IMPACT OF THE COMISSION BAN IN THE UNITED KINGDOM

Banning commissions improves quality of advice and strengthens trust in advisors

BACKGROUND

With the Retail Distribution Review (RDR), the United Kingdom banned commissions for advised investment sales in January 2013. The purpose of this ban was to increase transparency and improve incentive structures in financial advice markets. Since then, financial advisers may accept payments from their customers only. The ban is applicable to advice on investment products including insurance based investment products. Direct sales without advice are not within the purview of this ban. The Financial Conduct Authority (FCA) and HM Treasury (HMT) published their report (FAMR - Financial Advice Market Review) on the impact of the commission ban in March 2016. The latest instalment of the progress report was published on March 11th 2017.[1]

COMISSIONS BAN LEADS TO BETTER ADVICE

The key message of the report is that the quality of the advice provided to consumers has increased sharply in the wake of RDR.

„Over the past few years, there have been major improvements to the quality of financial advice, driven by the Retail Distribution Review (RDR) and other regulatory initiatives. These have raised standards of professionalism and enhanced consumer protection."[2]

The British finance industry seems to concur with this assessment. The majority of actors who were consulted by the authorities in the progress of FAMR do not seek to return to a commission-based system.[3]

Besides being beneficial to consumers, the new structure of the financial advice market produces winners on the supply side as well. In this vein, FAMR reports that employers profit from supporting their employees in seeking independent financial advice. According to recent polls, 20 percent of employees claim that worrying about their finances affect their work.[4]

Even the advice industry itself profits. The newly established competition based on price and quality has led to technological innovation and reduced costs in the production of financial advice.[5]

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[1] https://www.gov.uk/government/publications/financial-advice-market-review-terms-of-reference.
[2] FAMR final report (2016) P. 13.
[3] FAMR final report (2016) P. 46.
[4] FAMR final report (2016) P. 44.
[5] FAMR final report (2016) P. 26.

THE INITIAL ADVICE GAP IS CLOSING

Another issue on the advice market has become apparent through the introduction of the ban of commissions: Some categories of consumer do not seek advice for several different reasons. Particularly consumers with small amounts of money to invest (less than £10.000) tend to think that the benefit of professional advice is not worth the cost. The report differentiates three distinct causes for this advice gap: affordability, accessibility and liability.

Consumers refrain from using professional advice because of the costs of the service.

Due to the ban on commissions the perception of the cost of advice has changed. When using independent advice, the costs are transparent and have to be paid directly by the consumer to the advisor. When using commission-based advice, the consumer also pays the costs of advice but does so indirectly via operating costs of the purchased products.

The FCA has taken several measures to improve affordability in the face of changed cost perception. For example, employers who make independent financial advice available to their employees may earn tax benefits of up to £500. Besides this, additional financing options have been made available to consumers themselves. It is now possible to pay for advice in monthly increments or via a one-time advance on one's own pension fund of up to £500. Such payment models enable consumers with small incomes to benefit from professional and independent advice as well.

Consumers refrain from using professional advice because of a lack of trust

Consumer trust in the UK has been severely shaken in the wake of several misselling scandals.[6] From FAMR's point of view, the lack of trust is one of the key factors contributing to consumer's reticence towards seeking advice.

"There is evidence that trust in advisers remains low among the general population. For example, Mintel found that less than half of consumers trust financial advisers to act in their interests. A 2014 PwC study found that fewer than a third of people (28%) trusted financial advisers."[7]

Consumers have been slow to realise the structural improvements made to the markets for financial advice through the ban on commissions. However, according to FAMR, consumers who are currently undergoing advice report substantially higher levels of trust than their peers. A fact that may facilitate the closure of the "trustgap" in the mid-term.

Advisers felt that they could only provide full advice even for relatively simple problems to avoid litigation

Uncertainties about the distinction between regulated advice and unregulated guidance remained in the immediate aftermath of the introduction of the commissions ban. Therefore, many financial advisors chose to provide only advice so as

[6] FAMR final report (2016) P. 29.
[7] FAMR final report (2016) P. 23.

to avoid accidentally crossing into advice without fulfilling the corresponding legal obligations while providing guidance. This has led to consumers avoiding advice on relatively simple issues because of the disproportional costs incurred. Meanwhile, it is now possible for professional advisers to provide guidance to their customers even without offering full advice - provided no particular product is being recommended for purchase.

Contact

Federation of German
Consumer Organisations (vzbv)

Team
Financial Markets

Markgrafenstraße 66
10969 Berlin

finanzen@vzbv.de