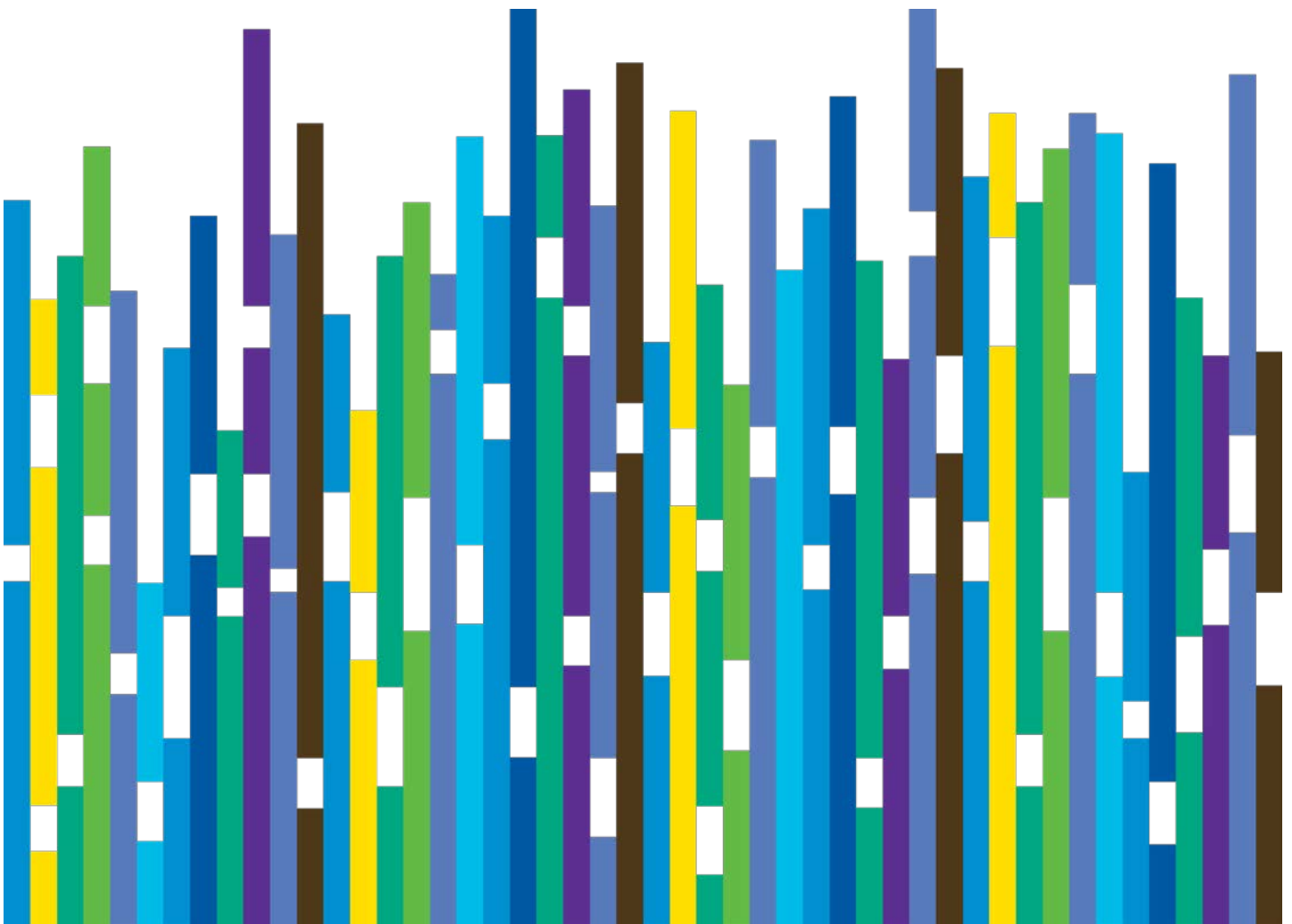


ISSUE BRIEF: RESTRICTING SALES INDUCEMENTS

Perspectives on the Availability and
Quality of Financial Advice for
Individual Investors



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Overview

In recent years, a number of markets, regulators, and policymakers have launched initiatives to improve access to financial advice by bringing greater transparency to the financial advice industry as well as addressing the problem of mis-selling. These initiatives have included improvements in the clarity required of financial advisers in reporting fees and conflicts of interest or, in some cases, limits or bans on inducements (payments, commissions, gifts, or kickbacks associated with the sale of investment products, often paid to advisers by distributors). Other markets are still in the evidence-gathering and decision-making stage, contemplating how best to combat mis-selling without a ban on inducements.

In markets that have banned inducements, larger financial institutions appear to be moving away from providing advisory services to smaller clients because of a lack of economic incentive to serve those clients. There is a concern among CFA Institute members that such middle-market retail investors will not have proper access to financial advice. In markets that ban commissions, new platforms with direct-to-consumer or low-cost/low-service investment options are expected to proliferate. This shift may result in aggressive direct-to-consumer advertising of financial products, a practice that may lead to instances of inappropriate investments sold to retail clients without proper oversight.

Commission vs. Fee-for-Service Model

Retail investors tend to prefer a commission model to a fee-for-service model, which complicates the move toward fee models in markets that have banned commissions and may result in a large underserved population. This preference for a commission model often arises from a misunderstanding of the fees charged through inducements or commissions. Often investors think financial advice paid through inducements is free. Investors often fail to understand just how much they are paying advisers, whether they are operating under a commission or a flat-fee structure. Greater transparency requirements and more investor education will help investors make better informed decisions.

A lack of proper enforcement of existing rules meant to combat mis-selling and inducement abuses is also a problem because a number of regulators lack either the resources or the ability to enforce investor protections already in existence.

Most of the reforms around inducements have taken place in the past few years. Investor behaviour and response to new products and advice schemes are not entirely predictable, and reactions in markets where reforms have been introduced should be closely observed. Regulators and lawmakers in markets considering inducements reforms in their markets would do well to pay attention to the consequences—intended and unintended — of inducement reforms already implemented in other markets.

Transparency should be part of any solution aimed at addressing mis-selling because simplified disclosures that give investors the information they need to make informed decisions can only improve the investment experience. Transparency should start with fee transparency, including a more informative breakdown of the fees that investors pay. Investors need to be informed about all the fees that they are

paying and about the origin of each of those fees (from the adviser, the distributor, or any other participant). It is also important to pursue uniformity in fee disclosures across jurisdictions to allow comparability of fees across markets, especially in the EU, where cross-border financial transactions are more common.

We also encourage financial advisers to invest in consistent and quality adviser training focused on fulfilling the needs of the client so that advisers can better understand their clients' goals and choose better products to help them reach those goals.

Inducements Survey

As part of our report on research on inducements, we surveyed CFA Institute members around the world. CFA Institute members who responded to this survey stressed the importance of improving transparency and disclosure and were wary of any policy reform that would diminish the incentives to open distribution networks or reduce the accessibility of investment advice for small retail investors.

In our survey, the two most popular solutions to mis-selling that did not involve inducement or commission bans were (1) revising commission structures to eliminate those that encourage volume sales (tiered commissions), and (2) setting equal commission levels (as a percentage of management fee) for all products in the same category. We encourage financial advisory firms to explore such reforms as self-regulatory mechanisms that can address some of the conflicts of interest in the adviser–client relationship without the need for outside regulatory forces.

See the full report on [*Restricting Sales Inducements: Perspectives on the Availability and Quality of Financial Advice for Individual Investors*](#) for more information.