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### RIS success depends on low costs and high trust for all

The European Commission’s landmark Retail Investment Strategy will likely contain improvements to product disclosures, quality and independence of advice, value for money, enforcement, and financial literacy. At the heart of the strategy is the ambition to get more European citizens to start investing while future-proofing the consumer protective framework.

#### Inducements

People will need to trust financial institutions before they start investing. They should be able to rely on financial institutions having their interests at heart and that financial products are sound and of high quality.

Remuneration matters a great deal in terms of incentives. A commission-based distribution model leads to an unacceptable risk of perverse incentives, mis-selling, and unnecessarily expensive products. The inducement ban in the Netherlands has decreased costs as advisors sold cheaper alternatives. We have also seen the quality of financial advice improve because of various investor protection measures, along with the ban on

inducements. Advisors have to critically examine their value proposition to their clients, instead of relying on provisions. This ultimately benefits the client.

There is a persistent misconception that inducement-based advice is free. First, the (relatively high) provisions that product manufacturers pay to advisors are not charity; they are charged to the retail client through opaque cost structures. Second, retail investors pay dearly for unsuitable products that they have bought because of bad advice. It is true that the use of advice has decreased, but this trend had started before the ban was introduced and was not accelerated by the ban. The possibility of an advice gap is the most common argument against a possible inducement ban, but wrong advice is clearly worse than no advice at all. We have not seen evidence for such a gap,<sup>[1]</sup> and the Dutch association for financial advisors reports that three out of four consumers is a client of an independent financial advisor.<sup>[2]</sup>

Brokers may similarly appear to offer a free service, but investors may be worse off if they pay higher transaction prices because the broker receives payments from third parties to carry out the order at unfavourable prices – a practice known as payment for order flow.

#### Cross-border enforcement

Digitalisation has further diminished national borders and helped to create a single market for financial services. Supervision of that market, however, is still largely carried out

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by national authorities, operating in different jurisdictions and with supervisory approaches. Cross-border enforcement is not discussed as passionately as inducements, but it is crucial for the framework’s success. Consistent and high-level supervision is key to ensuring that the legislative framework is complied with and followed in practice. From an operational viewpoint, home member state supervisors may find it difficult to effectively address transgressions in other markets with which they are not familiar. Information sharing between authorities can be unnecessarily cumbersome. To make the RIS future proof and ensure that the framework

delivers optimal outcomes, the Commission should critically look at making the division between home and host supervisors more effective and increasing the powers of host member state supervisors.

#### Disclosures

Product disclosures are a cornerstone of investor protection, but they are too lengthy, detailed, and complex for consumers. Most people do not read these documents or find it difficult to relate information to their personal situation. Significantly improving disclosures requires design based on consumer behaviour. Behavioural research shows that past performance is one of the most prominent pieces of information on which investors base their decision. Although understandable, past success offers no future guarantees. If firms want to maintain their clients’ trust, they must be clear about this and offer realistic expectation of the possible returns.

#### Value for money

Addressing unreasonably high costs is key to delivering the best outcomes for ordinary people saving for retirement or other long-term goals. A difference of one percentage point annually in costs may not seem like much but will significantly impact long-term returns. Cost efficiency is the result of a holistic package of consumer protection: strong product governance, incentives for distributors that favour the client, clear disclosures and a competitive market. If the European Commission can make these work together, the RIS will be a success.

[1] Decision and CentER Data, “Zakelijke verhoudingen: de markteffecten van het provisieverbod,” 22 March 2018, <http://decisio.nl/wp-content/uploads/Decisio-Periscoop-Evaluatie-Provisieonderzoek-Definitief.pdf>

[2] Adfiz, “Advies in Cijfers, 2022-2023,” p. 5, <https://www.adfiz.nl/media/5079/advies-in-cijfers-2022-2023-webversie.pdf>