Maintaining equal opportunities in private asset formation – a plea for commission-based advice

- *In times of permanently low interest rates, investing in securities is an indispensable component of asset formation and private pension provision.*
- *Especially households with low and medium investment amounts (retail clients) often need to be actively introduced to securities.*
- *A recent study by KPMG[1] shows that this can only be achieved with commission-based advice; fee-based advice is exclusively a model for wealthier investors.*

Why investing in securities is so important:
In times of demographic change and low interest rates, participation of private investors in the capital markets is more important than ever. It is not without reason one of the explicit objectives of the EU Capital Markets Union (CMU). And experience shows that the model works: Net sales of retail funds in Europe, for example, amounted to EUR 3,400 billion over ten years. The performance of capital market-based investment products (e.g. investment funds) has been extremely positive in recent years, while holders of savings deposits have suffered real asset losses. A new KPMG study shows that, for example, an investor with a savings balance of just under EUR 17,000[2] has suffered a loss of purchasing power of EUR 800 over the past ten years. If this amount had been invested in the capital market, the client's assets would have increased by around EUR 7,000. This success story must not be put at risk thoughtlessly.

What role does commission-based advice play in this context?
Commission-based investment advice, which is entirely or partly funded by inducements[3], provides qualified, regulated securities advice that is accessible to everyone. It ensures that the entire population – including citizens with small investment amounts or in rural areas – has access to securities advice and can be introduced to the capital market. Commission-based advice thus has an important social component that is often ignored in discussions. For example, investors can invest in a securities savings plan for as little as EUR 25 per month.

Personal advice is important to the majority of investors
Despite increasing digitalisation, face-to-face contact with an advisor is still important for investors. More than 80% of respondents state in a recent survey that personal advice is "important" or even "very important" to them.[4] Less than one-fifth feels comfortable making investment decisions without professional support. The broad branch network of German banks and savings banks guarantees citizens access to personal securities advice. This service involves high costs for the institutions, which are financed proportionately by inducements.

Commission ban would lead to advisory gap for less wealthy investors
An (absolute) ban on commission-based advice would, on the one hand, make it more difficult to obtain personal advice (due to branch closures) and, on the other hand, create high personal hur-

[1] Study by KPMG: "The future of advice: a comparison of fee-based and commission-based advice from the perspective of retail clients", November 2021.
[2] Corresponds to the average financial assets of German private households according to the Bundesbank study on the economic situation of private households.
[3] Inducements are payments made by third parties to the investment services firm, e.g. by the product manufacturer, directly for the completion of a transaction.
[4] Representative survey by KANTAR (with 2,064 interviews), June 2021.

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dles for individual retail clients. This is because personal advice would then only be available for a fee. In Germany, the average hourly rate for fee-based investment advice is currently EUR 180. These costs are incurred even if the client does not purchase any securities after the advice.

Most investors, however, are neither willing nor able to pay such a fee. A recent survey[5] shows that 74 % of respondents are not willing to pay for advice. Only 0.3 % of respondents would be willing to pay the average hourly fee of currently EUR 180. In the event of a commission ban, the majority of citizens would thus only be left with the option of acquiring securities without advice or (continue to) stay away from the capital markets.

The current study by KPMG for the German market shows that in the event of a commission ban 35 % of respondents would no longer take advice at all. 38 % would do so less frequently and 24 % would buy fewer or no financial products. This would be a severe setback for the asset formation (and private pension provision) of large parts of the population and contradicts the explicit objective of the Capital Markets Union to increase the participation of retail investors in the capital markets.

The average investor can only invest limited resources in securities

Another aspect in favour of maintaining commission-based advice lies in the investment behaviour of retail clients and the costs of the two advisory models. The vast majority of retail clients can only invest small amounts. For example, securities savings plans play a large role in practice. More than half (54.6%) of these amount to less than EUR 100 per month, a quarter (28.3%) even to less than EUR 50. In the case of one-off investments in securities, 55.5% are less than EUR 5,000. This corresponds to the average fund assets of German households, which were (only) around EUR 6,000 in 2017[6].

This shows: Securities savings plans with small amounts are often the only way for retail clients to invest in securities and build up assets over the long term.

Cost advantages for retail clients in the commission-based advisory model

For small amounts – whether in connection with one-off investments or savings plans – fee-based advice does not pay off for investors. On the contrary, the commission-based advisory model has clear cost advantages. Based on calculation examples, KPMG found that, from a cost-perspective, fee-based advice can only be advantageous for investors for investment amounts of more than EUR 25,000. However, considering the typical securities savings plans of retail investors in Germany (from EUR 25 per month), the costs of fee-based advice are disproportionately high. The following sample calculation illustrates this: Based on the median financial assets of German households in 2017 (EUR 16,900[7]), the costs of fee-based investment advice are 50% higher than those of commission-based advice. However, for the average EUR 6,000 in fund assets, the costs of fee-based investment advice would in practice be four times as high as the costs of commission-based advice.

The UK and the Netherlands show negative effects of an absolute ban on commissions

In countries where inducements are already banned (i.e. the UK and the Netherlands), the advice gap for retail clients predicted by the study for the German market in the event of a commission ban is already a reality.

Research by HM Treasury shows that 69 % of advisers in the UK have already turned clients away. The most common reason for this was affordability, with 43 % of advisers turning away clients stating the advice services offered would not have been economic given the circumstances of those clients.[8] Medium and low net worth investors in particular can no longer afford to take advice. For example, 40 % of UK investment advisers have a minimum asset requirement, which is often GBP 50,000 (around EUR 60,000). The situation is similar in the Netherlands, where traditional investment advice is

[5] Representative survey by KANTAR (with 2,064 interviews), June 2021.
[6] Bundesbank study on the economic situation of private households.
[7] Corresponds to the average financial assets of German private households according to the Bundesbank study on the economic situation of private households.
[8] HM Treasury and FCA (2016).

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found almost exclusively in private banking and requires assets of up to EUR 500,000.

In other words: The gap between more and less wealthy investors is widening as a result of the commission ban. Retail clients are left to their own devices and no longer have any incentive to save for retirement. Apart from the serious consequences for individual investors, the decline in capital market participation misses an important objective of the European Commission's action plan for the creation of a Capital Markets Union, which is intended to create a framework for promoting the investment activities of retail investors.

Inducements are used exclusively in the interest of the client

Another aspect that tends to be overlooked in discussions about commission-based advice: Inducements are not profits. They must be used entirely for the benefit of the client. Inducements thus enhance the quality of services provided to clients (e.g. free access to market data and financial analysis, tools to support investment decisions, tracking tools for real-time monitoring of investments and much more). Strict regulatory requirements ensure that inducements are used only for this purpose. This includes full disclosure to the client of the receipt of inducements, the maintaining of a list of inducements received and the use made thereof, and high-quality conflict-of-interest management.

Conclusion: Preserving clients' freedom of choice!

A Europe-wide commission ban resulting in an advisory gap for retail clients must be prevented at all costs. Especially households with low or medium assets must be actively introduced to securities in times of permanently low interest rates and must not be left in the cold. In addition to the lack of acceptance of advisory fees, fee-based advice is also simply too expensive for these clients. Investors must therefore continue to have the choice between commission-based advice and fee-based advice.

Synopsis:

- Commission-based advice is available to everyone - regardless of their "wallet" or where they live.
- Commission-based advice has an important social dimension that should not be ignored in the discussion on the future of commission-based advice.
- A commission ban would further widen the gap between wealthy and less wealthy investors.
- In countries where commissions are banned (the United Kingdom and the Netherlands), such a scenario is already a reality: investors with small investment amounts are barely advised any more.
- Therefore, a choice between the two models - commission-based and fee-based advice - is the best option for the future.

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