



# Financial Services User Group (FSUG)

## Financial guidance – FSUG Recommendations

### Background

For most people, making financial decisions has never been so complicated for many reasons:

- Multiple professional changes during a lifetime, less and less linear careers and possible periods of unemployment affect the level and regularity of incomes and future pensions. Most retirement pension schemes, originally designed for people who had a linear career and few employers, are proving outmoded today;
- Increased number of separations and divorces that also affect the incomes and pensions of the people concerned.

All these changes are difficult to anticipate and require regular financial adjustments.

- More and more decisions have to be taken by individual consumers in many areas where default products previously existed (e.g. state or defined benefit pension) or services were provided by a single monopoly provider (e.g.: energy, telecommunications). If that has increased competition and lowered prices, it has also made consumers' life much more complicated. Nowadays consumers are expected to compare the advantages and disadvantages of multiple products and services including the most innovative, of which they have no experience, ask the right questions to sellers and challenge them if needed, detect any potential unfair commercial practice, read all the terms and conditions in advance before signature, and switch to another product or provider as often as possible if they find a better deal. That is not realistic. One should not forget that being a consumer is not a job but very often a one-time decision!

- In the financial area, products have become more numerous and increasingly complex over the years, but also often unsuitable to meet most of consumers' needs. In addition, distribution and sales of retail financial services is characterized by a high level of mis-selling practices and scams, which explains the low level of consumer trust in the financial services providers and their intermediaries (see EC consumer scoreboards).

- Financial services have also the characteristic of not being attractive per se but being boring. Consumers buy a financial service in order to achieve an objective (buying a house, insuring a car, financing a pension ...) not for the financial service itself. Few people are really interested in financial services, while the majority of consumers will have fun choosing a piece of furniture, an electronic device, a trip ...and will take time to do so. Shopping for financial services is no fun!

- For most people, it is difficult to develop an individual financial strategy, combine different types of measures or products together, assess the impact of their decisions in the long run, and not forgetting the tax implications of their decisions.

- In many areas, when we need advice, we have access to trusted advisors such as doctors, lawyers, notaries, tax advisors. We trust them because they are highly qualified and competent, and because they are fully centered on our interests when making recommendations. Why does financial advice not meet the same standards in most EU member states?

- Most so-called financial advisers working directly or indirectly (intermediaries) for the financial industry are primarily salespeople. In addition, the remuneration mechanism based on commissions handed back by financial product providers incentivises the so-called advisers to recommend the products generating the highest level of commissions.

- Responsibility is increasingly on the shoulders of consumers. The current discourse is to blame consumers and feel them guilty: if you do not take good financial decisions, this is because you are financially illiterate. Get trained! Public authorities widely supported by the financial industry consider that financial education is the best response to consumer difficulties to make good choices, while it has been shown in a variety of independent studies that financial education by itself has never helped consumers to take better decisions.

- Individuals cannot afford to make the wrong financial decisions, especially when it comes to long-term commitments (e.g. pension funding) and large amounts (mortgage loans). The impact of some decisions can only be seen in the medium or long term, sometimes too late or too costly to be reversible. The individual cost of a wrong decision can be detrimental for the financial health of anyone and lead to over-indebtedness or to a too low income at retirement time.

- The cost of wrong individual decisions for the whole society, such as mortgage loans in foreign currencies in Eastern Europe, should not be neglected as well.

For all these reasons, the FSUG members have considered that there is a real need to think about what would really and effectively help consumers make better financial decisions on the basis of existing good practices that have proven successful.

This is the reason why a study on 'financial guidance' was commissioned, following an invitation to tender issued by the European Commission on the basis of specifications drawn up by the FSUG members. A consortium led by the Observatoire de l'Épargne Européenne (OEE) was the successful bidder.

The study<sup>1</sup> was based on desk research, a literature review, an on-line survey and interviews in seven countries: Australia, Belgium, Denmark, France, Germany, the Netherlands and the United Kingdom, between January and July 2016. The researchers investigated the following aspects of financial guidance services: the nature of current provision; business models and funding; how services are promoted and use is incentivised; effectiveness and quality of services; regulation, quality assurance and access to redress.

### **What is financial guidance?**

The phrase 'financial advice', which forms part of the common language, has been totally overused to the point that in many Member States, almost anyone working for a financial institution or a financial intermediary in contact with retail customers can call himself a 'financial adviser' and provide so-called advice.

This is really an issue because most consumers cannot detect that most of the time they have in front of them salespeople mainly focused on achieving their own business goals and not advisers who center their recommendations independently on the consumer's needs and requests.

At European level, financial advice is subject to piecemeal regulations (investment advice in Mifid, advice related to Mortgages in Mortgage Credit Directive, advice related to insurance products in Insurance Distribution Directive) on few aspects (mainly the question of remuneration), which leads to a rather patchy and incomplete legal framework.

As reported in the study, some advisers consider that it would be hard to differentiate between regulated and non-regulated advice.

In order to avoid any confusion, the FSUG suggests using another terminology to name the type of advice that could really help consumers, namely 'financial guidance'. This terminology has the merit of not having yet been overused or used in a misleading way.

Financial guidance has to be understood as a process of determining an individual's financial goals, purposes in life and life's priorities, and after considering his resources, risk profile and current lifestyle, to detail a balanced and realistic plan to meet those goals. Financial guidance provides a detailed strategy tailored to a consumer's specific situation, for meeting a consumer's specific goals covering various aspects of personal finance which includes cash flow management, education planning, retirement planning, investment planning risk management and insurance planning, tax planning, estate planning and succession planning but excludes the recommendation to purchase a particular financial product.

The recommended measures can be of different nature. For instance: save more, consider cuts in the family budget, better prioritise spending, renegotiate the mortgage, repay consumer loans, take out life insurance to protect the family, start investing in retirement products, change car insurance, switch bank, sell the house for a smaller one, invest in non-financial assets, take advantage of tax benefits .... The financial plan can combine various measures and provide steps. Depending on individual circumstances, a plan may exclude any purchase of financial products.

The FSUG considers that the main criterion for differentiating financial guidance and financial advice is that financial guidance is completely disconnected, either directly or indirectly, at any time, from any sale of financial products, while financial advice is a similar process than described above but prior to the recommendation of one or more financial products. It means that financial advice and financial guidance cannot a priori be provided by the same providers.

The report highlights that financial guidance as defined above is not yet widespread. While many financial services firms claim to provide financial guidance to all their customers, only two bodies have been identified as fully meeting the definition: the German consumer association (VZBV) and a service set up by the British public authorities (Money Advice Service). Many Member States have made available to all consumers some tools on their websites that provide a first port of call for consumers, but they are insufficient in most cases to help them make a comprehensive and tailored decision.

### **Why is financial guidance desirable?**

The FSUG considers that the main benefits of financial guidance are the following:

- Enabling consumers, in particular people who cannot afford wealth management services, to make good decisions as they could rely on independent and qualified persons focused on their personal needs;
- Facilitating wider dissemination of simple financial products and better suited products to consumer needs (too complex categories of products are not intended to be recommended by financial guidance providers);
- Cleaning up the intermediation market: competition in the distribution of financial products does not benefit the consumer, but only intermediaries. If the financial guidance is

developed enough and consumers are satisfied with the service they receive, the intermediaries who provide no value to consumers should disappear from the market.

### What types of cases would benefit from financial guidance?

Here are few examples:

#### Case 1

A (aged 50) and B (aged 40) have been married for 15 years. Their 2 children are teenagers.

A works as a manager in a furniture store. B is employed part time by a public school.

Both pay 5% of their salaries into personal pension schemes, the contributions both being matched by their respective employers.

They jointly own their own home with a repayment mortgage outstanding (25% of the value). The mortgage is on a 3.69% fixe rate with ten years left to run.

They have a joint life first death level term assurance policy which runs for the next 10 years.

Their expenditure is only just being covered by their incomes.

They have made no allowance for university fees should their children wish to go.

The couple would also like to plan for their own retirement. They both intend to retire when they reach 65.

#### Case 2

C is 45 years old and lives alone. Last year, she was promoted to a higher grade. Her monthly salary has increased of € 400. She would like to pay back her mortgage faster. She also knows she needs to build savings for her retirement.

#### Case 3

D is 28 years old. He is employed and earns a good salary. He currently lives in a rented apartment but would like to own his own home. He is saving for a down payment and hopes to have saved enough in 3 years to buy a house.

D cannot afford to lose his money. His financial risk tolerance is zero.

#### Case 4

E is 70 and her husband, F is 75. When F retired 10 years ago, E and F owned their home having paid off their mortgage some years ago.

When F's health worsened 1 year ago, he had to move in to a nursing home. That means that E and F have two places to pay for on the same income. Almost all their pension payments go to the nursing home.

E uses their savings to pay her living costs, property taxes, transportation, and personal and medical needs. With so little income, she finds it hard to cover all her costs. And she worries about unexpected issues, like home repairs.

She would like to avoid selling their house and wonders whether a reverse mortgage could not be the best solution.

## What kind of services should be covered by financial guidance?

- *Regular financial check-up.* The objective would be to propose to anyone interested to assess his personal financial situation on a regular basis. In the same way that in some countries, all persons covered by social insurance can benefit from a health check-up for the purpose of prevention, e.g. every 5 years in France, any household should have access to a financial health check-up. This could help raise awareness on the need to act, to detect major omissions or errors, make adjustments or strengthen consumers in their decisions.
- *Developing a financial plan to achieve a particular goal on medium or long term:* course of action that may be combined with recommendations of some categories of products.
- *Response to a specific and immediate need:* buying a home, investing an inheritance or a pension pot.
- *Providing simple advice about products or categories of products before taking decision* without going as far as recommending a specific product from a specific provider.
- *Providing adequate information and tools to consumers in order to help them access to reliable financial advice.* The objective is to create a bridge to cover the gap between financial guidance and financial advice in particular for consumers who have no time or do not want to shop around to find the best deal. It could cover a wide range of services such as list of reliable brokers, comparative websites, 'robo' advisers and where to find model portfolios that match their profile and are built by trusted and independent organisations.
- *Providing a complaint service* to support consumers resolve disputes with their financial services providers.

### Recommendations

- Adopt a unique and comprehensive approach to the concept of financial advice in European legislation;
- Clarify with ESMA whether a pure asset allocation recommendation (i.e. invest x% in ETFs, y% in bonds...) without the recommendation of one or more specific product(s) falls within its definition of investment advice.
- Regulate the terms 'financial advice', 'financial advisers' and similar terms so that they are used only by those who are entitled to provide financial advice;
- Regulate the terms 'financial guidance' and create a legal framework for financial guidance to reassure consumers about the quality of service (including qualifications, accreditations, training, professional liability).

## Financing financial guidance

According to the existing literature reported in the study, consumers are not willing to pay to receive financial advice. The budget allocated to the study was not sufficient to interview a representative panel of consumers to get their opinion.

One suspects that the vast majority of consumers do not know that every time they buy a financial product, they remunerate the person who is recommending the product and sometimes they are doing it for the whole time of the product holding period. Consequently, they also ignore the amount, sometimes high, they pay for having been 'advised'. Even if consumers are aware, they sometimes may be willing to decide to pay commissions that

would be even higher than an upfront fee merely because the payment is staggered over a longer term and does not have to be paid at once/at the beginning of the investment. As long as it is so profitable for a financial advisor to get commission for the products he recommends, the FSUG is of the view that it will be difficult to develop independent financial advice, but also financial guidance activities. Furthermore, the FSUG is of the opinion that the remuneration disclosure requirements laid down in European legislation will not be sufficient to improve the quality of advice provided to consumers.

### Recommendations

- Put an end to the myth of free advice by requiring 'advisers' paid through commissions to communicate in writing the exact amount of commission to the consumer before 'recommendation' of any financial product, and not only for investment products covered by Mifid 2, PRIIPs and IDD (there is no obligation to disclose the amount of commissions in the latter legislation).
- Consider a consumer awareness campaign on the remuneration schemes used for distributing retail financial services in the EU and their costs for consumers;
- As a second step: banning remuneration systems based on commissions or kickbacks in the EU as has already been done in the Netherlands and the United Kingdom;
- Allocate fines paid for non-compliance with consumer protection legislation of financial services to the financing of financial guidance;
- Require the financial industry to pay a levy to finance financial guidance;
- Transfer the major part of national financial education budgets to finance financial guidance.

### **Who should provide financial guidance?**

The report also highlights the lack of a business case for financial guidance in the private sector at this stage, and that consequently public authorities are key to directly or indirectly encourage the development of financial guidance services, promote their use, share best practice within and across countries, and encourage a regime of skills training and accreditation and provide oversight.

As pointed out above, the FSUG is also of the opinion that this is the current mode of remuneration of intermediaries which hinders the development of true financial advisers or providers of financial guidance in the private sector.

It is still early to assess the effects produced by some national laws banning commissions (UK, NL) in particular as regards the quality and pricing of financial advice to consumers. As it is not an option to wait years before all Member States ban remuneration through commissions, the FSUG believes that public authorities should immediately take the lead to promote the development of financial guidance.

### Recommendations:

- Convince national public authorities they have a key role to play as a catalyst: comprehensive provision of financial guidance needs a national body to encourage the development of services, promote their use, share best practice within and across countries, encourage a regime of skills training and accreditation and provide oversight. Optionally, national authorities could provide financial guidance.
- Promote the financial guidance provider function in the private sector and launch a

- deeper analysis into business case opportunities.
- Create a network of consumer organisations and other organisations representing retail financial end-users capable of providing financial guidance (see VZBV) or at least some financial guidance services.

### **How to encourage consumers to use financial guidance?**

Demand for financial guidance does not occur spontaneously but needs to be stimulated. There should be public awareness activities, as well as specific incentives to encourage consumers to use financial guidance services.

#### Recommendations

- Launch an information campaign on the benefits of financial guidance with concrete testimonies and evidence;
- Develop self-assessment tools, decision trees for the simplest needs, or as a first response. These tools should be independent, readily accessible for free, and designed in such a way that they are easy to use;
- Support the development of digital means to provide financial guidance (e.g. as a first step or for straightforward questions) at lower cost to consumers.
- Adopt incentive mechanisms e.g. through a tax deduction;
- Provide a universal right to financial guidance at a small price e.g. every 5 years.