum portfolio of more than £100,000 doubled from around 13% in 2013 to 32% in 2015.

The consequences of not seeking investment advice can be severe, particularly for lower-income consumers who risk having their savings eroded, especially in high inflationary environments. Lower-income consumers who do not seek financial advice run the risk of making poor investment decisions or not investing at all, resulting in a loss of potential gains and decreased savings over time.[221] Furthermore, they may be unaware of the various financial products and services available to them, such as low-cost index funds or government-backed savings accounts, which can assist them in effectively growing their wealth.

Figure 4.6 Mean financial capability scores, by quantile of total household income in Great Britain



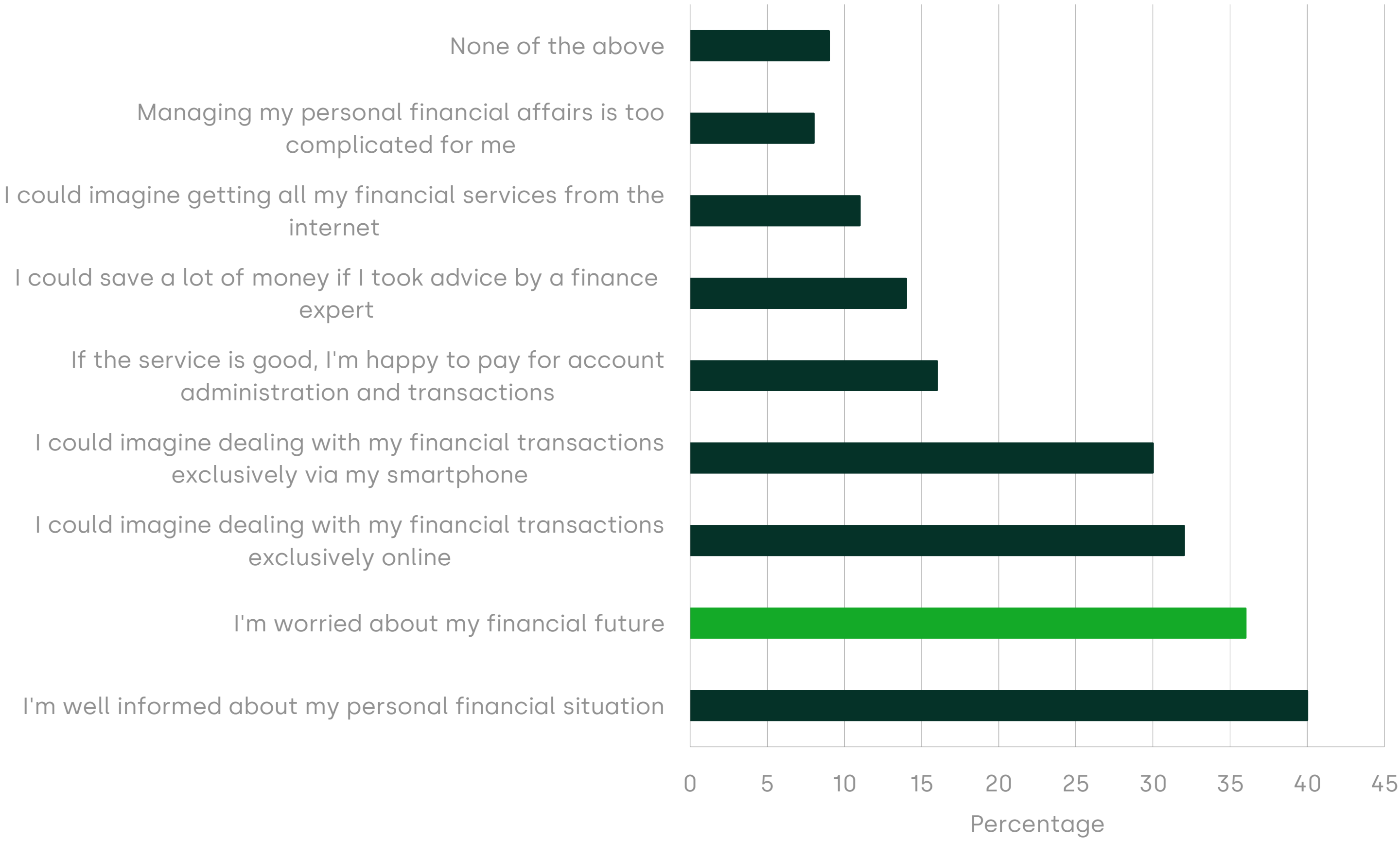
Source: Wealth and Assets Survey – 2015 - Office for National Statistics (ONS.)

Lower-income consumers may also be more vulnerable to financial scams or high-risk investments that promise quick returns but ultimately result in significant losses if they do not receive proper

[220] Detlef Pohl (2022), Provisionsverbot: Dramatische Folgen im Königreich, Procontra, 25 July.
[221] Money Helper, 'Do you need a financial adviser?'

financial guidance. Evidence from the UK Office for National Statistics (see Figure 4.6) highlighted that individuals' financial capability varies depending on the level of their households' income.[222] In the study, there was a clear relationship between financial capability and income. In some cases, low-income consumers may also turn to high-cost alternative financial services, such as payday loans or high-interest credit cards, eroding their savings and worsening their financial situation. These concerns should be alarming for any regulator, given in 2022 over 35% of people stated they were worried about their financial future (see Figure 4.7).

Figure 4.7 Attitudes towards personal finances in the UK in 2022



Source: Statista Global Consumer Survey, March 2023.

4.3.4 Affordability

Access to affordable financial advice is critical for individuals seeking financial stability and security because it provides them with the tools and knowledge they need to make informed financial decisions. Many people may struggle to navigate the complex financial landscape without affordable financial advice, potentially jeopardising their financial futures.

Product charges fell after RDR, as expected, due to the elimination of the commission element on retail investment products. According to the 2014 review, charges fell after the RDR. This was "due in part to competitive pressure from platforms and advisers, e.g. to gain access to lower cost share classes, and also the introduction of simpler

[222] ONS (2015), 'Financial capability in Great Britain', June.

products with lower charges'' that are easier to manage and thus have lower fees, such as EFT funds (as discussed further in Section 4.3.9).

Table 4.1 uses figures from a study commissioned by the FCA to estimate the indicative total cost to investors pre- and post-RDR, based on a £10,000 investment in equity funds (or ISAs).[223]

Table 4.1 Illustrative changes in costs to advised investors based on an investment of £10,000 for Equity Funds

	Pre-RDR	Post-RDR	Post-RDR max
Provider charge	75	54	66
Adviser charge	50	50	100
B2B platform charge	25	29	50
Initial	300	100	300
Total ongoing	**150**	**133**	**216**
Total initial	**300**	**100**	**300**

Source: Financial Conduct Authority (2014).

However, while product costs have obviously decreased, there is evidence that the cost of advice has increased. According to the 2014 review, rising advice costs had been partially realised, with evidence indicating that adviser charges had increased in some cases. The average annual charge for consumers is around 1.9%, and the hourly charge for financial advice is nearly £150 on average in the UK.[224]

Clearly, determining the overall impact of these changes on the cost of advice is difficult. The FCA's most recent review in 2020 did not provide a clear stance on this issue, which could indicate that higher advisory fees are prevalent in the post-RDR market.

Individuals with lower incomes have been disproportionately affected by the RDR's cost structures. While product prices have decreased, advisory fees have risen, creating a significant barrier to accessing financial advice for those who cannot afford or are unwilling to pay in advance.

The lack of access to financial advice has resulted in a concerning situation in which a significant proportion of the population is denied the potential benefits that financial advice can provide, with far-reaching consequences for the economy and society (the value of financial advice and engagement will be explored in more detail in Section 4.3.7).

4.3.5 Willingness to seek financial advice and consumer trust

Despite the numerous benefits of seeking financial advice, such as improved financial outcomes and increased decision-making

[223] Europe Economics (2014), 'Retail Distribution Review Post Implementation Review', December, table 8.4.
[224] See more information on the Money Helper website – available at https://www.moneyhelper.org.uk/en/getting-help-and-advice/financial-advisers/guide-to-financial-adviser-fees.

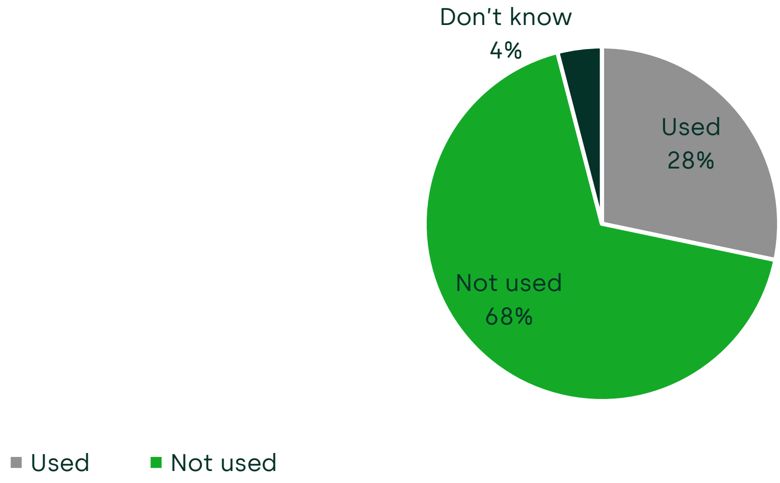
confidence, the RDR and the FAMR have failed to significantly increase engagement in the financial advice market. While the industry's professionalisation has undoubtedly improved the quality of advice (for those who can obtain it), trust (among other factors including concerns about risk, lack of knowledge and lack of disposable income) remains a significant barrier to engagement. This lack of trust limits the potential benefits of financial advice for those who could most benefit from it.

It should be noted that many of the worries that consumers may have when investing in financial goods without advise can be addressed by qualified and regulated assistance from professional advisors. Advisors can analyse income and costs, identify wasteful spending, and free up funds for retirement and risk management. They can also supply information regarding state or tax breaks, as well as financial insight into demand. Advisors can address risk concerns and offer solutions that meet customers' risk tolerance. They can also address return worries by offering information on prior performance and typical after-cost returns. According to EIOPA's cost and previous performance analysis, the average after-cost return on unit-linked products in 2021 will be 9.4%.[225]

While over 4.1 million UK adults sought financial advice in the previous 12 months, engagement remains alarmingly low. Approximately 68% of people stated that they did not require financial advice in the same time frame (see Figure 4.8). According to a Deloitte survey conducted in 2012, roughly one-third of investors would stop using advisers if they were charged directly, and half of those willing to pay a fee were unwilling to pay more than £50 per hour (well below the current hourly advice fee of £150).[226] More recently, one survey found that retirees were willing to pay an average of £253 for advice - equivalent to less than 2 hours of advice (compared to the average hourly fee);[227]clearly, these outcomes remain in line with negative pre-RDR predictions and have failed to improve in recent years.

[225] EIOPA (2023), 'Cost and Past Performance 2023', January.
[226] Deloitte (2012), 'Bridging the advice gap: Delivering investment products in a post-RDR world'.
[227] Holt (2015), Waste of money and intimidating: Why retirees shun pensions advice, August. MoneyMarketing (2015), 'Waste of money and intimidating: Why retirees shun pensions advice', August.

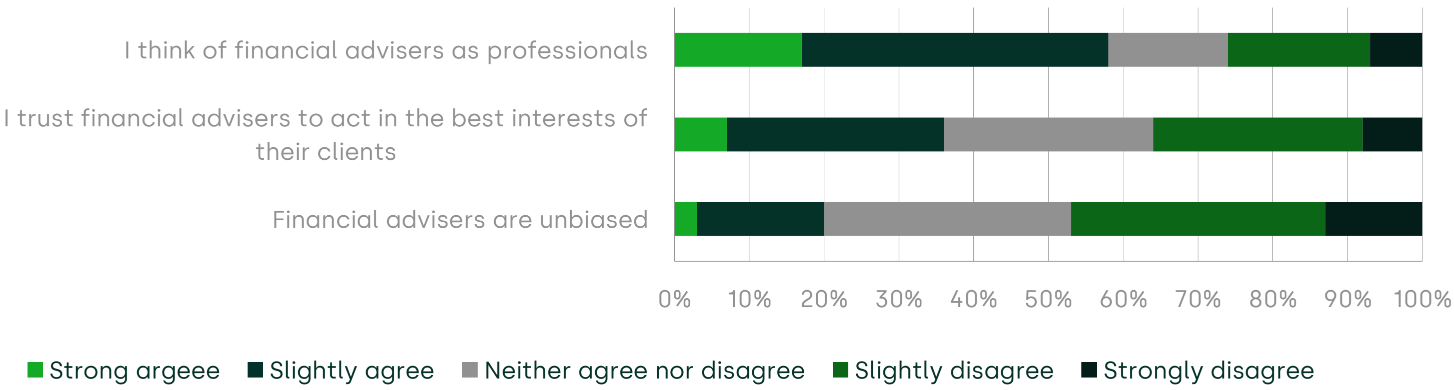
Figure 4.6 Proportion of UK adults who have used information or guidance in the last 12 months (2020)



Source: FCA (2020), Evaluation of the impact of RDR and the FAMR.

One goal of the European Retail Investment Strategy is to increase retail investors' trust in the capital markets in order to attract more savers to become investors. The lack of trust in the financial advice industry was also a key driving force behind the implementation of the RDR (and specifically the commission ban). Despite the ban, trust in the industry remains fractured. Customers continue to lack trust in financial advisers in general, and there is evidence that the RDR may not have fully met its objectives in this regard. Figure 4.9 illustrates attitudes towards financial advisers (in 2020) held by adults who have not had advice in the last 12 months but might have needed support and highlights the fractured nature of opinions towards the industry, and demonstrates that prohibiting commissions cannot be relied on as a means of improving trust.

Figure 4.7 Attitudes towards financial advisers in 2020



Source: FCA (2020).
Source: Financial Conduct Authority (2020), 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review'.

As discussed, access to and engagement with financial advice can ultimately help consumers (especially those on low-incomes) to grow their savings and investments over time. Even if these people do not fully understand the long-term benefits or need for financial advice, ignoring the need for financial advice for smaller investors can ultimately perpetuate inequality and prevent people from achieving greater financial security. This is especially concerning for lower-income consumers, who face having their savings eroded, particularly in the current inflationary environment. FCA consumer research found that the most common reason given for not seeking full regulated advice was that people do not think they need it (67% of consumers).[228]

The RDR regulations have clearly reduced engagement in advice-seeking. The International Longevity Centre's empirical evidence (detailed in Box 2.1) shows that taking advice has many additional benefits; thus, low engagement is harmful consumers in the UK who took professional financial advice between 2001 and 2006 enjoyed an average increase in their assets of nearly £48,000 after ten years, compared to those who took no advice. The benefits of advice were particularly significant for those with less disposable income, and for people who took advice more than once. The combined benefits of advice over the ten-year period work out at approximately 2.4% greater than the initial cost of the advice.[229]

Unlike the FCA's 2020 evaluation of the RDR, the International Longevity Centre study is a rigorous analysis based on causal identification. Thus, it can be said with some confidence that this study shows that the reduction in advice associated with the RDR is a true and material social cost.

It also is important to distinguish between regulated advice from qualified advisors, who are liable for their advice, and unregulated recommendations from friends, family, social media activities or trading platforms. The latter - more informal advice - does carry several risks including the risk to destroy trust in capital markets if consumers get experience with fraud, scam or simply with the results of bad decisions. As the GameStop case recently showed, investors not only do research online and via social media, but can also use social media or similar forums to coordinate strategies to buy meme stocks. This leads to high volatility and can even threaten financial stability.[230]

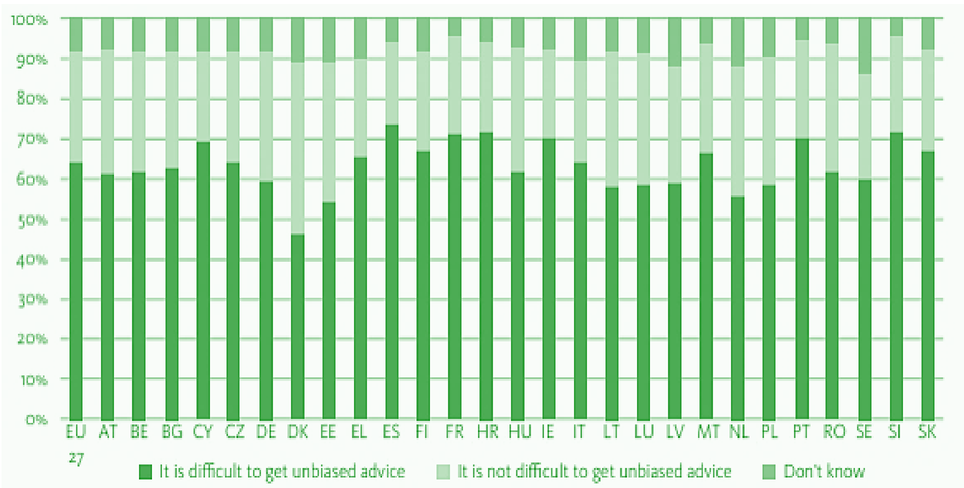
Also valuable is a differentiation between trust in the financial markets in general and confidence in the individual advisor, with the level of trust being considerably higher for the latter. In Germany, a study by the Ruhr University Bochum showed that investors have a high level of trust in their advisors. The vast majority stated that they fully trust their advisors in their investment decisions.[231] The Kantar study - provided for the EU Commission- confirmed this finding but is more critical of this. It assumes that clients too seldom question the

[228] https://www.fca.org.uk/publication/corporate/evaluation-of-the-impact-of-the-rdr-and-famr.pdf ; p. 6, no. 1.22.
[229] Unbiased (2022), 'Advice worth nearly £5k a year over a decade', 12 December.
[230] ESMA - Final Report on the European Commission mandate on certain aspects relating to retail investor protection, p. 34, no. 109.
[231] Disclosure, inducements, and suitability rules for retail investors study, p. 238.

recommendations of their advisors and too often follow them blindly.[232]

An important objective of the retail investment strategy is to provide clients with fair and unbiased advice. It needs to be assessed whether commission bans improve access to unbiased advice, worsen it or whether there is no impact. EIOPA's Consumer Trends Report 2022 shows that the differences between countries with and without commission bans are not significant.[233] The bans do not appear to have improved access to unbiased advice. As illustrated in Figure 4.10, almost 60% of consumers in Germany believe that it is difficult to get unbiased advice. In the Netherlands, where commissions are banned, the figure is 55%; across the EU, the figure is 65%. The link between commission bans and better access to fairer and unbiased advice is not apparent.

Figure 4.8 Consumers view on whether it is difficult to get unbiased advice on the perfect coverage for their needs by Member States



Source: Reproduced from the European Insurance and Occupational Pensions Authority, 2023.

It is open to question by which criterion the impartiality of advisors is judged. It seems to be a widespread assumption that the payment of commissions per se is not compatible with unbiased advice. This view seems to be ideological and one-sided. For example, commissions can be paid out over long periods of time, or reimbursement agreements can be made if the concluded contract is cancelled early ('lapse mechanisms'). Such measures are common practice in the insurance sector and reduce the incentive for advisors to act based on commission interests. Potential conflicts of interest are thus effectively prevented. Moreover, as shown in Section 2, conflicts of interests might also arise in pure fee-based remuneration models. Hence, it seems right to run a holistic assessment of any factors that might raise or lower the risk of harming consumers, as is already required within IDD.

[232] Disclosure, inducements, and suitability rules for retail investors study, p. 229.
[233] European Insurance and Occupational Pensions Authority (2023), 'Consumer Trends Report 2022', January.

4.3.6 Removing conflicts of interest

Given the context outlined earlier in this report (cases of mis-selling and misaligned incentives), the removal of potential conflicts of interest was a central pillar of the RDR. Indeed, as noted, a core objective of the review was to create remuneration arrangements that enable competitive forces to work in favour of consumers. To achieve this aim, the FSA banned commission payments for retail investment products (as outlined in section 4.1).

Broadly speaking, the removal of commission has led to a reduction of product bias in adviser recommendations, possibly showing an enhancement in quality of advice for at least some consumers, ''Although other factors, such as the influence of platforms, will also have effected changes here''.[234] There was a decline in the sale of products which had higher commissions pre-RDR and an increase in the sale of retail investment products which paid lower or no commission pre-RDR. [235] There was also a general decline in the proportion of investment products sold from the highest charging share classes relative to other, lower cost share classes.[236] It appears, however, that the FCA did not gather any evidence about whether the shift in the mix of products sold was beneficial to consumers. It is conceivable that products with higher commissions required these levels of commission due their complexity and that these complex features were important for some consumers.

4.3.7 Quality of advice

Both the RDR and the FAMR sought to improve the quality of financial advice by raising adviser professionalism standards, improving the quality of service received by consumers, reducing cases of redress and mis-selling, and improving consumer perceptions of advisers.

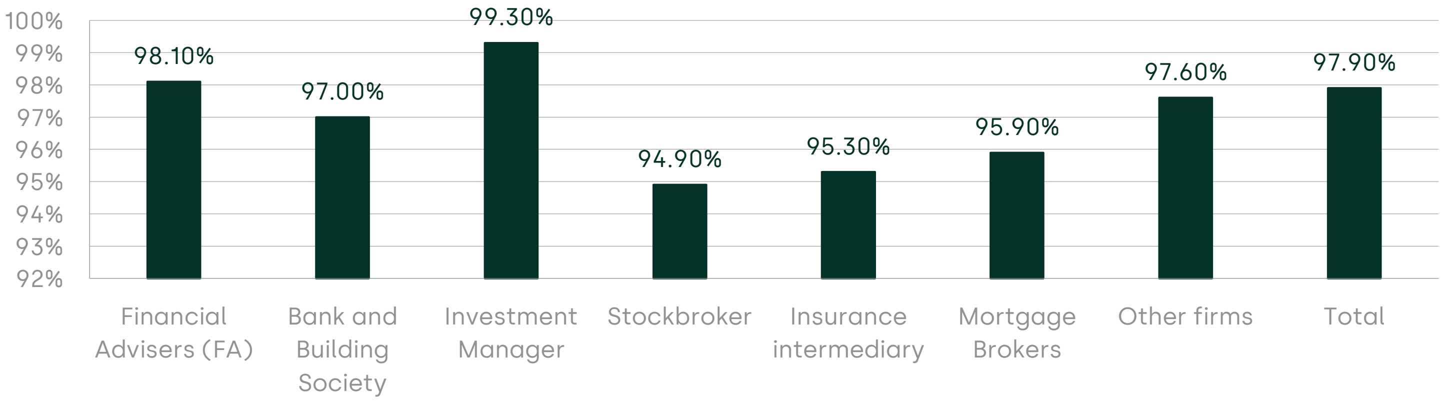
Quality of advice has improved, according to the FCA's 2020 analysis of the RDR and FAMR. According to the Financial Lives Survey 2020, 56% of consumers were satisfied with the advice they received.[237] In addition, in 2012 (pre-commission ban) research showed that when people were asked whether they had made suitable product decisions for their circumstances, 76% of those with an adviser said yes, illustrating the declining satisfaction with advice following RDR.[238] This indicates that more than half of consumers are not satisfied, suggesting that it is not an ideal outcome or a result that the FCA would find satisfactory. Furthermore, data from the Financial Ombudsman Service shows that the number of new cases against financial advisers has decreased from 2197 in 2016/17 to 1635 in 2019/20, although this is based on unreliable numbers.[239] The level in

[234] Europe Economics (2014), 'Retail Distribution Review Post Implementation Review', ,December, p.5.
[235] IMA (2014), 'Asset management in the UK 2013-2014'.
[236] An investment product can have multiple share classes with differing annual management charges. The highest-charging share class in this sense is that with the highest annual management charge.
[237] FCA (2021), 'Financial Lives 2020 survey', February.
[238] Unbiased (2012), 'The Value of Advice Report', p. 12.
[239] FCA (2020): 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review', p. 51.

2018/19, over six years after the RDR was introduced, was 1915. Moreover, the FCA's own evaluation report in 2020 (page 55) shows a steady increase in complaints received by customers of advice firms from about 6,000 per half year when the RDR was introduced to around 11,000 for the second half of 2019, which are the latest figures in the FCA's report.[240]

In addition, data from the FCA's 2020 review shows that nearly all advisers meet the required standards of professionalism. RMAR data (see Figure 4.7) shows that in 2019, 97.9% of advisers held a valid Statement of Professional Standing (SPS), an increase from 2017.[241] Increased professional standards for financial advisers result in higher quality advice because they are required to adhere to a higher level of competency, ethics, and professionalism, resulting in more accurate, appropriate, and beneficial recommendations for their clients. This reduces the likelihood of conflicts of interest, mis-selling, and other harmful practices, and contributes to the development of trust between advisers and their clients. Therefore, even if there has been an increase in the quality of advice since the commission ban was introduced, it cannot simply be attributed to the ban. It is even possible that the other changes are the cause of any benefit achieved.

Figure 4.9 Percentage of advisers who have valid Statement of Professional Standing (SPS) by sector, 2020



Source: Financial Conduct Authority (2020) RMAR data [Financial Conduct Authority (2020), 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review'.
Source: FCA (2020) RMAR data.

The statistics above do not offer a complete assessment of the quality of advice in the UK. The implementation of the RDR may have resulted in a decrease in the quality of financial advice provided in the UK due to competition issues. While it has been argued that the RDR has reduced cross-subsidies and resulted in a more socially preferred outcome, others argue that it has left less-active consumers with fewer options and lower-quality advice. According to a recent report, a small number of active consumers are insufficient to drive competition for the benefit of all consumers.[242] According to the report, more consumers must be persuaded to shop around and

[240] FCA (2020): 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review', p. 55.
[241] FCA (2020): 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review', p. 51.
[242] The Open University (2017), Consumers and competition, March.

switch in order to reduce cross-subsidies and improve competition. While some consumers may suffer in the short term, increased competition will ultimately benefit all consumers by lowering prices and improving quality advice.

The FCA also acknowledged that there are still some instances where the quality of the advice is concerning. The suitability of advice offered has improved over time, growing from a low point of 47% in prior years to over 60% in 2018, according to findings from the FCA's targeted supervisory work, which looked at the advice companies have given to people wanting to transfer out of a Defined Benefit (DB) pension scheme. Despite this, 17% of files had advice that seemed to be inappropriate, and the FCA acknowledged that this number is still "unacceptably high".[243] It is understood that the quality of advice about pension transfers may have improved because it was an area of supervisory focus, following past scandals, which led among other things to the exit of the worst firms.

Despite the positive changes brought about by the RDR in raising professional standards for financial advisers, a significant portion of the population lacks access to financial advice due to issues of accessibility and affordability. This has resulted in essentially zero quality financial advice for those who are unserved, resulting in a net reduction in the overall quality of advice available. As a result, while RDR may have improved the quality of advice for those who can afford it, it has failed to address systemic issues of accessibility and affordability, resulting in a negative impact on the overall quality of financial advice.

4.3.8 Competition

Above we explained that the RDR's ban on commission and other features appear to have dampened competition and that this is costly. Here we provide more detail. Strong market competition forces providers to innovate and improve quality-adjusted price if they are to increase market share. The financial advice market is no exception, and the RDR prioritised improving its competitive dynamics. Despite these efforts, evidence suggests that the market for financial advice remains largely uncompetitive. We therefore do not regard improvements in competition as an argument for commission bans in retail financial markets, many of which feature a weak demand side.

There are a number of compelling arguments which support the financial advice industry's lack of competitive pressure, particularly in terms of loyalty and non-price sensitive characteristics. Consumers tend to remain committed to ongoing services, according to survey findings, with advisers perceiving their clients as having long-standing loyalty and minimal price sensitivity, often extending their relationship for more than a decade. The rate of attrition in terms of regular clients lost to competing firms is impressively low, at less than 5%.[244]

[243] FCA (2020): 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review', p. 51.
[244] FCA (2020): 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review', p. 20 - report.

Contrary to popular belief, firms are not competing on price; less than 25% strongly support competitive pricing as a key strategy for client acquisition and retention.[245] According to consumer research, the quality of services and other service-related attributes are more important to consumer preferences. But while competition on service is both possible and desirable, service is hard to assess and in particular compare with rival offerings as much of it only reveals itself over time. These arguments, taken together, confirm the industry's low competitive pressure, with customer loyalty and competition-relevant but, as explained, often weak non-price factors having a greater influence on market dynamics.[246]

Additionally, a well-functioning market should have a wide range of fees that take into account various factors such as the quality of service provided, the costs incurred by advisory firms, and the incentives to compete on price. However, according to FCA research, adviser fees are highly concentrated, which may indicate that the market is not functioning as expected., For example, it may indicate that market competition is weak, implying non-trivial market power enabling imposition of fees or charges well in excess of total costs. While price clustering can indicate a healthy market (all firms are forced to be efficient, have similar costs and are price-takers), the FCA found that some firms could charge prices very different from the cluster price but there was no discernible difference in the features offered at the two price levels. Furthermore, there was little evidence that firms with a larger client base or more affluent clients charged lower adviser fees.[247]

This could suggest that the market failures present in the industry for retail investment advice are such that fee competition cannot work, whereas the competition provided by the existing of commissions previously worked better because the commission price was set business-to-business.

4.3.9 Product usage

Following RDR, evidence suggests that demand has shifted towards less complex and lower-cost products, such as ETFs. While this may appear to be a positive development, it also may have negative effects. The elimination of commissions may incentivise financial advisors to sell the product that requires the least amount of effort, even if it does not meet the client's long-term investment goals. Since equity products typically have higher costs (and, historically, commissions) than debt or other interest-based products, this shift towards lower-cost products could harm long-term investment returns. If investors are no longer advised to invest in equities, they will miss expected higher long-term returns.[248]

[245] FCA (2020): 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review', p. 20 - report.
[246] FCA (2020): 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review', p. 20 - report.
[247] FCA (2020): 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review', p. 20 - report.
[248] BlackRock, 'What are equity investments'.

4.4 Future developments in the UK

The **Consumer Duty**, due to come into effect on 31 July 2023 in the UK financial advice market, was established in response to the shortcomings of the RDR regulations. While the RDR aimed to increase professionalism and reduce potential conflicts of interest in the industry, it damaged many consumers' interests by shifting advisers' focus to wealthier clients who could afford to pay fees rather than commissions, with the consequent negative impacts on lower-income customers discussed above.

This may matter a great deal, given the link between financial literacy and income. Moreover, there is no clear evidence that the RDR resolved the market failures that it was introduced to tackle.

The Consumer Duty aims to address all this by requiring businesses to prioritise the interests and needs of their customers.[249] This will help to ensure that consumers, regardless of wealth or income, receive appropriate and high quality advice and products. The main requirements that the Consumer Duty seeks to impose (in order to rectify the underlying issues within the UK financial advice market) are as follows.[250]

- Consumers should **receive communications they can understand**, products and services that meet their needs and offer fair value, and customer support when they need it. This is intended to increase the quality of advice and improve engagement.
- Firms should consider whether products and services offer **fair value** to different groups of customers, including those with characteristics of vulnerability or with protected characteristics – this objective seeks to increase engagement and the quality of advice.
- Firms should give customers the information they need, at the right time, and in a way they can understand to make effective decisions. They should **develop new communication standards**, including consideration of reading age, comprehensibility, visual accessibility and layout – this will improve accessibility.

The introduction of the Consumer Duty implies that the RDR regulations have ultimately failed in many regards in the UK financial advice market. It shows that the FCA believes that significant additional regulatory intervention is required to protect consumers. The prohibition on commission payments did not resolve the potential for conflicts of interest – many of these still exist. The Consumer Duty aims to increase financial firms' accountability to act in the best interests of their customers, ensuring that consumers are better protected and served by financial service distributors.[251]

As part of its consumer investment strategy, the FCA has set out new proposals to improve people's access to financial advice. The aim is to

[249] FCA, Consumer Duty: Final rules.
[250] Financial Conduct Authority (2023), 'Consumer Duty implementation plans', January.
[251] The need to operate honestly, fairly, and in the best interests of customers is also established in Article 17 paragraph 1 of the Insurance Distribution Directive (IDD). MiFID II imposes similar standards (Article 24 paragraph 1).

create a separate, simplified financial advice regime. Actually, the regulator is consulting on:[252]

- Streamlining the customer 'fact find' so advice is more straightforward for both firms and customers
- Limiting the range of investments within the new regime so the advice is easier to deliver and understand
- Making the qualification requirements for the new regime more proportionate so delivering the simplified advice is less costly for firms
- Allowing advice fees to be paid in instalments so customers aren't burdened by large upfront bills.[253]

4.5 Lessons for the EU policy debate

For several years, the EU has been debating whether to prohibit commissions on sales of certain retail products or distribution channels in financial services. While the UK has already implemented the ban for investment advice through the RDR in 2012, the EU debate remains active. However, it is important to note that the UK and the EU more broadly have vastly dissimilar underlying market characteristics, particularly in terms of pension protection systems.

The United Kingdom has a strong pension system in place, which has ensured that a larger proportion of the population is saving for retirement. While Defined Benefit Occupational Pension Schemes (DB OPS) have declined, some of these have been replaced by Money Purchase Occupational Pension Schemes (MP OPS), while very many other individuals are in new Group Personal Pension (GPP) schemes run by employers.

Overall, employer-based pension schemes are widely used in the UK, with ONS data indicating a nearly 80% participation rate in 2021.[254] In these, guidance is provided directly through employers. Thus, the absence of financial advice as a result of the RDR, whether induced by the commission ban or other RDR aspects, does not have the negative consequences that it would in many other nations.

In this particular regard, the UK financial advice market performs particularly well (compared to its counterparts elsewhere in Europe), given that GPPs in the UK are subject to regulations requiring employers to act in the best interests of their employees and to ensure that the pension schemes on offer are suitable for their employees' needs. This regulatory framework protects employees and helps to ensure that they are not unfairly disadvantaged by a lack of financial advice.

On the other hand, many EU member states lack a sophisticated multi-pillar pension scheme or have built up their pension systems differently to the UK. The imposition of a commission ban would

[252] FCA (2022), 'Broadening access to financial advice for mainstream investments', November.
[253] FCA (2022), 'FCA proposes ways to make financial advice more accessible', November.
[254] ONS: Employee workplace pensions in the UK: 2021 provisional and 2020 final results.

therefore be expected to have material negative effects in those countries.

Another possible policy lesson for the EU is that a commission ban on retail investment products could have unforeseen implications for both consumers and the financial industry. A ban would have no effect on direct sales, which might profit from an increase in business volume due to a lack of competition and the internalisation of broker and intermediary portfolios. As observed in the EU Commission's study in the Netherlands (see section 3), this could lead to a trend towards unadvised business. This move could be concerning since it could lead to an increase in demand for financial products that do not require assistance, without any corresponding improvement in the goods. Policymakers should carefully evaluate these unforeseen consequences and establish rules that balance the interests of consumers and the financial industry.

It is critical to recognise that a lack of engagement in financial decisions can have far-reaching consequences, affecting not only consumers but also Member States and the European Union as a whole. A lack of consumer engagement can result in missed chances for long-term financial growth, thus putting a strain on social security systems in relevant states. Low participation in capital markets can lead to lower retail investments and stifle economic growth in Member States and the European Union. In addition, intermediaries may need to modify their business models to accommodate the changing regulatory environment.

5 Consideration of alternative options for regulation and market design

While much of the debate has centred on the potential conflict of interest created by a commission model, it is important to recognise that it is the harm to consumers that should drive policymaking. Indeed, a commission based model is not the only remuneration model where a conflict of interest can arise.

In practice, we can see from countries where a commission ban has been put in place, the effect has been at best unclear. Despite some of the positive outcomes in the Netherlands, it is not possible to disentangle the impact of the ban on commissions from the broader series of regulatory interventions that preceded and accompanied it, while impacts on the quality of advice and number of consumers seeking advice raise questions the overall effect of the ban. In the UK, the introduction of the RDR has also led to questions over the accessibility of advice, the quality of advice and the number of customers seeking advice.

Importantly, both the UK and Netherlands have mandatory or semi-mandatory multi-pillar pension systems. In other European countries that rely to a larger extent on voluntary pension systems, the role of advice is more important and the potential negative impact of a commission ban on the use of pension products would be of much greater concern.

A ban on commissions is unlikely to be a panacea for improving outcomes for consumers. Indeed, the bluntness of a ban carries with it a number of risks. The decision over whether to impose such a ban should be made based on a careful assessment of the costs, including any undesirable side effects, and benefits. These include the effectiveness of a ban, which should in turn consider the effects on consumer behaviour (which can be subject to bias).

Alternative options

Given the risks and limitations of a ban on commissions, it is important to consider the range of alternative policy options that have become part of the debate that could reduce the risk of unintended consequences of a ban while addressing some of the concerns about the commission-based remuneration model.

These include greater use of measures centred around disclosure of product and distribution fees. Adjusted, updated and more focused disclosure requirements would need to be carefully designed to ensure consumer engagement, but could help increase consumer understanding and more effective regulatory oversight.[255]

Value-for-money assessments are another form of regulation relying on oversight rather than prohibiting certain types of advisory arrangement. Under such as measure, firms would bear the responsibility of ensuring that their products and services deliver good

[255] For instance, see EIOPA (2022), 'Final Report on Technical advice to the European Commission regarding certain aspects relating to Retail Investor Protection', April.

value-for-money. This form of POG regulation would require supervision by the regulator and a consistent approach to specification.[256] Such alternative options are highly relevant to the discussion over market reforms.

[256] To a certain extent, aspects related to value-for-money are anchored in the Insurance Distribution Directive ('IDD'), although not explicitly.

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