Research Report

Financial Advice Markets: A Cross Country Comparison

Final Report

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Contents

1. Introduction

Because many people are ill equipped to make complex financial decisions on their own, financial advisers can provide a valuable service in helping investors make such decisions. However, it can be difficult for individual investors to evaluate the advice they receive and identify when that advice has been influenced by a conflict of interest. In a recent review, we investigated the impacts that conflicts of interest have in the financial services industry and found that such conflicts are pervasive and affect the behavior of many actors, including analysts and mutual fund managers and financial advisers[1]. In our review of the empirical evidence that looked at the behavior and compensation schemes of financial advisers, we found that compensation schemes have an influence on advisers' behavior and that investors who invest through advisers earn lower returns than those who invest directly. However, most empirical studies of financial advice and conflicts of interest cannot account for selection issues and the intangible benefits that investors may receive from financial advisers.

Given the considerable evidence that conflicts of interest influence advisers' behavior in ways that may be detrimental to their clients' interests, it is informative to examine how countries around the world have used regulation to try to improve the quality of financial advice, and how the regulatory tools used have affected their respective financial advice markets. In this review, we compare the financial advice markets in the United States, the United Kingdom, Australia, Germany, Singapore, and the European Union. Our intention was to select a cross-section of countries that recently made regulatory changes aimed at improving financial advice. The key research questions were:

1. How do the countries compare in terms of regulating conflicts of interest in professional financial advice (e.g., a misalignment between an adviser's compensation scheme and the interests of his client)?
2. What are the observable impacts of recent changes in regulation? In particular, what are the impacts on investor outcomes, such as investment holdings, rates of return, and access to professional financial advice?

[1] J. Burke, A. Hung, J. Clift, S. Garber, and J. Yoong, "Impacts of Conflicts of Interest in the Financial Services Industry," 2015, working paper.

For each country or region, we begin by describing the retail financial advice market. We investigate the type of financial advisers in a country, whether there are any legal distinctions between the different types, and whether the different types have varying minimum qualifications or standards of care. We looked for measures of the size of the financial advice market, such as statistics on investors who seek professional financial advice, or the number of advisers in a country.[2] We then describe the regulatory environment, starting with current regulations, with a focus on compensation, standards of care, conflicts of interest, and credentials and qualifications. Subsequently, we investigate any recent or upcoming changes in the regulatory environment. Finally, we review available evidence on the impacts of those regulatory changes.

Chapters 2 through 7 compare the financial advice markets and regulatory environments in the United States, the United Kingdom, Australia, Germany, Singapore, and the European Union, respectively. Chapter 8 summarizes available evidence about the impacts of recent regulatory changes, while Chapter 9 concludes.

[2] Importantly, the level and depth of information available about financial advice markets varied across countries. As a result, the background information we were able to present in one section for one country does not perfectly mirror the type of information presented in another. Rather, we attempted to provide background information important to interpreting a country's regulatory approach.

2. United States

In the United States, investment advisers (IAs) and broker-dealers (BDs) provide financial advice to retail clients. In 2010, there were over 26,000[3] registered IAs, with over 275,000 IA representatives, and over 5,100 registered BDs, with over 600,000 registered representatives.[4] Registered IAs, who are regulated by the SEC, managed more than $38 trillion for more than 14 million clients at the end of 2010.[5]

In 2013, 49 percent of American households held stocks, either directly or indirectly. Eighty-seven percent of stockowners held stocks through retirement accounts, 28 percent directly hold stocks, 16 percent hold pooled investment funds, and 8 percent hold stocks though managed investment accounts, a trust, or an annuity.[6]

Estimates vary on what fraction of the population receives investment advice from either IAs or BDs. One recent study estimates that 34 percent of investors received professional, management, or planning advice in 2007.[7] Another study estimates that 17–22 percent of employees with a defined contribution (DC) plan consulted a professional adviser for retirement plan advice in 2008.[8]

[3]This represents over 11,000 IAs registered with the SEC and over 15,000 state-registered IAs. IAs with over $100 million in assets under management must register with the U.S. Securities and Exchange Commission (SEC). Otherwise, they must register with the state security agency in which they have their primary place of business.

[4]U.S. Securities and Exchange Commission (2011), "Study on Investment Advisers and Broker-Dealers."

[5]SEC (2011).

[6]Federal Reserve Bulletin, "Changes in U.S. Family Finances from 2010 to 2013: Evidence from the Survey of Consumer Finances," Vol. 100, No. 4, 2014.

[7]A. Hung, N. Clancy, and J. Dominitz, "Investor Knowledge and Experience with Investment Advisers and Broker-Dealers," in *Financial Literacy; Implications for Retirement Security and the Financial Marketplace*, Olivia S. Mitchell and Annamaria Lusardi, eds., Oxford University Press, 2011.

[8]A. Hung and J. Yoong, "Asking for Help: Survey and Experimental Evidence on Financial Advice and Behavior Change," in *The Market for Retirement Advice*, Olivia S. Mitchell and Kent Smetters, eds., Oxford University Press, 2013.

Types of Financial Advisers

IAs and BDs have distinct definitions: A BD is defined as someone who conducts transactions in securities on behalf of others,[9] while an IA is defined as someone who provides advice to others regarding securities.[10] Brokers tend to be compensated by transaction-based commissions, while the vast majority of IAs charge fees based on assets under management.

Despite differences in definition and compensation, both BDs and IAs provide clients with financial advice. In fact, approximately 5 percent of SEC-registered IAs are also registered as BDs, and 22 percent have a related person[11] who is a BD.[12] Almost nine out of every ten IA representatives are also registered representatives of BDs. Also, about 18 percent of registered BDs are also registered as IAs.[13]

Licensing for BDs and IAs

While registered representatives of BDs are generally subject to the licensing requirements of the Financial Industry Regulatory Authority (FINRA) (e.g., Series 6, 7 licenses), associated persons of BDs have no qualification requirements, unless they will effect securities transactions.[14] Further, while an IA or firm engaged in investment advisory services must be registered with either the SEC (if managing at least $25 million or more in assets) or state securities authorities (if managing less than $25 million in assets), there are no state or federal licensing requirements for IA representatives. Furthermore, there are no education requirements for IAs, BDs, or their representatives. There have been recent calls for harmonizing the regulatory regimes under federal law when providing investment advice about securities for representatives associated with IAs and BDs.[15]

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[9]Securities Exchange Act of 934, Section 3[a][4].

[10]Investment Advisers Act of 1940, Section 202[a][11].

[11] A "related person" includes an entity or a person controlled by, or controlling, the IA, or other entities that are under common ownership with the IA.

[12]SEC (2011),

[13]SEC (2011).

[14] Even though brokers and dealers are defined as a "person," a BD can be either an individual or an entity. If a BD is a person, then he must be a registered representative. If a BD is an entity, then the entity does not have its own licensing requirements.

[15]SEC (2011).

Regulatory Environment

Despite the overlap in services, BDs and IAs are subject to different federal regulations. The Securities Exchange Act of 1934 (1934 Act) (48 Stat. 881) regulates BDs, and they are also subject to oversight from FINRA, an independent self-regulatory organization. IAs are regulated by the SEC through the Investment Advisers Act of 1940 (the 1940 Act) (54 Stat. 847). The 1940 Act (§202[a][11]) defines an *IA* as:

> any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.

To avoid duplicate regulation of brokerage activities, registered BDs are excluded from the terms of the 1940 Act (§202[a][11][C]), as long as the following are true:

1. Any advice that the BD gives to clients is "solely incidental" to its business as a BD
2. The BD does not receive any "special compensation" for rendering such advice.

The proscription on special compensation had traditionally meant that BDs receive compensation in the form of commissions, markups, and markdowns on specific trades. IAs' business practice of charging a general fee, rather than BDs' practice of charging transaction-specific fees, has evolved into one of the distinctions between IAs and BDs. However, over the past two decades, the activities of BDs and IAs have begun to move closer together, since both provide advice.

An important implication of the different regulatory regimes governing IAs and BDs is the different standard of care such regimes impose. BDs are obligated to make suitable recommendations. That is, a BD making a recommendation to a retail customer must have grounds for believing the recommendation is suitable for that customer with respect to his or her portfolio, financial situation, and needs. BDs may also have additional suitability requirements, depending on the products they offer. Unlike BDs, federally registered IAs owe a fiduciary obligation, as articulated in the 1940 Act, to their clients. These obligations require the IA to act solely with the client's investment goals and interests in mind, free from any direct or indirect conflicts of interest that would tempt the IA to make recommendations that would also benefit him or her.

Those who provide financial advice on employer-sponsored retirement plans may also be regulated by the Department of Labor (DOL) as fiduciaries under the Employee Retirement Income Security Act of 1974 ("ERISA"). ERISA defines a fiduciary under ERISA Section 3(21) as an individual who (1) has discretionary authority or control with respect to managing the plan or disposition of plan assets, and (2) renders investment advice for a fee, or has discretionary authority or responsibility for administering the plan. In addition, under ERISA Section 3(38) an individual is also a fiduciary if he or she agrees in writing to be an investment manager for the plan, having the power to manage, acquire, or dispose of any assets of the plan. This individual is either (1) a registered IA under the 1940 Act, (2) not registered under the Act but registered with the state, or (3) a bank or an insurance company.

Dodd-Frank Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) brought sweeping changes to the American financial regulatory environment. Section 913 of the Dodd-Frank Act required the SEC to evaluate

> (1) the effectiveness of existing legal or regulatory standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice and recommendations about securities to retail customers imposed by the Commission and a national securities association, and other Federal and State legal or regulatory standards; and
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> (2) whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute.

In addition, the Dodd-Frank Act granted authority to, but did not require, the SEC to adopt a uniform fiduciary standard of conduct for IAs and BDs when providing personalized investment advice about securities to retail customers, and that any such standard be no less stringent than the standard applicable to IAs under the 1940 Act.

The resultant 2011 study by the staff of the SEC recommends that the SEC exercise its rulemaking authority to implement a uniform fiduciary standard of conduct for BDs and IAs when providing personalized investment advice about securities to retail investors. Under such a uniform fiduciary standard, BDs could become subject to the existing fiduciary standard

currently imposed on IAs. The SEC argues that a uniform standard would increase investor protection and decrease investor confusion.[16] In March 2013, the SEC posted a request for data and other information to help inform the consideration of adopting alternative standards. In March of 2015, the SEC indicated that it will work to implement a uniform fiduciary duty for BDs and IAs, where the standard is to act in the best interests of the client; however, the timing of when a uniform standard would be imposed remains unclear.[17]

[16] SEC (2011).

[17] Mary Jo White, *Testimony on "Examining the SEC's Agenda, Operations and FY 2016 Budget Request,"* before the U.S. House of Representatives Committee on Financial Services, Washington, D.C.: U.S. Securities and Exchange Commission, March 24, 2015.

3. United Kingdom

Citing work by Platforum, Europe Economics reports that in 2013, over 70 percent of investors in the United Kingdom seek professional advice or assistance in dealing with investments.[18] Thirty-seven percent of investors deal with investments mostly on their own, occasionally seeking professional advice, and 34 percent leave most or all their investment dealings to a professional.[19] However, the fraction of UK citizens participating in the financial market appears to be relatively low. A 2011 Eurobarometer survey suggested that only 22 percent of respondents in the United Kingdom owned stocks or bonds.[20]

On the supply side, there were an estimated 31,220 retail investment advisers and 14,378 firms at the beginning of 2014.[21] Investors seek advice from financial advice firms, banks, employee benefits consultants, and wealth managers. Financial advice firms constitute the largest share of the financial advice market, with over 21,000 advisers providing service.[22]

Types of Advice and Advisers

There are two types of financial advisers in the United Kingdom—*independent* advisers and *restricted* advisers.[23] A restricted adviser can recommend only certain products, product providers, or both, while an independent adviser (also called an "independent financial adviser" [IFA]) must consider and recommend all types of retail investment products, from all firms across the market, and must give unbiased and unrestricted advice.[24] In particular, independent

[18]Europe Economics, "Retail Distribution Review: Post Implementation Review," London: Europe Economics, December 16, 2014.

[19]Europe Economics, 2014.

[20]European Commission ,*Retail Financial Services*, Special Eurobarometer Report 373, March 2012.

[21] FCA Professional Standards data, as reported in Association of Professional Financial Advisers,"Advice Market Post RDR Review," working paper, June 2014.

[22]Association of Professional Financial Advisers, 2014.

[23] After the Retail Distribution Review, the term "restricted adviser" replaced "tied adviser" and "multi-tied adviser." See G. McMeel, "International Issues in The Regulation Of Financial Advice: A United Kingdom Perspective—The Retail Distribution Review And The Ban On Commission Payments To Financial Intermediaries. *St. John's Law Review*, Vol. 87, No. 2, April 2014, pp. 595–627.

[24] In a recent survey of advisers, 65 percent reported that they provide independent advice. B.Atkin,, A. Toberman, D. Wintersgill, and A. Wood, "RDR adviser population and Professionalism research: 2012 Survey," April 2013.

advice is defined as "a personal recommendation to a retail client in relation to a retail investment product where the personal recommendation provided meets the requirements of the rule on independent advice" (Financial Conduct Authority [FCA] Conduct of Business Sourcebook [COBS], 6.2A.3R). The requirements of the rule on independent advice are that the personal recommendation is (a) based on a comprehensive and fair analysis of the relevant market, and (b) "unbiased and unrestricted".[25]

In contrast, restricted advice is defined as a personal recommendation that does not meet the standard for independent advice. Restricted advisers are required to disclose the nature of the restriction (i.e., if they specialize in certain types of products only or provide recommendations from a limited number of providers) to clients.

Both independent and restricted advisers have to be registered with the FCA. They have the same qualification requirements and are subject to the same standards. They are required to hold an approved Qualifications and Credit Framework (QCF) Level 4 qualification, which is somewhat similar to one year of completed university courses in the United States. Approved QCF Level 4 qualifications include Level 4 Diplomas in Financial Planning, Investment Planning, Banking, Investment Advice, or Financial Advice.

Each type of adviser is required to "act honestly, fairly and professionally in accordance with the best interests of its client."[26] Furthermore, they are prohibited from receiving commissions. A firm that provides personal recommendations to retail clients on investment products must

> 1) only be remunerated for the personal recommendation (and any other related services provided by the firm) by adviser charges; and
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> 2) not solicit or accept (and ensure that none of its associates solicits or accepts) any other commissions, remuneration or benefit of any kind in relation to the personal recommendation or any other related service, regardless of whether it intends to refund the payments or pass the benefits on to the retail client; and
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> 3) not solicit or accept (and ensure that none of its associates solicits or accepts) adviser charges in relation to the retail client's retail investment product which are paid out or advanced by another party over a materially different time period, or on a materially different basis, from that in or on which the adviser charges are recovered from the retail client.[27]

[25]Financial Services Authority (FSA), "Retail Distribution Review: Independent and Restricted Advice," June 2012.
[26]FCA, COBS, London: Bank of England Prudential Regulation Authority, undated, 2.1.1.
[27]COBS, 6.1A.4R.

Regulatory Environment

Beginning in the 1980s, there was a series of mis-selling scandals in the UK financial services industry where consumers were sold unsuitable products deliberately, recklessly, or negligently. Notable products involved in the mis-selling scandals included pensions, mortgages, and payment protection insurance.[28] In 2006, the FSA, the predecessor to the FCA, launched the Retail Distribution Review (RDR), with the aim of identifying the root causes of poor investment advice provided to consumers in the retail investment market.

The FSA established a series of industry working groups to develop proposals identifying how the retail investment market should change. Subsequently, the FSA published its own proposal in 2008 outlining its thinking and established final policy in 2010 and 2011. The final proposals became effective at the end of 2012 and contained several provisions attempting to improve the quality of advice provided to retail investors and to institute confidence and trust in the UK investment market. Some of the key objectives of these provisions include:

- *to maintain an industry that engages with consumers in a way that delivers more clarity for them on products and services.* To provide more clarity to retail investors, the RDR defined the requirements for an adviser to describe itself as "independent" and introduced mandatory disclosure requirements on the type of advice provided (e.g., an adviser must disclose whether and how the advice provided is restricted).
- *to establish remuneration arrangements that allow competitive forces to work in favor of consumers.* The RDR banned commissions, as described in the previous section.
- *to maintain standards of professionalism that inspire consumer confidence and build trust.* The RDR increased minimum qualification levels and requirements for continuing professional development.

[28] See McMeel, 2013.

4. Australia

The market for financial advice in Australia is relatively small. On the supply side, there are about 17,000–20,000 active professional financial advisers[29] offering advice. On the demand side, about 10 percent of the population receives advice in a given year, while about 20–40 percent of the population has received advice at some point.[30] As in the United States, older individuals and those with higher levels of wealth are more likely to seek professional financial advice.[31]

Types of Advice and Advisers

Consumers in Australia receive financial advice predominantly from financial advisers and financial planners, but they may also receive advice from other parties, such as lawyers.[32] There is little distinction between financial advisers and financial planners, and the terms are often used interchangeably. However, the nature of information offered by financial professionals does vary considerably and can be broadly categorized as factual, general advice, or personal advice.[33]

Factual information is considered to be "objectively ascertainable information, the truth or accuracy of which cannot reasonably be questioned."[34] *General advice* is financial advice that does not take into account an individual's objectives, financial situation, or needs, while *personal advice* is financial advice tailored to an individual's unique situation. Advisers providing factual information are not required to hold an Australian financial services license (AFSL). However, professional financial advisers who provide general advice or personal advice are required to

[29]Rice Warner Actuaries, "The Financial Advice Industry Post FoFA: Industry Super Network," July 2013; Australian Securities and Investment Commission (ASIC), *Report 224, Access to Financial Advice in Australia*, December 23, 2010

[30]Association of Financial Advisers, "AFA Submission—Financial System Inquiry," August 26, 2014; Rice Warner Actuaries, 2013.

[31] Ibid.

[32]Australian Securities and Investments Commission, "Choosing a Financial Adviser," *MoneySmart: Financial Guidance You Can Trust*, undated(a) web page.

[33] Australian Securities and Investments Commission, *Regulatory Guide 244: Giving Information, General Advice and Scaled Advice*, December 13, 2012b.

[34] ASIC, 2012b.

hold an AFSL or be an authorized representative of a license holder. Also, as described in more detail below, advisers providing personal advice are required to adhere to a "best interests duty."[35]

Adviser Licensing

The requirements to holding an AFSL are relatively low and are detailed in ASIC's Regulatory Guide 146. To provide advice on investment products, an adviser must have generic knowledge relevant to the products on which he or she advises and the markets in which he or she operates, and specialist knowledge about the specific products advised. In addition, advisers must be able to apply their knowledge in practical situations.[36] The level of education required to provide advice on investment products is broadly equivalent to a "diploma" under the Australian Qualifications Framework, meaning advisers should be able to demonstrate specialized knowledge and skills in the areas in which they operate. Advisers, however, are not required to obtain a degree (e.g., a bachelor's degree) and may satisfy the training and knowledge criteria by satisfactorily completing approved training courses or other methods, including individual assessment (which can include, but does not require, a written examination).[37]

There is considerable concern, among both financial services firms and industry groups including the Association of Financial Advisers,[38] that the level of training standards required for financial advisers is too low. The Parliamentary Joint Committee on Corporations and Financial Services conducted an inquiry in 2014 into whether and how professional standards should be raised for those in the financial services industry. The committee made numerous recommendations, including adopting a minimum degree qualification for all new financial planners, mandatory ongoing professional development, and completion of a structured professional year as a prerequisite to being registered as a financial adviser.[39] Others, including

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[35]ASIC, 2012b.

[36]Australian Securities and Investments Commission, *Regulatory Guide 146: Licensing: Training of Financial Product Advisers*, July 2012a.

[37]ASIC, 2012a.

[38]Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Financial Products and Services in Australia*, Canberra: Commonwealth of Australia, November 2009.

[39]Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Proposals to Lift the Professional, Ethical, and Education Standards in the Financial Services Industry,"* Canberra: Commonwealth of Australia, 2014.

ASIC, Australia's financial services regulator, have recommended that financial advisers be required to pass a national examination to demonstrate competence.[40] It remains unclear, however, which if any of these proposals will become requirements.

Regulatory Environment

The Australian regulatory environment has experienced a significant amount of change in recent years. In response to the collapse of several advisory firms and financial institutions after the 2007–2008 crisis and mis-selling scandals in which sales targets incentivized financial advisers to persuade clients to switch out of safe term deposit accounts into funds that delivered banks increased compensation,[41] the Australian government introduced its Future of Financial Advice (FoFA) reforms designed to improve the integrity of the financial advice market, predominantly through mitigating conflicts of interest. FoFA was passed by Parliament June 25, 2012, and implemented July 1, 2012. Compliance was initially voluntary until July 1, 2013, at which point compliance became mandatory.[42]

Most notably, FoFA significantly altered how financial advisers were allowed to receive compensation in the future. In particular, FoFA bans conflicted compensation arrangements, including commission and volume payments in relation to advice about and distribution of many retail investment products. FoFA also requires that advisers

- Act in the best interests of their clients and place the interests of their clients ahead of their own when providing financial advice
- Renew agreements with clients charged ongoing fees every two years, such that clients "opt-in" to continue ongoing fees
- Provide an annual fee disclosure statement
- Not accept soft dollar benefits in amounts over $300, or benefits under $300 that are frequent or regular.[43]

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[40]Australian Securities and Investments Commission, "PJC Inquiry into Proposals to Lift the Professional, Ethical, and Education Standards in the Financial Services Industry: Submission by the ASIC," Submission 25, September 2014a.

[41] See, for example, A. Ferguson and C. Vedelago, "Targets, Bonuses, Trips—Inside the CBA Boiler Room," Sydney Morning Herald, June 22, 2013; and A. Sinodinos, "Delivering Affordable and Accessible Financial Advice," Australian Government: The Treasury, media release, December 20, 2013.

[42]Australian Securities and Investments Commission, "FOFA—Background and Implementation," undated(b).

[43]ASIC, undated(b); BT Financial Group, "FOFA—Where Are We Now?" September 2012.

In March 2014, the recently elected Liberal-National Coalition introduced amendments to FoFA, substantially scaling back key provisions. In particular, the proposed changes included

- removing a "catch-all" provision in the best interests duty requiring advisers to take any other reasonable steps that would be regarded as being in a client's best interests
- removing the requirement that fee disclosure statements be sent to pre–July 1, 2013 clients
- removing the opt-in requirement for ongoing fee arrangements entered into after commencement of the FoFA amendments
- exempting general advice from conflicted compensation in some circumstances (in particular, certain incentive payments for general advice would not be considered conflicted).[44]

Most of the changes were implemented through the Streamlining Future Financial Advice Regulation, commencing July 1, 2014. The other changes were to be implemented through changes to the Statement of Advice (SOA) requirements, effective January 1, 2015. However, the Streamlining Future Financial Advice Regulation was disallowed by the Senate on November 19, 2014, and the SOA Regulation was repealed on December 16, 2014. Thus, much of FoFA is as initially implemented. Importantly, the prospective ban on commissions, best interests duty, opt-in requirement, and fee disclosure statements remain. But it remains unclear whether there will be future modifications to FoFA.

[44] ASIC, undated(b).

5. Germany

Despite being the European Union's (EU's) largest economy, Germany experiences relatively low financial market participation. The 2011 Eurobarometer survey found that only 12 percent of German respondents indicated they owned stocks or bonds.[45] However, a relatively large proportion of individuals who choose to invest also choose to receive financial advice. The Eurobarometer survey found that 42 percent of German respondents who purchased an investment fund in the previous five years also received advice from the product provider, while 33 percent received advice from intermediaries or an adviser. Previous studies have also estimated that about 80 percent of individual investors in Germany receive professional advice about investment decisions.[46] As in the United States, older, wealthier, and more experienced investors are more likely to receive professional advice.[47]

Types of Advice and Advisers

German investors can receive financial advice from tied (e.g., bank) advisers and independent financial advisers (e.g., those not directly affiliated with a financial product provider). All advisers and investment service enterprises are to "provide investment services and ancillary services with the requisite degree of expertise, care and diligence in the interests of their clients."[48] As in much of the European Union, consumers are more likely to receive advice from a bank adviser than an independent adviser.[49] Financial services firms providing investment advice generally must receive written authorization from the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht,* or BaFin) prior to advising clients.

[45]European Commission (2012).

[46]R. Bluethgen, A. Gintschel, A. Hackethal, and A. Müller, "Financial Advice and Individual Investors' Portfolios," working paper, Social Science Research Network, March 1, 2008.

[47]A. Hackethal, M. Haliassos, and T. Jappelli, "Financial Advisers: A Case of Babysitters?" *Journal of Banking and Finance*, Vol. 36, No. 2, 2012, pp. 509–524.

[48]Federal Financial Supervisory Authority, home page, undated.

[49]S. Ahlswede, "Fee vs. Commission: Quality of Advice Is Not Only Determined by Remuneration," *DB Research Current Issues*, Frankfurt am Main, Germany: Deutsche Bank, March 27, 2012.

Consumers can select from fee-based advisers or those compensated through commission. Currently, commission-based investment advice dominates the market, although legislation designed to improve the transparency of fees or commissions paid and the quality of advice and establish a new class of "fee-only advisers"[50] has recently been enacted.

Regulatory Environment

In the wake of the financial crisis, German lawmakers have passed a series of reforms aimed at improving the quality of financial advice that retail consumers receive. In April 2011, lawmakers passed the Act relating to Strengthening Investor Protection and Improving the Functionality of the Capital Market, which became fully effective in November 2012.

The Act contained two key provisions targeted at the market for financial advice. First, the Act compels advisers to provide clients with a product information sheet for each investment the client is advised to purchase. The product information sheet should contain all the information required for an investor to make an informed comparison across financial instruments, including the nature of the recommended financial instrument, how it works, and its associated costs and risks. To improve readability, the information sheet must be no longer than two or three pages and clearly written. Importantly, consumers must receive the information sheet in a "timely manner" before a contract on a transaction is executed.[51]

Second, the Act sought to improve the quality of advice provided by increasing adviser monitoring and adviser qualifications. Pursuant to the Act, institutions must disclose to BaFin the individual employees who provide financial advice to clients and all complaints lodged against an adviser based on the advice provided. Using the information, BaFin has created a database to identify and respond to serious abuses. Furthermore, institutions must ensure their advisers have sufficient expertise and reliability to provide financial advice. In particular, all advisers must have expertise in contract law and securities law and be knowledgeable about the functioning, risks, and costs of the financial investments on which they advise. Expertise may generally come from job certificates, university diplomas in a relevant field, or targeted training.

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[50]Begner, Jorg, "Fee-Based Investment Advice: New Rules to Enter into Force in August," BaFin expert article, July 15, 2014.

[51]BaFin (2011), BaFin Quarterly - Q1/11, http://www.bafin.de/SharedDocs/Downloads/EN/Mitteilungsblatt/Quarterly/bq1101.pdf?__blob=publicationFile.

As for reliability, an adviser must not have been convicted of theft, extortion, or other financial breaches in the five years prior to registration with BaFin.[52]

To increase transparency about adviser compensation and promote unconflicted advice, German lawmakers introduced the Fee-Based Investment Advice Act, effective August 1, 2014. The regulation introduces "fee-based investment advice" as a legally protected designation and imposes specific restrictions on those seeking to become fee-only advisers. As the name of the act suggests, fee-only advisers are prevented from receiving commissions or remuneration from third parties and must receive payment only from clients.[53]

Also, fee-only advisers must consider a sufficiently broad set of financial products when issuing recommendations to clients (i.e., fee-only advisers cannot exclusively offer financial products from issuers with whom the adviser is associated). Advisers are not prevented from offering financial products issued by their institution, but they must consider other providers' products when constructing advice. Should a fee-only adviser recommend a product from a firm the adviser is affiliated with, the adviser must disclose that affiliation.

Fee-only advisers are also generally prevented from conducting recommended transactions on a fixed-price basis (e.g., transactions when the client pays a single price for the investment without separate charges for commission or fees). An exception to this rule is that fixed-price transactions are permitted when a fee-based adviser recommends a financial product issued by the adviser itself.

To further promote the provision of investment advice in the clients' interest, institutions providing fee-based investment advice must segregate fee-only advisers from conventional advisers to help ensure that fee-based investment advice is not influenced by commission-based investment advice. Moreover, firms are prevented from setting sales targets for their fee-only advisers that may conflict with the interests of clients.

Prior to designating their services as "fee-based investment advice," institutions must register with BaFin and be entered into the regulator's database of fee-only advisers. To become registered, an institution must submit proof—an audit certificate establishing that it meets the above requirements to provide fee-only advice. BaFin publicly releases the register of fee-only

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[52] "BaFin's Employee and Complaints Database Live as of 3 September 2012," Ashurst Frankfurt, memorandum, September 2012.

[53] Begner, 2014.

investment advisers to help consumers learn where to obtain such advice. As of August 14, 2015, there were 17 entries in the register.[54]

[54] BaFin, "Honoraranlageberater-Register," August 14, 2015.

6. Singapore

In Singapore, investors receive advice predominantly from financial advisers, of which there are two main types: Licensed Financial Advisers (LFAs) and Exempt Financial Advisers. In 2013, there were 62 LFA firms in Singapore,[55] the smallest of the financial advice markets in our selection of countries.

Types of Advice and Advisers

Corporations that want to provide financial advice must apply for a license from the Monetary Authority of Singapore (MAS). Organizations such as banks, merchant banks, finance companies, insurance companies, insurance brokers, and holders of a capital markets services license are exempt from this licensing requirement because they are regulated by MAS under other legislation.[56] There are a few other exemptions to the licensing requirement, such as financial advisers who provide advisory services to institutional investors only or to fewer than 30 "accredited" investors, investors with more than SGD2 million in assets.[57]

Financial advisers can be paid through fees or through commissions. A financial adviser, either licensed or exempt, may call itself an "independent financial adviser" only if

> (i) the financial adviser does not receive any commission or other benefit from a product provider which may create product bias and does not pay any commission to or confer other benefit upon its representatives which may create product bias;
>
> (ii) the financial adviser operates free from any direct or indirect restriction relating to any investment product which is recommended; and
>
> (iii) the financial adviser operates without any conflict of interest created by any connection to or association with any product provider. (*Financial Advisers Act, Financial Advisers Regulation*, Section 21)

[55] C. T. Lee, "Presentation of Financial Advisory Industry Review Panel Report," Monetary Authority of Singapore, speech presented January 16, 2013.

[56] Monetary Authority of Singapore, "Dealing with a Financial Adviser: What to Look out for?" Singapore: MoneySense, December 2003.

[57] *Financial Advisers Act, Financial Advisers Regulations*, Rg2, G.N. No. S 462/2002, Revised Edition, Singapore Statutes Online, February 21, 2004, Section 27. See, also, Monetary Authority of Singapore, "FAQs on Exempt Persons," updated August 7, 2012.

LFAs are regulated by MAS under the Financial Advisers Act. Exempt Financial Advisers are held to the same standards as LFAs, even though they are regulated under other legislation. Financial advisers are expected to conduct their business with integrity, objectivity, confidentiality, and competence. They are required to act with due care and diligence, which includes prompt and best execution of client orders. Required disclosures include key features on any recommended investment products and full disclosure on how the financial adviser is paid. Financial advisers are required to take reasonable steps to understand the client's financial objectives, risk tolerance, financial situation, investment experience, and particular needs and use this information to make suitable recommendations.

Employees of an LFA who provide financial advisory services must hold a representative's license. Employees of an exempt financial adviser are exempt from holding this requirement, but all representatives of LFAs and exempt financial advisers must meet education and examination requirements.

Regulatory Environment

In April 2012, MAS formed the Financial Advisory Industry Review (FAIR) Panel. The primary aims of FAIR were to raise the standards of practice in the financial advisory industry and improve efficiency in the distribution of life insurance and investment products in Singapore. The panel comprised 14 members drawn from industry, consumer and investor bodies, academia, media, and other stakeholders and was chaired by MAS.

The panel released its recommendations in January 2013. The panel made 28 recommendations, grouped under five key topics:

1. raising the competence of financial adviser (FA) representatives
2. raising the quality of FA firms
3. making financial advising a dedicated service
4. lowering distribution costs
5. promoting a culture of fair dealing.[58]

After a public comment period from March to June of 2013, MAS announced in September 2013 that it accepted 19 of the recommendations, modified eight, and dropped one.

[58]Monetary Authority of Singapore, "Consultation Paper on Recommendations of the Financial Advisory Industry Review," March 5, 2013a.

The recommendations MAS accepted related to improving quality of financial advice include[59]

- requiring a "balanced scorecard" framework for remuneration of FA representatives that would reward the provision of good-quality advice to clients
- banning short-term product-related incentives that reward FA firms, representatives, and supervisors for recommending specific investment products or a specific class of investment products, because such incentives may encourage poor market conduct practices such as product pushing and improper switching
- raising the minimum education levels, from a tenth grade–equivalent education to an educational level equivalent to one year of postsecondary education[60] and implementing a more structured continuing professional development framework for FA representatives
- tightening up the admission criteria for LFAs by imposing minimum years of experience for the firm and CEOs and requiring LFAs to have a compliance function independent of advisory and sales business
- requiring that registered insurance brokers[61] who want to provide financial advisory services as exempt financial advisers must meet the same management expertise, financial, and compliance requirements as LFAs
- tightening the types of nonadvisory activities that LFAs and their representatives are allowed to conduct and imposing a cap on revenue from nonadvisory services:
  - For LFAs, permitted activities include making referrals of nonadvisory services to other financial institutions licensed by MAS, providing financial education to consumers, and providing estate and tax planning services
  - LFAs will also be required to exercise greater control over their representatives' nonadvisory activities

Even though FAIR was modeled partly after RDR and FoFA, MAS chose not to ban commissions, citing an April 2012 survey it conducted in which 80 percent of respondents said they were not willing to pay a fee for advice. MAS stated that "it is not clear if Singaporeans are ready for a move towards a fee-based regime."[62]

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[59]For further details, see Monetary Authority of Singapore, "Response To Feedback Received—Public Consultation On Recommendations Of The Financial Advisory Industry Review," September 2013b, and Monetary Authority of Singapore, "Consultation Paper on (1) Draft Legislation and Proposed Legislative Amendments to Effect the Policy Proposals Under the Financial Advisory Industry Review; and (2) Proposed Legislative Amendments to Authorise Inspections by Foreign Regulatory Authorities under the Financial Advisers Act," October 2, 2014b.

[60]The education requirements increased from four General Certificate of Education "O" Level credit passes to a full certificate in GCE "A" Level, an International Baccalaureate diploma, or a diploma awarded by a polytechnic in Singapore, or equivalent. See Monetary Authority of Singapore, "Financial Advisers Act (Cap. 110), Notice on Minimum Entry and Examination Requirements for Representatives of Licensed Financial Advisers and Exempt Financial Advisers: Frequently Asked Questions," updated January 10, 2014a.

[61]Insurance brokers are exempt from holding an FA license because they are regulated under the Insurance Act.

[62]MAS 2013b, p. 55.

7. European Union

While the Markets in Financial Instruments Directive (MiFID) implemented in 2007 (discussed in more detail later) helped to harmonize regulation in the financial markets across EU states, there is still considerable variation in practice. A 2011 Eurobarometer survey found large differences in financial market participation across member states. On the high end, 46 percent of respondents in Sweden and 44 percent of respondents in Denmark indicated they own stocks or bonds. However, in most countries, stock ownership appeared to be in the low single digits, bottoming out in Bulgaria (0 percent) and Romania (1 percent).[63] Across all 27 EU member states at the time of the survey,[64] only 11 percent of respondents indicated they owned stocks or bonds.[65]

Among respondents who purchased an investment fund in the previous five years, 42 percent indicated they received advice from the product provider (e.g., the bank), and 28 percent indicated they received advice from an intermediary or adviser. Country-level responses, however, varied considerably. In Italy, 76 percent of respondents indicated they received a recommendation from the product provider, while 25 percent of respondents indicated they received advice from a third party. In comparison, only 30 percent of respondents from France indicated they received advice from the product provider, and 17 percent indicated they received advice from an intermediary or adviser.[66] Other studies have found similar results. A review of research compiled by Deutsche Bank Research suggested that close to 40 percent of investors in the European Union do not receive financial advice and that banks continue to dominate the market for investment advice in most EU countries (though notably not in the United Kingdom, as discussed earlier).[67]

[63]European Commission, 2012.

[64]Croatia joined the European Union in 2013.

[65]European Commission, 2012.

[66]European Commission, 2012.

[67]Ahlswede, 2012.

Types of Advice and Advisers

There is also considerable variation in the types of advice available to retail customers across the European Union. Adviser licensing requirements and quality standards are established by individual member states, resulting in a spectrum of different standards. Importantly, advisers are also compensated in different ways across the member states. In particular, advisers in the United Kingdom and the Netherlands are prevented from receiving commissions related to financial advice, while some advisers in other countries, including Germany and France, are allowed to receive inducements. While MiFID places few restrictions on adviser compensation schemes, subsequent regulation will seek to improve investor protection in the European Union, as described below.

Regulatory Environment

In April 2004, the Council of the European Union and the European Parliament adopted MiFID, which was designed to increase consumer protection and the competitiveness of the EU financial markets by creating a single market for investment services and activities.[68] MiFID sought to enhance consumer protection by, among other provisions, requiring investment firms and advisers to provide consumers with adequate information, incorporate information about a client's knowledge and financial situation into advice so that only suitable financial products are recommended, and imposing a "best execution" obligation to ensure that investment firms execute client orders on terms most favorable to the client.[69] MiFID became effective on November 1, 2007, harmonizing requirements across member states, although member states were also allowed to adopt additional requirements over and above those imposed by MiFID in exceptional circumstances to target additional investor protection issues not addressed by the regulation.

In response to shortcomings experienced during the financial crisis, the European Commission adopted two legislative proposals for reviewing MiFID in 2011. The review was designed to find ways to establish a safer, more transparent, and more responsible financial

[68] European Commission, "Legislation in Force: MiFID 1," February 18, 2015.

[69] European Parliament, "Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on Markets in Financial Instruments," Official Journal of the European Union, April 30, 2004.

system. The European Parliament and Council reached political agreement on changes to MiFID in January 2014, and the final legislative texts of the new Markets in Financial Instruments Directive (MiFID II) were approved by the European Parliament in April 2014 and by the European Council in May 2014.[70] It is anticipated the MiFID II will become effective in January 2017.[71]

MiFID II contains numerous provisions designed to increase investor protection. In terms of suitability, investment firms must provide suitable personal recommendations that consider a client's knowledge, experience, and financial situation and must also provide clients with a statement specifying why the recommended investment is suitable. Additionally, firms must disclose whether they will provide ongoing assessments of suitability.[72]

MiFID II also seeks to introduce increased transparency on cost. The directive requires firms to provide consumers with information about all costs and charges related to both investment and ancillary services, including the cost of advice, the cost of the financial instrument, and any third-party charges. Costs must be provided to investors in aggregate so they can understand the overall cost and the cumulative effect on investment return, with an itemized breakdown provided upon client request.[73] MiFID II also requires investment firms that offer investment services coupled with other services to disclose whether a client could purchase the components separately and provide evidence about the costs of each component and information about how their interaction influences risk.[74]

Importantly, MiFID II distinguishes between independent and tied advice.[75] In particular, firms must disclose to their clients whether advice is being provided on an independent basis (e.g., whether the advice considers products from a range of providers) and whether that advice is based on a broad or restricted consideration of different types of financial instruments. Those providing independent advice will be required to assess a sufficient range of available financial

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[70]European Securities and Markets Authority, "Consultation Paper on MiFID II/MiFIR," May 22, 2014.

[71]European Securities and Markets Authority, "MiFID II Application," undated.

[72]European Securities and Markets Authority, undated.

[73]C. Bernard, "MiFID II: The New Investor Protection Regime," Linklaters, May 2014.

[74]European Securities and Markets Authority, undated.

[75]Tied advisers are generally representatives of a particular product provider and recommend only the financial products offered by that provider.

products, particularly a broader set than is provided by the investment firm itself.[76] Further, firms providing advice on an independent basis (or portfolio management) are banned from receiving commissions or other monetary benefits from any third party in relation to providing services to clients.[77] Notably, this does not prevent those who do not provide independent advice from receiving commissions, although member states are allowed to impose additional restrictions in some circumstances.[78]

[76] European Securities and Markets Authority, undated.

[77] European Securities and Markets Authority, undated. Nonindependent firms are required to disclose commissions and fees to clients.

[78] For example, the United Kingdom's RDR bans commissions regardless of whether the advice is provided by an independent adviser.

8. Impacts of Regulatory Changes

Despite sweeping regulatory changes in many countries after the financial crisis, there has been little rigorous research investigating the impact of these changes. This lack of research is partly because of how recently regulations have been put in place. In Germany, the Fee-Based Investment Advice Act took effect in August 2014, while MiFID II and Singapore's FAIR regulation have yet to be fully implemented. However, there has been research into the impacts of the RDR in the United Kingdom and FoFA in Australia. Below, we summarize the literature documenting this research. It is important to note that even in the United Kingdom and Australia, not much time has passed since the reforms became active. Thus, any conclusions that can be drawn from the existing research are preliminary.

Impacts of the RDR

As planned prior to the RDR's implementation, the FCA has conducted a Post-Implementation Review (PIR) designed to investigate the early impacts of the regulation.[79] The PIR comprised two main components: thematic reviews examining how firms were implementing the required changes, and commissioned research investigating the wider impacts on the market for financial advice.

Evidence About Implementation

In January 2013, the FCA began a three-stage thematic review looking at how financial advisers and firms were adjusting to the new requirements imposed by the RDR. The first-stage review was conducted in May 2013 and surveyed 50 firms—chosen to reflect a cross-section of the industry—to examine how they devise, disclose, and deliver their services and charges. The review found that firms had made substantial progress implementing the new requirements. However, the FCA noted there were concerns about (1) some firms not disclosing charges in cash (pounds) terms, (2) lack of clarity about what ongoing services would be provided, and (3)

[79]Subsequent reviews are planned to examine medium- and longer-term impacts.

whether independent firms were behaving independently and restricted firms were adequately describing the nature of their restrictions.[80]

The second review, published in March 2014, surveyed 113 firms selected from a cross-section of the industry and focused on whether firms describing themselves as independent were operating independently in practice and how firms were disclosing their service proposition and the associated charges to clients. Of the 88 firms that claimed to offer independent advice, the FCA identified two not acting independently in practice and had concerns about an additional 28 firms. As part of the second review, the FCA conducted a more in-depth review of 17 of those 28 firms and concluded that six were not operating independently and had concerns that another four firms might not be acting independently, but it did not have enough evidence to determine this with certainty.[81] As for disclosure, the FCA found that a high proportion of firms were failing to correctly disclose to clients the cost of advice, the type of service offered, and the nature of any ongoing service. Of the firms surveyed, 73 percent failed to provide the required generic information about how they charge for advice and/or did not clearly convey the cost of advice to clients in a timely manner.[82]

The third review, completed in December 2014, randomly selected 110 firms and assessed their disclosures about charges and services and investigated how the firms were providing ongoing services to clients in return for an ongoing adviser charge. The review found that firms had made significant improvements in how costs and the scope and nature of services were disclosed, suggesting that firms responded positively to the findings from the second thematic review. In addition, the review found evidence suggesting that most firms are delivering on the ongoing service commitments they have made to clients, with only isolated examples of clients being charged an ongoing service fee without receiving genuine service in return. However, the

[80]Financial Conduct Authority, "Supervising Retail Investment Advice: How Firms Are Implementing the RDR," TR13/5, July 2013.

[81]Financial Conduct Authority, "Supervising Retail Investment Advice: Delivering Independent Advice," TR14/5, March 20, 2014a.

[82]Financial Conduct Authority, "Supervising Retail Investment Firms: Being Clear About Adviser Charges and Services," TR14/6, April 7, 2014b.

FCA noted it still had concerns that some firms were failing to clearly disclose, in cash (pounds) terms, the fees clients would be charged for ongoing service.[83]

Evidence About Market Impacts: Advice Gap

Prior to RDR implementation, there was a great deal of concern that the regulation would restrict the supply of advice, particularly for consumers on the lower end of the wealth spectrum. Several commentators noted that individuals with little wealth might not be able to afford (or be willing) to pay a separate fee for advice and that financial advisers might focus on higher-wealth clients. Also, there was concern that advisers might leave the market altogether because of changes in remuneration and increased qualification levels.[84]

Indeed, the number of advisers did drop, from about 40,000 in 2011 to about 31,000 by January 2014.[85] Banks, in particular, appear to have decreased their presence in the financial advice market; the estimated number of advisers working at banks dropped from around 8,600 to 3,600 over the period.[86] The number of advisers working at independently owned firms also seems to have decreased, although more modestly at an estimated 15 percent decline.[87] An NMG Consulting survey of 1,000 investors and 350 advisers found similar results—that while many banks withdrew from the retail advice market, there was only a small decline in the number of advisers from independently owned firms.[88]

Although the number of advisers decreased, there is conflicting evidence about whether this decline has resulted in an "advice gap." A 2013 survey of 250 financial advisers conducted by NMG Consulting (commissioned by APFA) found that 47 percent had recently turned away clients because the cost of their service had become disproportionately high for some clients'

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[83]Financial Conduct Authority, "Retail Investment Advice: Adviser Charging and Services," TR14/21, December 16, 2014c.

[84]See, for example, E. Simon, "RDR: Are You Prepared to Pay a Fee for Financial Advice?" *Telegraph*, July 9, 2012.

[85]FCA Professional Standards data, as reported in Association of Professional Financial Advisers (APFA), 2014.

[86]APFA (2014,) see, also, CFA Institute , "Restricting Sales Inducements: Perspectives on the Availability and Quality of Financial Advice for Individual Investors," *Codes, Standards and Position Papers*, Vol. 2013, No. 15, December 2013.

[87]APFA (2014)

[88]D. Burns, "The Results Are in: Which RDR Predictions Proved True?" *New Model Adviser*, Citywire, November 25, 2013.

needs.[89] In contrast, subsequent NMG Consulting research (also commissioned by APFA) found that 83 percent of surveyed advisers indicated they had capacity to advise additional clients seeking guidance on pension decumulation; also, only 19 percent claimed they would not advise on accounts below a certain threshold, while 50 percent indicated it would depend on the particular case.[90]

Towers Watson was commissioned by the FCA to develop an estimate of one year's demand and supply of retail financial advice as of early 2014 to investigate whether an advice gap exists after RDR implementation. The study suggests there is no advice gap from a shortage of advisers, estimating an aligned demand and supply for advisers: a demand of about 25,000 and a supply of about 30,000.[91] However, given a lack of data, the authors could not estimate supply by consumer segment and note, thus, that supply and demand may not be perfectly aligned across the market. In particular, Towers Watson estimated that over 60 percent of the demand was likely to be transactional (rather than holistic) and that firms' movement toward a focus on holistic financial advice could lead to capacity mismatch, particularly at the lower end of the market.[92]

Although there is some suggestive evidence indicating that individuals with few investable assets are having more difficulty receiving financial advice, the size of the advice gap may be small. An NMG Consulting survey (commissioned by the FCA) of 6,923 adults[93]—drawn from a large online opt-in panel and sampled to ensure that it was representative of the UK population in terms of age, gender, region, and working status—found evidence that individuals' propensities to seek advice are correlated with the asset amount they have to invest. Using a series of questions, the study classified individuals as "advised" or "non-advised" based on whether they had recently received a personal recommendation for their most recent post-RDR activity. The

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[89]Money Marketing (2013), "APFA Claims Thousands Priced Out of Advice"; NMG Consulting, *Financial Adviser Census for APFA, Adviser Charging*. November 2013.

[90]NMG Consulting, *Financial Adviser Census for APFA, The "Guidance Guarantee,"* May 2014b; APFA (2014).

[91]The study's authors relied on publicly available data, much of which was pre-RDR, and had to make numerous assumptions to model supply and demand. Consequently, the results are sensitive to those assumptions, though the authors note that they attempted to err on the side of overdemand.

[92]Towers Watson, *Advice Gap Analysis: Report to FCA*, December 5, 2014.

[93] 2,234 respondents were screened out because they were not the financial decisionmaker in the household or because they had less than £5,000 in investable assets.

study found that when investing £5,000, 80 percent of advised clients and 94 percent of nonadvised clients indicated they would make the investment decision on their own. However, with £50,000 to invest, 83 percent of advised clients and 57 percent of nonadvised clients claimed they would seek financial advice.[94] Also, the study found little evidence that the move to separate charges for advice has dampened consumer willingness to seek advice; of those not receiving advice, only 14 percent indicated that this was because they did not want to pay the adviser's charge or fee.[95]

Europe Economics conducted a review of the literature and evidence as part of the FCA's PIR and concluded that while some advisers have appeared to move toward higher–net worth clients (although minimum thresholds vary by firm), the evidence suggests that the number of low–net worth consumers who lost access to advice is small, though likely positive.[96] The study cited evidence from Schroders suggesting that less than 15 percent of advisers stopped providing service to "smaller" clients, and evidence from NMG Consulting suggested that, on average, surveyed advisers refused to advise only three clients because of profitability concerns.[97] Importantly, clients not offered advice from one financial adviser may have received it from another.

Evidence About Market Impacts: Impact on Advice

One of RDR's central goals in banning commissions was to reduce biased financial advice from misaligned incentives between advisers and advisees. Indeed, there is suggestive evidence that the regulation may have helped to reduce product bias. After RDR, there has been a substantial reduction in flows into high-cost investments and an increase into funds with lower fees.

Using data from Morningstar Direct and Lipper IM, as well as its own data, the Investment Management Association (IMA) analyzed flows by individual share class on over 2,500 funds

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[94]NMG Consulting, *Impact of the Retail Distribution Review on Consumer Interaction with the Retail Investments Market: A Quantitative Research Report*, London: NMG Consulting, September 2014c. The study found similar results in regard to investment complexity, with individuals more willing to seek advice when starting a pension or planning their retirement as opposed to saving for a "rainy day."

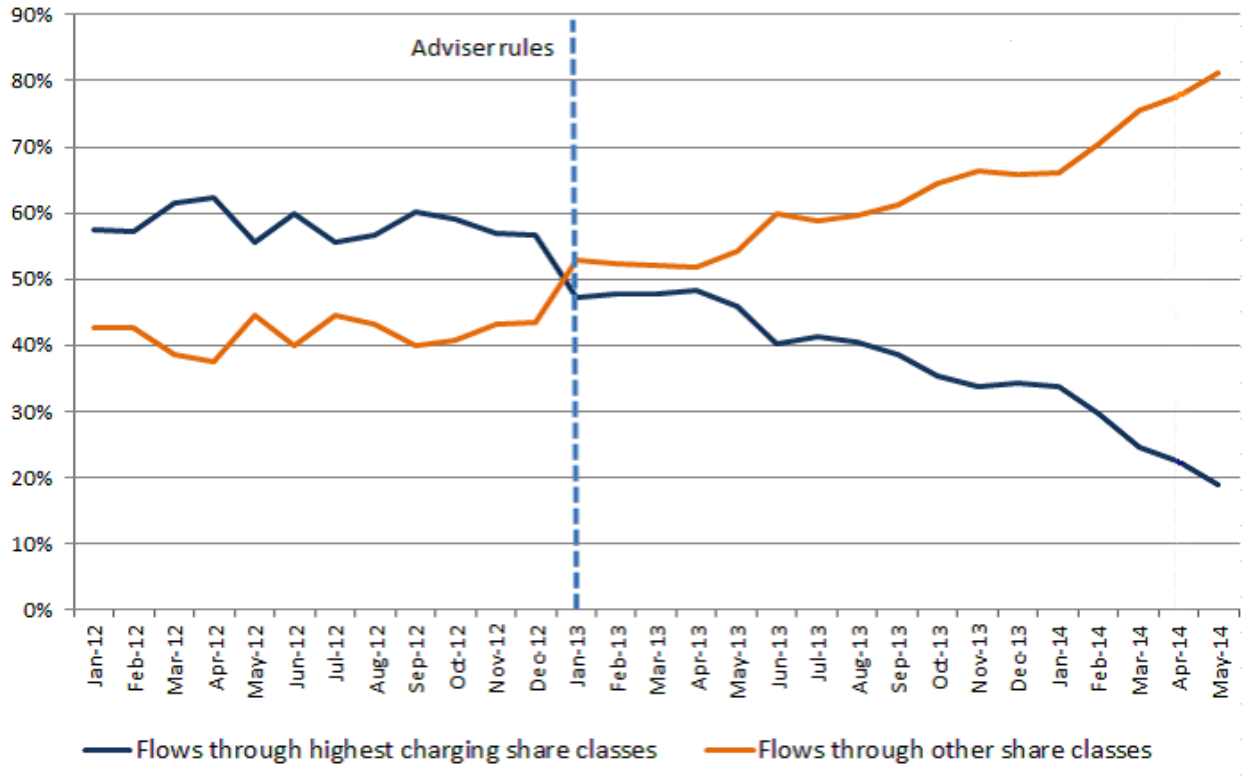
[95]NMG Consulting, 2014c.

[96]Europe Economics, 2014.

[97]Europe Economics, 2014.

pre- and post-RDR and found that immediately before RDR implementation, around 60 percent of all gross retail flows were in the share classes with the highest annual management charges (Figure 1). As of May 2014, that figure dropped to about 20 percent.[98]

Figure 8.1 Gross Retail Sales at Share Class Level (January 2012–May 2014)[99]



Source: IMA (2014) as adapted from Europe Economics (2014).

Further, IMA's analysis suggested that flows into index funds increased substantially from £1.8 billion in 2012 to £3.2 billion in 2013, representing 9.6 percent of industry funds under management (up from 6.1 percent in 2004).[100]

While the evidence is consistent with the RDR leading to a reduction in biased product advice, other factors may also have contributed to the changing investment mix. For example,

[98]Investment Management Association, "Asset Management in the UK 2013–2014: The IMA Annual Survey," London: Investment Management Association, September 2014.

[99]"Adviser rules" denotes the implementation of the RDR.

[100]IMA, 2014.

the departure of the banks from the retail investment advice market may have had a direct impact on fund flows, since banks tended to sell a large proportion of high-cost investment products.[101] Europe Economics reviewed the evidence and concluded that while other factors may be at play, they do not explain the large change in investment flows immediately following the introduction of the RDR.[102]

It is important to note that adviser/advisee incentives may still not be perfectly aligned following the regulation. Evidence suggests that many advisers charge based on a percentage of funds invested, and that a large proportion of charges may be contingent on making an investment.[103] Thus, advisers may still have an incentive to nudge consumers toward investing more than might be appropriate for their individual situations.

Evidence About Market Impacts: Cost of Advice

While there was a substantial shift in flows away from high-cost investments after RDR was implemented, there is some evidence the cost of receiving advice has increased. Europe Economics reviewed the available evidence and concluded that it does not appear as though adviser remuneration has decreased post-RDR, noting that "one-off charges appear in line with pre-RDR initial commissions paid to advisers, and ongoing charges have increased relative to ongoing commissions for at least some firms and in some regions of the UK."[104]

Further, there is evidence that the cost of receiving advice may have increased for some consumers. Citing evidence from Touchstone and the FCA's Retail Mediation Activities Returns (RMAR) data, Europe Economics estimates that current adviser charges are typically between 1 and 3 percent of investment in initial charges and between 0.5 and 1 percent in ongoing charges. Europe Economics' fieldwork suggested pre-RDR trail commissions were in the range of 0.5 percent to 0.75 percent, indicating that some consumers who receive ongoing services may be incurring higher costs post-RDR.[105]

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[101] Europe Economics, 2014

[102] Europe Economics, 2014.

[103] Europe Economics, 2014.

[104] Europe Economics, 2014.

[105] Europe Economics, 2014.

Evidence About Market Impacts: Adviser Qualifications

Another central aim of the RDR was to increase the level of professionalism in the financial advice market. Evidence suggests that adviser qualifications have indeed improved post-RDR. Europe Economics cites RMAR data indicating that the fraction of advisers who hold appropriate qualifications increased from 89 percent in 2008 to 95 percent in 2013.[106] While the increase is notable in its own right, it may actually underrepresent the improvement, because the implementation of the RDR also increased the minimum qualification level from QCF Level 3 (roughly equivalent to A-level, or completion of secondary school) to QCF Level 4 (roughly equivalent to the first year of a university degree).

There has also been a large increase in the fraction of advisers attaining qualification levels beyond the minimum. The NMG Financial Adviser Census suggests that the fraction of advisers who have attained QCF Level 6 qualification (roughly equivalent to a university degree) increased from 14 percent in the fourth quarter of 2012 to 29 percent in the first quarter of 2014.[107]

Impacts of FoFA

Although FoFA became mandatory only shortly after the implementation of the RDR, our review uncovered far less research into its impacts. The lack of available evidence may be partly the result of the debate about whether some of FoFA's provisions would be rolled back. Given the regulatory uncertainty, it may have been difficult for some market participants to form long-term expectations and adjust accordingly.

As part of the review process to propose amendments to FoFA, the Australian Treasury released a FoFA Regulation Impact Statement (RIS) in March 2014, noting that the number of financial advisers had declined following the economic crisis and FoFA.[108] However, no

[106]Europe Economics, 2014.

[107]NMG Consulting, *Financial Adviser Census–Business Trends Report Q1*, January–March 2014a.

[108]Australian Government, Department of the Prime Minister and Cabinet, "Future of Financial Advice Amendments—Details-Stage Regulation Impact Statement," Canberra: Office of Best Practice Regulation, Department of the Treasury, March 19, 2014.

evidence is directly cited,[109] nor is there an attempt to separate the impacts of the economic downturn from the effect attributable to FoFA. The RIS also claims that industry concentration and compliance costs have increased, but it is unclear if this has led to an increase in the cost of, or reduced access to, financial advice for retail consumers.[110]

In September 2014, ASIC released a review of the industry's implementation of FoFA, assessing, among other things, impacts on remuneration, adviser numbers, and compliance challenges.[111] The review was based on interviews with 60 licensees, which accounted for approximately 10,000 advisers and 4.6 million retail clients.[112] The report found that there had been little impact on the number of advisers at firms in the sample. In particular, 92 percent of respondents indicated that there had been no change in their adviser numbers because of FoFA, while 7 percent indicated that adviser numbers had decreased and 2 percent indicated that adviser numbers had increased.[113]

The majority of licensees surveyed indicated that there was no change to the type of advice services they offered as a result of FoFA, although some indicated that they increased scaled advice (13 percent) or strategic advice (10 percent).[114] Similarly, the introduction of the best interests duty and related obligations did not have an impact on most firms' approved product lists (which provide guidance to advisers on which products to recommend), although 14 percent of respondents indicated that they had reduced the number or types of products on their approved products list, while 11 percent indicated they had introduced or amended product benchmarking.[115]

In terms of compensation, surveyed licensees estimated a reduction in commissions paid by product issuers, a reduction in fees based on volume of assets under advice, and an increase in

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[109]The report notes: "[m]uch of the evidence in this RIS has been provided to the Treasury under commercial-in-confidence arrangements and cannot be directly quoted. Where this is the case, the evidence is paraphrased and no source is referenced."

[110]Australian Government, 2014.

[111]Australian Securities and Investments Commission, *Review of the Financial Advice Industry's Implementation of the FOFA Reforms*, Report 407, September 2014b.

[112]ASIC 2014b.

[113]ASIC 2014b.

[114]ASIC 2014b.

[115]ASIC 2014b.

fixed fees paid by clients.[116] However, the (unweighted) average revenue source changed little after FoFA was implemented. For example, respondents on average believed that ongoing commissions dropped from 24 percent of revenue to 19 percent, while fixed fees increased from 18 percent of revenue to 22 percent. Further, some respondents indicated that they continue to receive the majority of revenues from commissions (either from arrangements that existed before July 2013 or from insurance commissions not subject to the ban).[117]

[116]ASIC, 2014b.

[117]ASIC, 2014b.

9. Summary

There is considerable variation in the financial regulatory environment around the world. Compared with the United States, which has several agencies and organizations supervising the adviser market (e.g., Department of Labor, SEC, FINRA, as well as state-level regulators), the countries we have examined here take a more concentrated approach to supervision, with a single primary regulatory body (e.g., the FCA in the United Kingdom, ASIC in Australia, BaFin in Germany, MAS in Singapore). While the United States places different standards of care on investment advisers and broker-dealers, financial advisers in the other countries we reviewed are frequently held to the same standard of care, regardless of the type of adviser or type of advice provided (as in the United Kingdom, Australia, and Singapore, for example).

Following the financial crisis of 2007–2008, a significant amount of regulation enacted around the globe aimed at improving investor protection and the functioning of capital markets has been put in place. In particular, many countries have reassessed how financial advisers are compensated, with an eye toward mitigating conflicts of interest to improve the quality and suitability of advice provided to retail investors.

Several countries, including those in the United Kingdom and Australia, have taken a more stringent approach to adviser remuneration than the United States by placing outright bans on some commissions to help align incentives between advisers and their clients. As in the United States, however, many other countries have stopped short of banning commissions for financial advisers and have instead sought to improve transparency of adviser compensation schemes. Across the European Union, and in Germany in particular, recent and impending legislation has sought to promote improved advice by creating classes of advisers that are to be compensated *only* through fees collected from clients to ensure that potential conflicts of interest are mitigated. Thus, consumers in these marketplaces can choose between advisers compensated through commissions or fees.

In contrast to the United States, which does not establish minimum standards required for advisers, several countries among those we reviewed here have attempted to improve the quality of advice that retail investors receive by raising the professional standards required to become a financial adviser. For example, Singapore, Germany, and the United Kingdom have all instituted

enhanced educational and expertise requirements designed to improve advisers' recommendations.

While there have been significant changes to regulatory regimes around the globe, there is only limited, and preliminary, evidence about the impact of those changes on consumers. Early research into the impact of the RDR provides suggestive evidence that the regulation has reduced the amount of bias present in advice—fund flows into high-charging share classes have decreased substantially, while flows into low-cost index funds have grown. In addition, there has been a noticeable increase in the level of qualifications attained by financial advisers following RDR implementation. However, there is also suggestive evidence indicating that the cost of financial advice may have increased modestly, with some investors now paying 0.5 percent to 1 percent in ongoing charges compared to pre-RDR trail commissions typically in the range of 0.5 percent to 0.75 percent. Moreover, there is conflicting evidence on whether the RDR has led to an "advice gap," but on balance it appears that in some cases lower-wealth clients may now find it more difficult to receive advice. However, there is also evidence suggesting that the number of low-wealth clients who lost access to advice may be small.

Preliminary analysis of the impacts of FoFA in Australia conducted by ASIC has found little impact on the supply of advice—the vast majority of licensees surveyed indicated no change in adviser numbers due to FoFA—as well as little impact on the types of services offered by advisers. The study did, however, suggest adviser compensation had responded to the legislation, citing an estimated reduction in commissions paid by product issuers, a reduction in fees based on volume of assets under advice, and an increase in fixed fees paid by clients.

While preliminary evidence on the impacts of the RDR and FoFA suggest that the respective legislations are achieving some of their aims, it is still too early to draw any conclusions about the ultimate impact on consumers or firms. Additional future research will shed light on the longer-term impacts.

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