Strengthening Capital Markets

February 2023

REPORT

CFA Institute Global Survey on Inducements

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This survey examines the implications of possible regulations restricting inducements on the sale of specific investment products. Findings suggest that a complete ban would fail and regulators should focus on improving cost-disclosure standards.

KEY FINDINGS

The key findings of the survey are as follows:

- The current remuneration structures in place at distributors are seen as the main cause of mis-selling practices. Linking remuneration to the sale of specific financial instruments or their sales volume does not encourage distributors to provide services in the clients' best interests. The two most desirable regulatory reforms to address the mis-selling issue are to mandate clearer and full disclosures of all commission and fees paid and to improve product information, including cost structures, to clients.
- A complete ban on inducements paid to financial advisers is not seen as a solution. A plurality of respondents think that such a measure could have a negative impact on the variety of products offered to clients. In particular, distributors may stop (or reduce) offering third-party products. A reasonable percentage (39%) of survey respondents, however, do believe that a prohibition on commission payments could lead to a better and more transparent investment market and to greater fee competition between providers.
- Regulators should focus on the enhancement and clarification of standards on cost disclosures, similar to the standards that are in place for performance information.
- Strengthening investor education is a priority and should be the regulators' main focus before introducing new regulatory measures.

CFA Institute

Introduction

In the wake of the 2008 financial crisis, reforms concerning rules on payments or commissions (inducements) associated with the sale of investment products have been the subject of detailed analysis by legislators and regulators around the globe.

In 2013, CFA Institute published the report "Restricting Sales Inducements" (Fargeot and Orsagh 2013), which was based on a global survey that the organisation conducted with its global membership. The report found that most investors were calling for improved transparency and disclosure. CFA Institute members were also concerned about future policy measures that could reduce incentives to open distribution networks and accessibility of investment advice by retail investors.

In 2019, our organisation also published the report "Sales Inducements in Asia Pacific" (Leung, Cheng, Zembrowski 2019), which reviews four key Asia Pacific capital markets—Hong Kong SAR, Singapore, India, and Australia—and analyses their respective approaches regarding the treatment of inducements in the sales process.

The effects of possible restrictions on inducements on the sale of specific investment products are currently being discussed by regulators, industry participants, and other stakeholders in various jurisdictions around the world. Through this new global survey, CFA Institute aims to understand how investors, investment advisers, portfolio managers, and analysts perceive the issue of mis-selling of financial products and the implications of possible new regulatory measures on commissions paid to distributors of retail financial instruments. We are particularly keen to gauge whether CFA Institute members' views have changed compared with the results from the 2013 global survey. This report should be of interest to regulators, who have been reflecting on the impact of the possible introduction of a ban on inducements, as well as to investors, academics, and other stakeholders who are interested in understanding the evolution of market trends in light of regulatory changes.

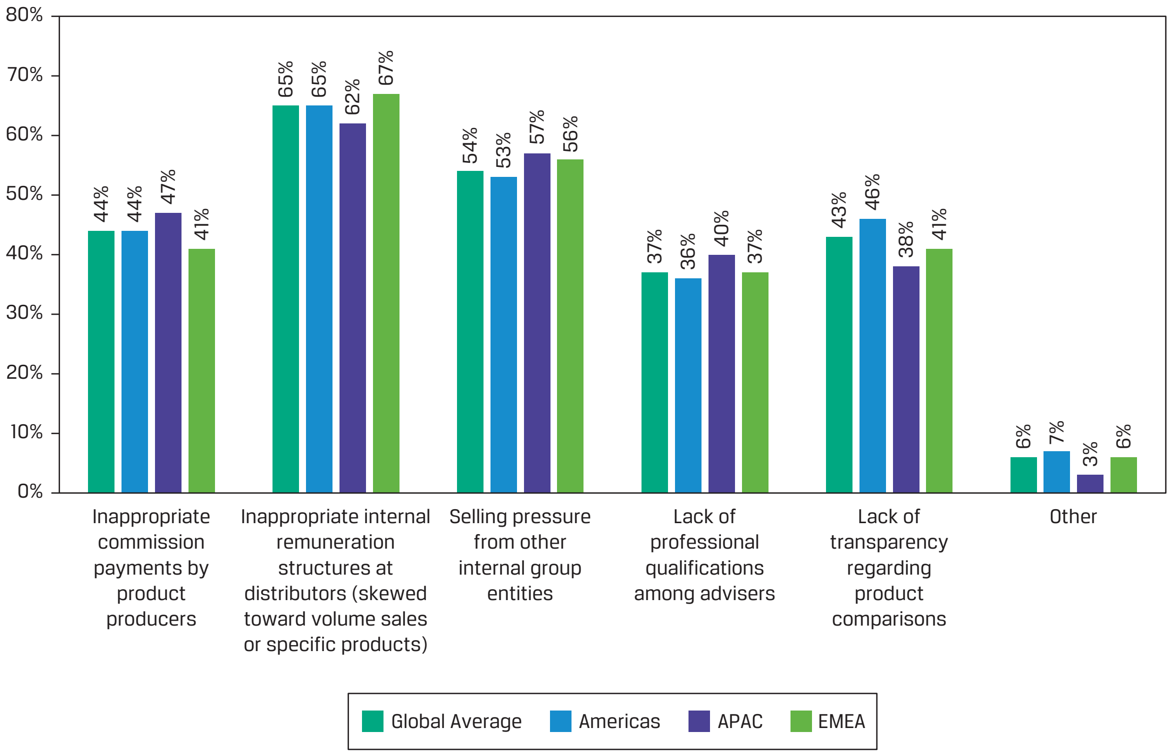
Survey Methodology and Results

A survey was sent to CFA Institute members on 1 April 2022 and closed on 8 April 2022. We received 1,028 valid responses with a response rate of 2% and a margin of error of ±3.0%.

The first question asks CFA Institute members what, in their opinion, are the main causes of mis-selling (**Exhibit 1**). The survey shows that inappropriate internal remuneration structures at distributors represent the main issue. A total of 65% of respondents believe that such structures, which tend to be skewed toward volume sales or specific products, do not provide incentives for distributors to act in the clients' best interest. Other relevant causes identified in the survey include selling pressure from other internal group entities (54%), inappropriate commission payments by product producers (44%), and lack of transparency regarding product comparisons (43%).

Looking at the breakdown of responses by region, members from the Americas, Asia Pacific (APAC), and Europe, the Middle East, and Africa (EMEA) noted the same main causes of mis-selling. However, we observed that, unlike respondents from APAC and EMEA, members from the Americas consider the lack of transparency concerning product comparisons as the third main cause of mis-selling (46%), followed by inappropriate commission payments by product producers (44%).

Exhibit 1. Responses to Question 1: In Your Opinion, What Are the Main Causes of Mis-Selling?



The second question concerns the reforms that policy makers and regulators should adopt to discourage mis-selling practices (**Exhibit 2**). Most respondents support a mandate for a clear disclosure of all commission payments received by distributors before investment (66%) and measures to improve disclosures of product key features, including full disclosure of all product costs (65%). The same top two recommendations are shared by members from the Americas, APAC, and EMEA.

Nevertheless, we noted that a significant percentage of members from APAC (52%) and EMEA (56%) indicated the need for increased initiatives on financial literacy and financial education for retail investors as another important measure against mis-selling practices.

The next two questions refer to a possible ban on inducements. We first asked our members whether commission payments by product producers to financial advisers should be banned completely (**Exhibit 3**). Nearly half (49%) of global respondents would be against a total prohibition, whereas 30% would support such a measure. The breakdown of responses by region shows similar results.

We then asked CFA Institute members about the consequences of a total prohibition of commission payments by product producers to financial advisers (**Exhibit 4**). A plurality of respondents (45%) believes that a ban on inducements would result in distributors stopping offering particular products (such as products from third parties) or offering only in-house products, so product choice will diminish. More than a third (39%) of respondents argue that such a measure would give rise to a positive market development, a more transparent investment market, and more fee competition between providers, whereas 32% of respondents counter that a ban would negatively affect small distributors, which would go out of business, reducing distribution channel choice and reducing product and service choice. Members from all three regions expressed similar views. However, we noted that a significant number of members from the APAC (38%) and EMEA (35%) regions believe that, if a complete ban on inducements is introduced, retail investors would steer away from advisers and advice channels in favour of self-directed, execution-only, or retail brokerage

Exhibit 2. Responses to Question 2: What Are the Most Important Reforms Needed to Combat Mis-Selling?

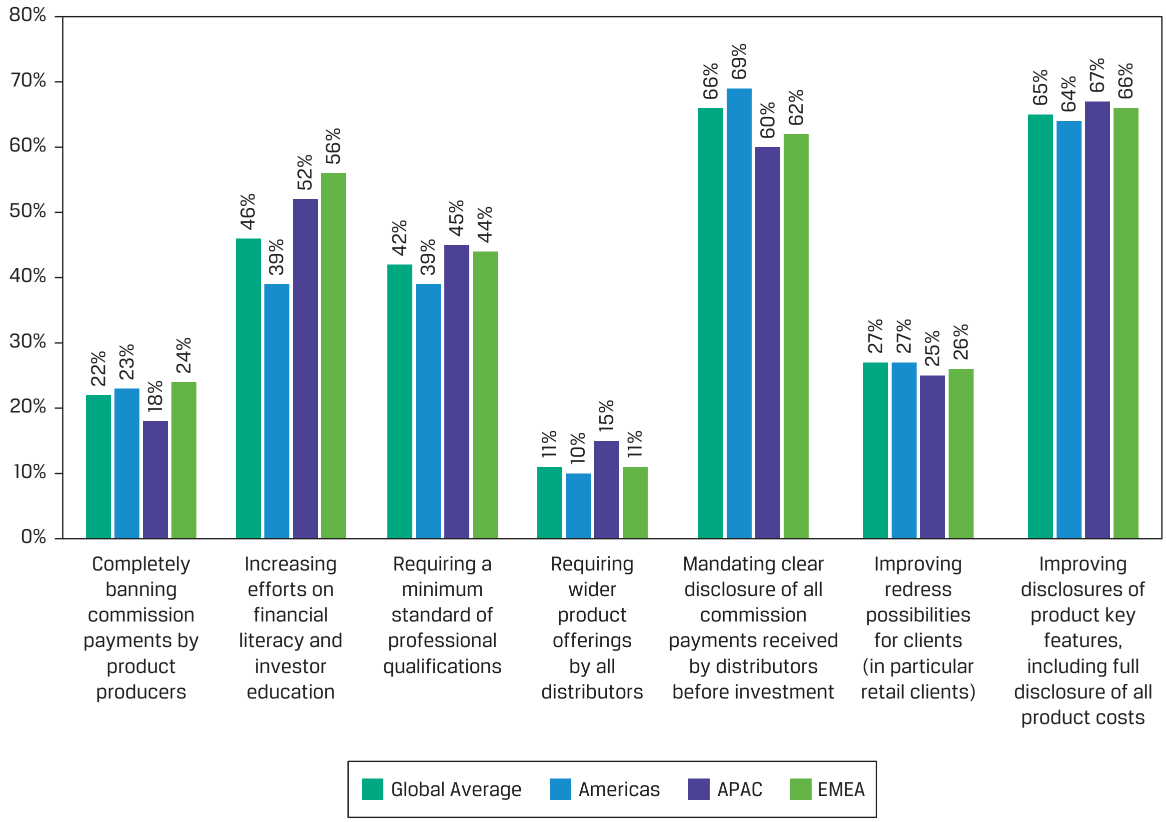


Exhibit 3. Responses to Question 3: Should Commission Payments to Financial Advisers in Respect of Retail Financial Products Be Banned Completely?

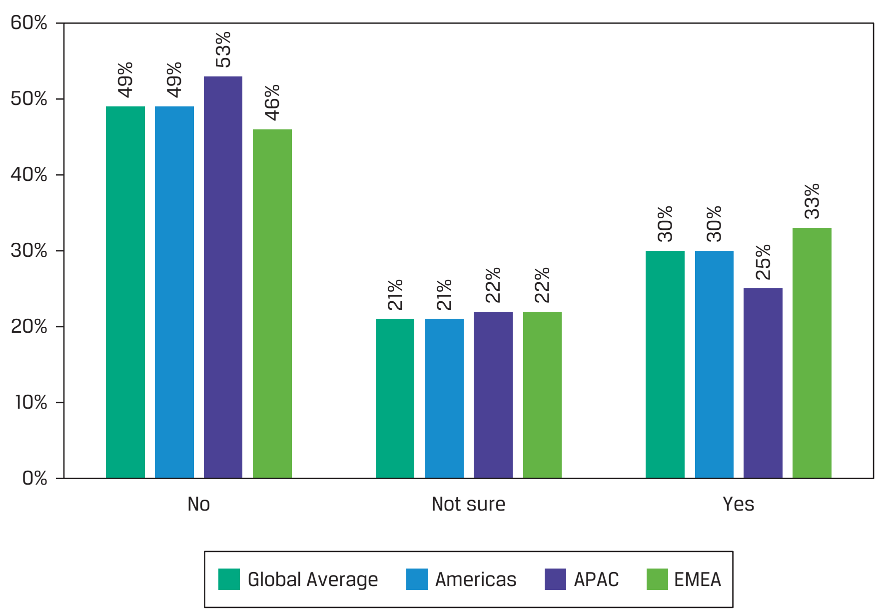
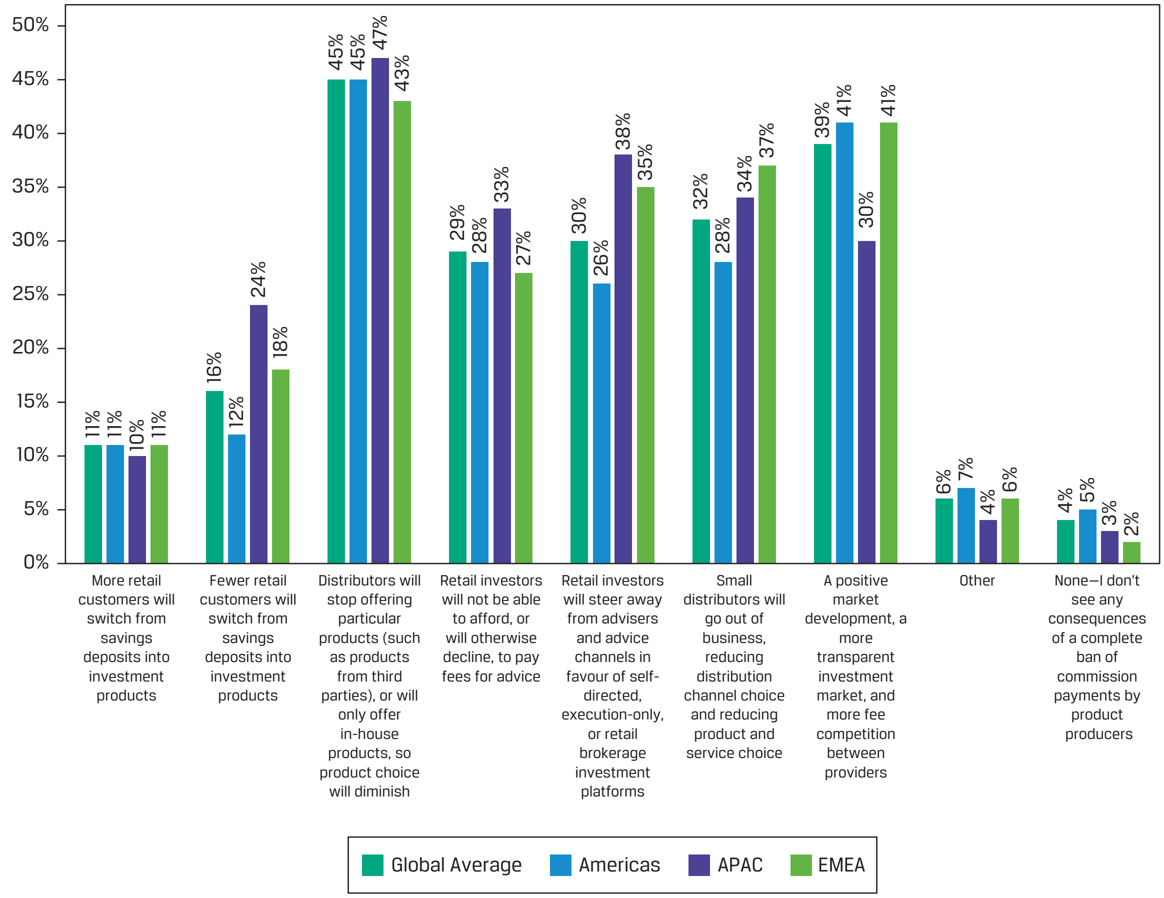


Exhibit 4. Responses to Question 4: If Commission Payments by Product Producers to Financial Advisers Are Banned Completely, What Consequences, If Any, Do You See Occurring as a Result?

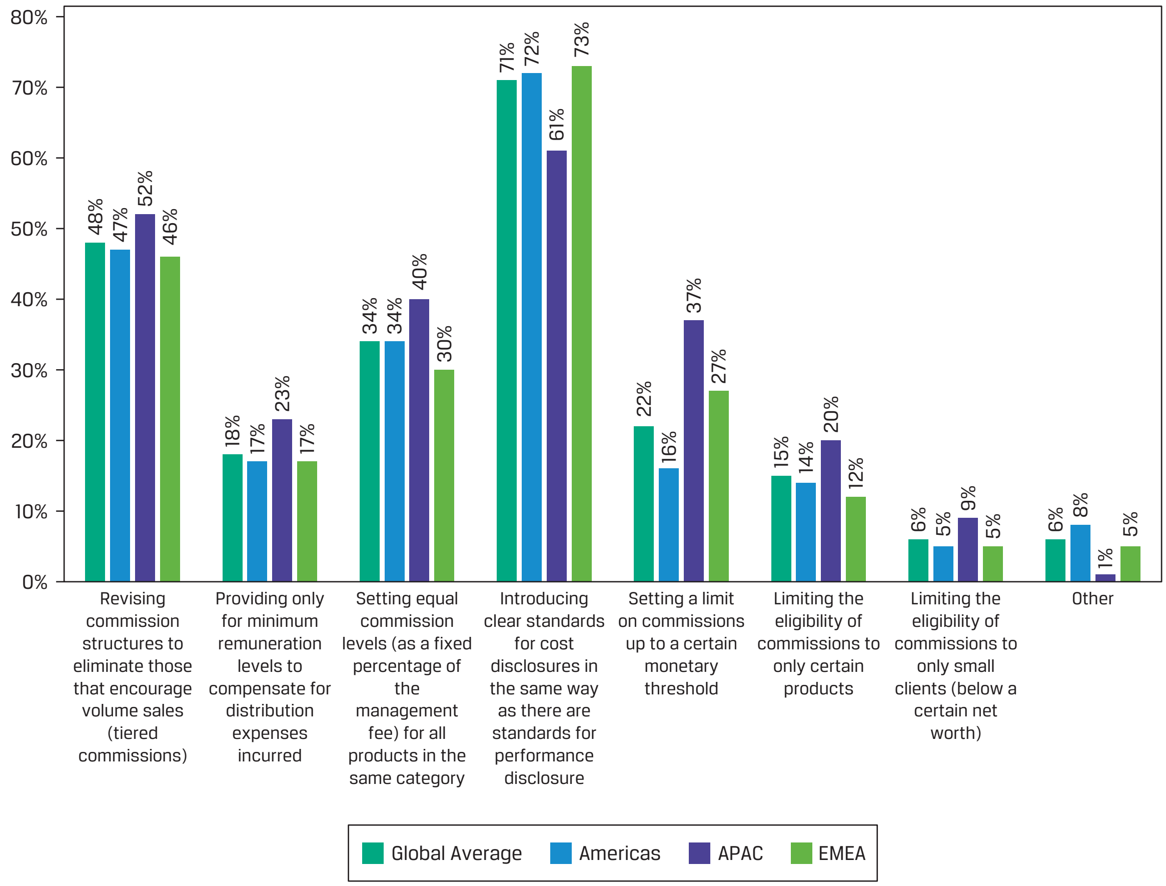


investment platforms. Such a development could encourage more self-directed trading, which is a practice that has been growing since the outbreak of Covid-19. Many investors may move to digital platforms that advertise zero-commission trading, which could lead to riskier investment solutions. CFA Institute recently published the study "Fun and Games: Investment Gamification and Implications for Capital Markets" (Ramachandran 2022), which analyses the use of gamification techniques in the investment industry and their implications for capital markets.

Question 5 concerns the way commission payments by product producers to advisers could be reformed without introducing a ban (**Exhibit 5**). The vast majority of CFA Institute members (71%) stressed that the most important regulatory measure would be to set up clear standards for cost disclosures in the same way as standards have been established for performance disclosure. Other popular reforms are to revise commission structures to eliminate those that encourage volume sales (48%) and to set up equal commission levels (as a fixed percentage of the management fee) for all products in the same category (34%).

The breakdown of responses by region shows no particular differences as members from the Americas, APAC, and EMEA regions underlined the same top three reforms regarding commission payments to advisers. Notably, a significant number of APAC members (37%) believe that setting a limit on commissions up to a certain monetary threshold could be a positive regulatory measure.

Exhibit 5. Responses to Question 5. How, If at All, Could Commission Payments by Product Producers to Advisers Be Reformed without a Complete Ban?



Question 6 asks whether commission payments to retail brokers by wholesalers in respect of brokerage services (i.e., payment for order flow) should be prohibited (**Exhibit 6**). Survey respondents do not have a significant view, as 39% of CFA Institute members globally would be against such a requirement, whereas 35% would be in favour. Looking at the responses by region, few members in APAC (23%) would approve a ban on inducements to retail brokers by wholesalers, compared with respondents from the Americas (39%) and EMEA (33%) regions, who do not have a clear opinion on the topic.

Question 7 concerns the possibility of requiring and enforcing a full disclosure requirement on all commissions and fees paid. CFA Institute members were asked whether such a measure would significantly contribute to solving mis-selling issues (**Exhibit 7**). Survey respondents overwhelmingly agree (81%) that a full disclosure requirement (with appropriate enforcement) on all commissions and fees paid could be helpful to combat the issues of mis-selling of financial products. A large majority of members from the Americas, APAC, and the EMEA regions also would fully support this requirement.

Exhibit 6. Responses to Question 6: Should Commission Payments to Retail Brokers by Wholesalers in Respect of Brokerage Services (i.e., payment for order flow) Be Banned?

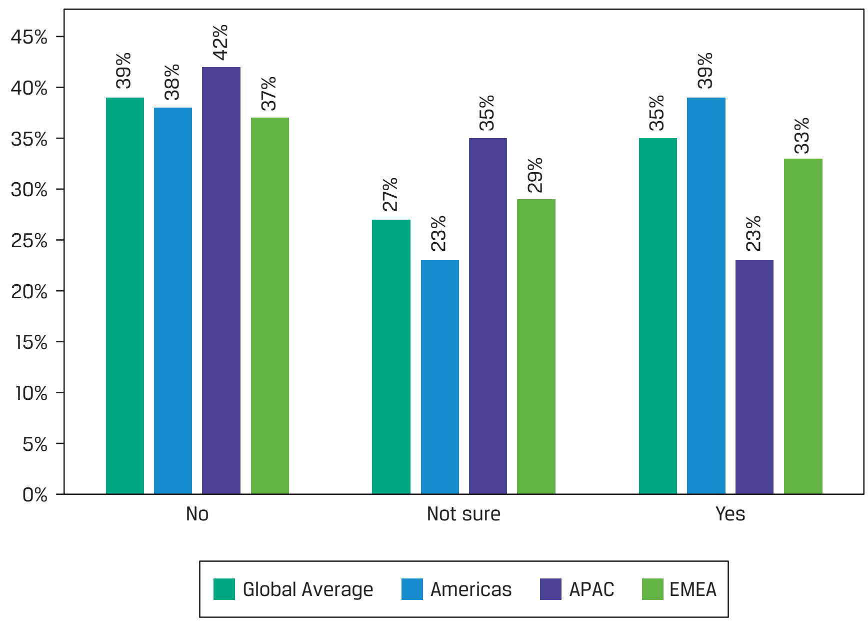
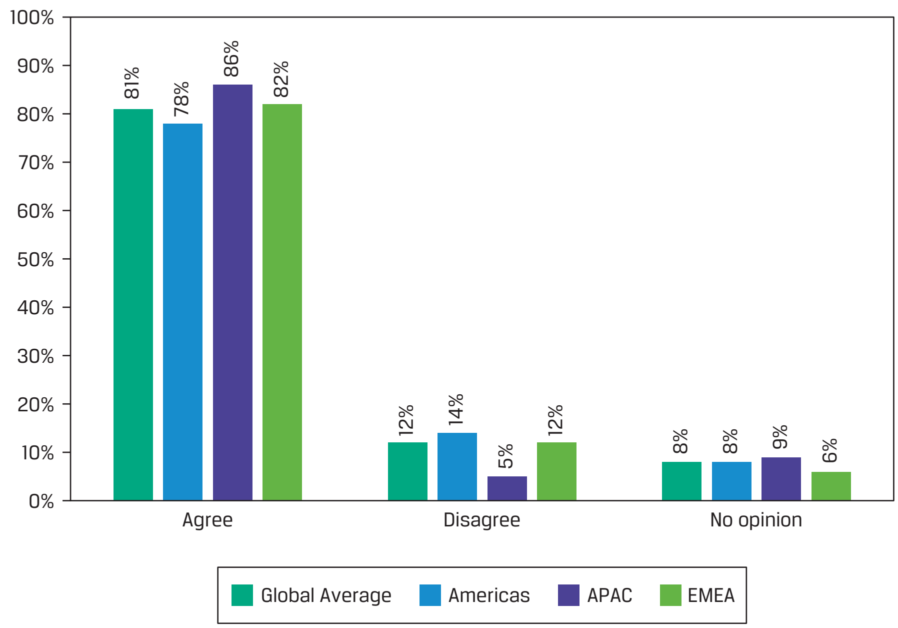


Exhibit 7. Responses to Question 7: Would Requiring and Enforcing a Full Disclosure Requirement on All Commissions and Fees Paid, and to Whom, Go A Long Way to Solving Mis-Selling Issues?



Box 1. Highlight: European Commission Study on Disclosure, Inducements, and Suitability Rules for Retail Investors

In July 2022, the European Commission et al. published the report "Disclosure, Inducements, and Suitability Rules for Retail Investors Study," which analyses the current investment environment for EU retail investors and the challenges on product costs, advice, and product provision.

In the section on inducements and investment advice, the study highlighted that the majority of surveyed consumers do not understand the concept of inducements. In addition, investors are mainly concerned with the overall product costs and are not very concerned about the costs of selling the products that are being passed on to them. Hence, disclosure of inducements does not seem to have an impact on the consumer's informed choice and does not make investors more vigilant about the advice received.

The report also underlined that a format that provides prominent information on inducements but fails to disclose that the institution has to have conflict-of-interest rules represents the best approach to the possibility that investors would reject inappropriate advice. However, the analysis also shows that the potential benefits from changing disclosure warnings likely would be minimal.

The study also looked at the effects of the ban on inducements in the United Kingdom and the Netherlands. It was found that:

- the product costs in these two markets have decreased, thus providing better value for money for consumers;
- many investors moved to execution-only products and access to advice has declined; and
- the level of retail investments has not been affected by the prohibition on commissions.

Source: European Commission, Directorate-General for Financial Stability, Financial Services and Capital Markets Union, D. Uličná, M. Vincze, M. Mosoreanu et al. (2022).

Question 8 focuses on the current level of investor education. We asked our global members whether a greater level of investor education is required for any regulatory moves associated with mis-selling to be effective (**Exhibit 8**). Nearly three-quarters (71%) of survey respondents agree with such a statement, whereas 18% disagree. Notably, a higher percentage of members from the APAC region believe that more investor education is needed (87% of APAC respondents compared with 74% of EMEA respondents and 66% of Americas respondents).

Question 9 asks CFA Institute members how serious they would consider a potential loss of distribution channels and/or the reduction of product range by distributors in case of restrictions or bans on commission payments (**Exhibit 9**). The survey results highlight a moderate concern about the possible lack of product diversity. About one-third (32%) of respondents are neither serious nor unconcerned about the negative impact of restrictions or prohibitions on commission payments, whereas 21% of our global members are a little concerned and 20% of these members are somewhat concerned. The breakdown by region shows similar results.

Exhibit 8. Responses to Question 8: Is Greater Investor Education Required for Any Regulatory Moves Associated with Mis-Selling to Be Effective?

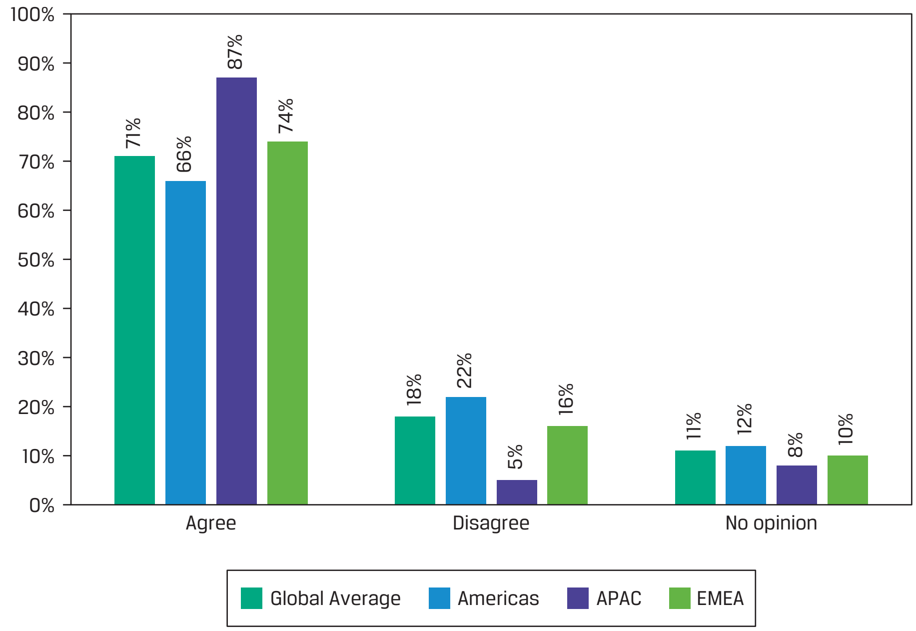
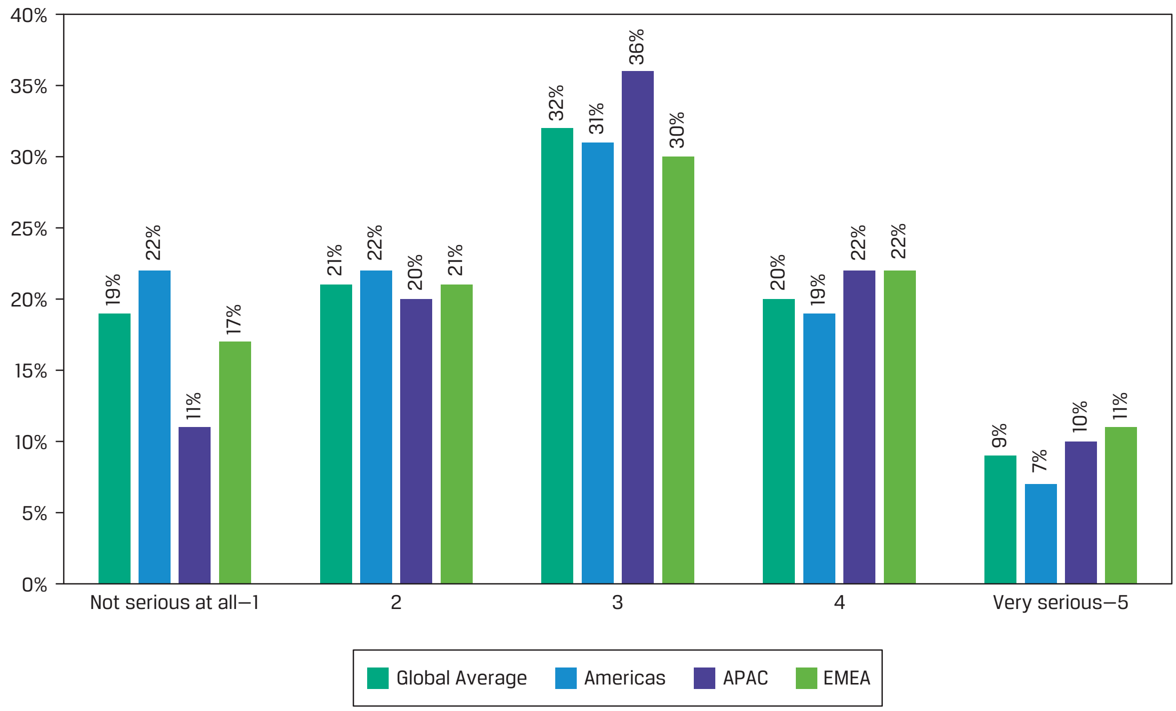


Exhibit 9. Responses to Question 9: How Serious (on a scale of 1 to 5) Do You Consider a Potential Loss of Distribution Channels and/or the Reduction of Product Range by Distributors in Case of Restrictions or Bans on Commission Payments?



Box 2. Regulatory Policies on Inducements in the Main Jurisdictions around the World

In the European Union, the Markets in Financial Instruments Directive II (MiFID II) covers a series of inducement requirements, including rules on conflicts of interest and payment for order flow. (See European Parliament and the Council of the European Union 2014.)

Under MiFID II, investment firms are restricted from paying or receiving benefits provided by a third party in relation to the provision of services to clients, unless such benefits are aimed at enhancing the quality of the service provided and do not impair compliance with the investment firm's duty to act in the best interest of the client. Moreover, when providing portfolio management services or independent investment advice, firms must not accept or retain benefits from third parties in relation to the provision of such services.

In 2013, the Netherlands introduced a complete ban on inducements for a series of financial services products, such as insurance, mortgage credits, and complex financial products. Since 2014, investment firms have been prohibited from applying commissions on all types of investment services provided to retail investors.

Since 2012, the United Kingdom has banned inducements related to the provision of independent advice or restricted advice on retail investment products.

European legislators are now considering the introduction of a prohibition on commissions in retail investment services. An amendment concerning the ban on the payment of inducements is currently being discussed by members of the European Parliament (Hübner 2022) in the context of the revision of the EU rules surrounding market structures and execution of client orders (namely, the Review of the MiFID II/MiFIR framework).

Payment for order flow is currently allowed in the United States. However, the US Securities and Exchange Commission (US SEC) is exploring whether the current system encourages conflicts of interest and, if so, whether this can be mitigated by stronger regulation (Gensler 2022). Currently, the US SEC does not seem to be considering a possible introduction of a ban on inducements.

In the Asia Pacific region, Australia and India are the two main jurisdictions in which the practice of commission payments is prohibited. Australia has banned inducements since 2012, while India has implemented a ban on upfront commissions since 2018. Hong Kong SAR and Singapore have decided not to introduce a ban on inducements, but they have put in place requirements to enhance fee transparency and mandate disclosure of potential conflicts of interest.

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Appendix

Question 1. In Your Opinion, What Are the Main Causes of Mis-Selling?

	Global Average	Australia*	Brazil*	Canada	China	EU	Hong Kong SAR*	Japan*	Switzerland	UK	US
Inappropriate commission payments by product producers	44%	54%	31%	50%	45%	39%	43%	48%	39%	50%	44%
Inappropriate internal remuneration structures at distributors (skewed toward volume sales or specific products)	65%	63%	77%	68%	53%	67%	50%	62%	50%	73%	64%
Selling pressure from other internal group entities	54%	54%	38%	54%	47%	56%	57%	81%	53%	55%	52%
Lack of professional qualifications among advisers	37%	29%	38%	41%	40%	37%	29%	38%	37%	32%	34%
Lack of transparency regarding product comparisons	43%	25%	38%	38%	41%	35%	29%	43%	34%	48%	50%
Other	6%	7%	3%	6%	0%	2%	0%	0%	8%	11%	7%

*We received less than 30 responses from economies marked with an asterisk (*). These results may not be large enough to allow for valid statistical inference and comparison with other markets.

Question 2. What Are the Most Important Reforms Needed to Combat Mis-Selling?

	Global Average	Australia*	Brazil*	Canada	China	EU	Hong Kong SAR*	Japan*	Switzerland	UK	US
Completely banning commission payments by product producers	22%	62%	17%	32%	14%	25%	8%	5%	31%	35%	20%
Increasing efforts on financial literacy and investor education	46%	38%	58%	39%	48%	59%	42%	70%	39%	55%	39%
Requiring a minimum standard of professional qualifications	42%	52%	42%	48%	48%	40%	33%	40%	39%	50%	36%
Requiring wider product offerings by all distributors	11%	19%	8%	12%	24%	8%	25%	5%			
Mandating clear disclosure of all commission payments received by distributors before investment	66%	67%	67%	67%	48%	55%	50%	55%	44%	78%	69%
Improving redress possibilities for clients (in particular retail clients)	27%	10%	17%	27%	18%	20%	8%	30%	14%	33%	28%
Improving disclosures of product key features, including full disclosure of all product costs	65%	33%	83%	61%	80%	55%	67%	55%	64%	68%	66%

*We received less than 30 responses from economies marked with an asterisk (*). These results may not be large enough to allow for valid statistical inference and comparison with other markets.

Question 3. Should Commission Payments to Financial Advisers in Respect of Retail Financial Products Be Banned Completely?

	Global Average	Australia*	Brazil*	Canada	China	EU	Hong Kong SAR*	Japan*	Switzerland	UK	US
No	48%	38%	50%	45%	52%	45%	91%	50%	42%	30%	49%
Not sure	19%	10%	42%	20%	26%	21%	0%	35%	14%	23%	21%
Yes	33%	52%	8%	35%	22%	34%	9%	15%	44%	48%	30%

*We received less than 30 responses from economies marked with an asterisk (*). These results may not be large enough to allow for valid statistical inference and comparison with other markets.

Question 4. If Commission Payments by Product Producers to Financial Advisers Are Banned Completely, What Consequences, If Any, Do You See Occurring as a Result?

	Global Average	Australia*	Brazil*	Canada	China	EU	Hong Kong SAR*	Japan*	Switzerland	UK	US
More retail customers will switch from savings deposits into investment products	11%	0%	8%	14%	11%	9%	11%	17%	11%	14%	10%
Fewer retail customers will switch from savings deposits into investment products	16%	20%	33%	11%	32%	17%	0%	17%	11%	8%	11%
Distributors will stop offering particular products (such as products from third parties), or will only offer in-house products, so product choice will diminish	45%	50%	58%	48%	45%	41%	22%	33%	29%	28%	44%
Retail investors will not be able to afford, or will otherwise decline, to pay fees for advice	29%	55%	33%	29%	23%	26%	44%	33%	23%	22%	28%
Retail investors will steer away from advisers and advice channels in favour of self-directed, execution-only, or retail brokerage investment platforms	30%	30%	17%	31%	45%	33%	56%	33%	34%	36%	24%
Small distributors will go out of business, reducing distribution channel choice and reducing product and service choice	32%	35%	42%	24%	32%	34%	44%	33%	34%	25%	29%
A positive market development, a more transparent investment market, and more fee competition between providers	39%	35%	17%	40%	23%	33%	44%	39%	57%	56%	44%
Other	6%	10%	0%	7%	2%	4%	0%	6%	3%	17%	7%
None—I don't see any consequences of a complete ban of commission payments by product producers	4%	10%	17%	5%	2%	1%	0%	6%	6%	3%	5%

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Question 5. How, If at All, Could Commission Payments by Product Producers to Advisers Be Reformed without a Complete Ban?

	Global Average	Australia*	Brazil*	Canada	China	EU	Hong Kong SAR*	Japan*	Switzerland	UK	US
Revising commission structures to eliminate those that encourage volume sales (tiered commissions)	48%	76%	44%	56%	32%	38%	63%	50%	36%	44%	45%
Providing only for minimum remuneration levels to compensate for distribution expenses incurred	18%	18%	11%	14%	23%	15%	0%	38%	18%	9%	18%
Setting equal commission levels (as a fixed percentage of the management fee) for all products in the same category	34%	53%	44%	43%	27%	28%	38%	44%	24%	26%	31%
Introducing clear standards for cost disclosures in the same way as there are standards for performance disclosure	71%	65%	78%	63%	59%	61%	63%	56%	67%	79%	76%
Setting a limit on commissions up to a certain monetary threshold	22%	24%	11%	20%	50%	20%	50%	38%	24%	26%	14%
Limiting the eligibility of commissions to only certain products	15%	24%	11%	12%	18%	11%	25%	13%	3%	18%	15%
Limiting the eligibility of commissions to only small clients (below a certain net worth)	6%	6%	0%	8%	18%	3%	0%	13%	3%	3%	4%
Other	6%	0%	11%	6%	0%	2%	0%	0%	6%	21%	8%

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Question 6. Should Commission Payments to Retail Brokers by Wholesalers in Respect of Brokerage Services (i.e., payment for order flow) Be Banned?

	Global Average	Australia*	Brazil*	Canada	China	EU	Hong Kong SAR*	Japan*	Switzerland	UK	US
No	39%	22%	40%	34%	45%	31%	50%	31%	35%	26%	39%
Not sure	27%	22%	50%	21%	39%	27%	25%	50%	24%	25%	23%
Yes	35%	58%	10%	45%	16%	42%	25%	19%	41%	49%	38%

*We received less than 30 responses from economies marked with an asterisk (*). These results may not be large enough to allow for valid statistical inference and comparison with other markets.

Question 7. Would Requiring and Enforcing a Full Disclosure Requirement on All Commissions and Fees Paid, and to Whom, Go A Long Way to Solving Mis-Selling Issues?

	Global Average	Australia*	Brazil*	Canada	China	EU	Hong Kong SAR*	Japan*	Switzerland	UK	US
Agree	81%	83%	78%	80%	88%	67%	63%	75%	79%	79%	78%
Disagree	12%	11%	11%	14%	7%	10%	0%	6%	15%	15%	14%
No opinion	8%	6%	11%	6%	5%	23%	38%	19%	6%	6%	8%

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Question 8. Is Greater Investor Education Required for Any Regulatory Moves Associated with Mis-Selling to Be Effective?

	Global Average	Australia*	Brazil*	Canada	China	EU	Hong Kong SAR*	Japan*	Switzerland	UK	US
Agree	71%	72%	100%	63%	93%	65%	75%	88%	68%	62%	66%
Disagree	18%	17%	0%	22%	0%	11%	25%	0%	21%	26%	23%
No opinion	11%	11%	0%	15%	7%	24%	0%	12%	11%	12%	11%

*We received less than 30 responses from economies marked with an asterisk (*). These results may not be large enough to allow for valid statistical inference and comparison with other markets.

Question 9. How Serious (on a scale of 1 to 5) Do You Consider a Potential Loss of Distribution Channels and/or the Reduction of Product Range by Distributors in Case of Restrictions or Bans on Commission Payments?

	Global Average	Australia*	Brazil*	Canada	China	EU	Hong Kong SAR*	Japan*	Switzerland	UK	US
Not serious at all—1	19%	22%	0%	14%	2%	12%	13%	19%	24%	38%	25%
2	21%	33%	0%	20%	24%	18%	13%	19%	35%	24%	23%
3	32%	17%	44%	33%	48%	29%	63%	31%	24%	18%	29%
4	20%	17%	44%	23%	17%	29%	13%	19%	9%	15%	17%
Very serious—5	9%	11%	11%	10%	10%	12%	0%	13%	9%	6%	6%

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