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CSA CONSULTATION PAPER 81-408 – CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS

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Thank you for this opportunity to comment on CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions. While I strongly support the elimination of embedded commissions, I did not intend to participate in this consultation. Familiar with both the large body of work already developed by regulators on this topic and the many articles and op-eds dealing with this issue, I did not think that I could add anything new, different or worthwhile. However, after reading some of the initial comment letters submitted, I became intrigued and a bit concerned by the recurring references to the UK 'advice gap' in several submissions advocating for the retention of embedded commissions. Many of these commenters asserted unequivocally that the UK's decision to eliminate commissions was directly responsible for producing an 'advice gap', i.e. individuals unable or unwilling to pay for financial advice; and they proceeded to warn that Canada would suffer a similar fate if a decision were made to outlaw embedded commissions. Troubled by this worrisome prospect, I decided to learn more about the UK experience and particularly about the cause and nature of the advice gap. This comment letter offers me the opportunity to share what I learned.

The Retail Distribution Review (RDR) came into effect in the UK on December 31, 2012 and applied to every adviser across the retail investment market, including independent financial advisers. The most visible change for many clients was the introduction of explicit fees for financial advice. Historically, advisers relied on commission from product providers to pay at least some of the costs for advice. Regulators took the view that this could give rise to conflicts of interest and prohibited product providers from paying commissions directly to advisers.

Speculation in the UK about the potential emergence of an advice gap began prior to the introduction of RDR and intensified after its launch. Estimates of the size of the potential gap varied widely. In 2012, Deloitte calculated an advice gap of up to 5.5 million consumers, but only two years later Towers Watson estimated no advice gap at all. This confusion was amplified by data showing a decline in the number of financial advisers offering professional advice - from around 26,000 in 2011 to 24,000 in 2014; and an increase in the proportion of retail investment products sold without advice from about 40% in 2011 to 2012 to about two thirds in 2014 to 2015. Many observers blamed the fall in advice usage on RDR's elimination of commissions. They claimed that RDR had made advice less accessible by driving up its cost and reducing the number of advisers. However, many challenged this explanation of the UK advice gap as too simplistic.

Confronted with these conflicting views and inconclusive data, the UK government launched the Financial Advice Market Review (FAMR) in August 2015. FAMR began its work with a public consultation process that asked for evidence on "the extent and causes of the advice gap for those people who do not have significant wealth or income". This request generated a wide range of responses. One of the most emphatic assessments was offered by the Financial Services Consumer Panel (FSCP), the independent statutory body set up to represent the interests of consumers in the development of policy for the regulation of financial services (like the OSC's Investor Advisory Panel). The FSCP asserted that there was no evidence of a glut of savers looking for advice that it could not get. According to the FSCP "consumers do not always seek professional advice, even when they could benefit from it: some are not aware of what is available; they do not want to pay for advice because they do not understand the price or value of it; they cannot afford it; or they prefer to take decisions themselves." In a similar vein, Which?, a UK consumer group that promotes informed consumer choice in the purchase of goods and services, sampled 1,000 UK adults with between £10,000 and £50,000 available to invest and discovered that the demand for advice was not as high as some had thought. Their research found 67% of respondents had never considered using an adviser for advice on a specific investment.

The FAMR consultation also elicited the view that efforts to tackle the advice gap would be misplaced and that public policy should more appropriately focus on addressing the more serious problem, a savings gap. Others suggested that the advice gap would be more aptly described as a 'sales gap' that did widen when banks left the 'advice' market because their staff were generally poorly qualified and did not have a transparent charging structure. Furthermore, they were confident that individuals who need and value advice, rather than product sales, could find it; while any product sales gap left by the departure of the banks was being filled by online discount brokers. Still others suggested that there was enough adviser capacity to satisfy the current demand and the advice gap should be treated as a case of inadequate demand rather than supply. They claimed that the public had been dissuaded from advice in an environment where it was easier to borrow than save, and amid a constant barrage of scandals and fines. This group clearly believed that there was a needs gap, and a habit of longer-term saving had to be restored.

Admittedly, several respondents to the FAMR request, did attempt to provide evidence of an advice gap. They pointed to people who were being turned away by financial advisors that in the past would have served them. They believed that a lot of advisers were setting the bar for new clients much higher than before. However, the FAMR was not convinced by these arguments. In its final report released in March 2016, there was no suggestion that commissions should be reinstated. Instead, the FAMR recommended that regulators and government focus their efforts on supporting the development of new and more cost-effective ways of delivering advice and guidance to consumers through more effective use of technology. The FAMR also noted that absent a more trusting consumer engagement with financial services, it would not be possible to achieve a long-term, sustainable solution to making financial advice more valued by and accessible to consumers.

The FAMR made specific recommendations in three areas:

1. Affordability – Several recommendations were intended to allow firms to develop more streamlined services and engage with customers in a more effective way. These included a proposal to help firms develop mass-market automated advice models to bring them to market more quickly.

2. Accessibility – Several measures were designed to help consumers engage more effectively with advice. These included making their own information more easily available to them and those that advise them and the development of nudges to encourage customers to seek advice at key life stages.

3. Liabilities and consumer redress – Several recommendations dealt with increasing clarity and transparency about the way in which the Financial Ombudsman Service deals with consumer complaints and consumer redress.

These recommendations make clear that the FAMR did not regard the elimination of commissions as the root cause of the UK advice gap. Therefore, while the UK experience does highlight the issue of advice accessibility, it provides no succor for those commenters in the current CSA consultation championing the retention of embedded commissions. The UK review clearly rejected the notion that accessibility could be addressed by reinstating commissions and instead recommended several other initiatives, many of which Canadian regulator would do well to consider adopting.

I thank you once again for the opportunity to provide you with my comments.

Sincerely,

Harvey S. Naglie

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