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Chapter 3

Policy measures to improve the quality of financial advice for retirement

This chapter looks at policy measures which can be taken to help ensure that consumers receive appropriate financial advice for retirement. The measures include duty of care standards, disclosure requirements, and remuneration limits in order to mitigate conflicts of interest, qualification standards to ensure that advisors are competent to provide advice, and ensuring that mechanisms are in place to facilitate dispute resolution for consumers. The chapter discusses the objectives and potential effectiveness of each of these measures, along with their potential impact on the affordability and availability of advice. Finally, it proposes approaches to improve the effectiveness of these measures and reduce the impact on the accessibility of advice.

Individuals are bearing increasing responsibility for planning how they will finance their retirement. This planning involves the decision to save, the selection of investments and the determination of the best strategy for drawing down assets in retirement. Yet much evidence shows that individuals are ill-equipped to make such complex decisions on their own. Savings gaps are persistent, levels of financial literacy are low, and retirement planning in particular includes numerous variables that are uncertain, including future inflation, returns and longevity, which most individuals simply do not have the knowledge to assess. Furthermore, retirement products can be particularly complex and present features which may be difficult for the average consumer to easily understand.

Given the complexity of retirement planning, individuals need support or assistance to make the right financial decisions for retirement. Financial literacy and financial advice for retirement play a complementary role in guiding individuals to make better retirement decisions (Calcagno and Monticone, 2015; Debbich, 2015). Chapter 5 looks at how policy makers can support this process through financial education and initiatives to empower individuals themselves to take charge of their retirement planning. This chapter focuses on financial advice for retirement.

In light of the potentially important the role that financial advice can play in retirement planning, there has been an increased focus on the regulation of financial advice in recent years. Many jurisdictions have adopted, or are in the process of adopting, new regulations that aim to improve the quality of financial advice received. Measures implemented to improve consumer outcomes from financial advice revolve around ensuring the appropriateness of advice, the competency of the advisor, and consumer access to redress in the event of a complaint.

Measures implemented to address the appropriateness of advice focus on mitigating the conflicts of interest of financial advisors. Conflicts of interest can result in a bias in the advice to be more in the interest of the advisor than the consumer, and therefore have been of primary concern for regulators. Conflicts of interest most often relate to the way in which financial advisors are compensated for their services. Commission payments for selling certain products, for example, can incentivise advisors to recommend to their clients products paying higher commissions when a lower commission product may be just as suitable. Regulators have relied upon three main tools to mitigate the conflicts of interest faced by financial advisors: standards regarding the duty of care that advisors owe to their clients, requirements for disclosure of conflicts, and limits with respect to the remuneration that advisors can receive for their services. The resulting exposure of advisors to legal liability and other penalties from non-compliance aids in the enforcement of these measures and helps to align advisors' incentives with those of their clients.

Regulators are also placing more emphasis on qualification standards required to provide financial advice in order to ensure the competency of the advisor and to ensure that advisors have the knowledge and skills needed to provide appropriate recommendations to their clients.

Most jurisdictions also have dispute resolution schemes to resolve consumer complaints in an efficient and cost-effective manner. As these schemes form an important aspect of the process in which consumers can seek financial advice, regulators have also been looking to ensure their proper functioning.

While such measures can improve the quality of financial advice, ensuring that advice remains accessible and affordable remains a challenge. Regulators are increasingly looking towards technology as a potential way to improve the accessibility and affordability of financial advice as well as to provide an alternative to overcome advisor bias, and are making sure that regulation is in place to provide the same level of consumer protection as for traditional channels.

This chapter discusses measures that policy makers can use to improve the quality of financial advice for retirement.[1] It first looks at how financial advice is typically regulated and discusses the implications of the differences in the application of the regulation for different types of financial advice. It then provides some examples of the regulatory developments relating to financial advice over the last years in several OECD jurisdictions. The objectives and potential effectiveness of each of the measures to improve the quality of financial advice are subsequently discussed, relying on literature and real-world evidence where available. The chapter then considers the impact that these measures may have on the affordability and availability of financial advice, which may create an advice gap, along with policy measures which can be taken to reduce this gap. The report concludes with a discussion of policy implications to consider when implementing regulation to improve consumer outcomes from receiving financial advice for retirement.

3.1. Scope and application of the regulation of financial advice

Regulation generally differs across the potential sources of financial advice for retirement planning. Distinctions in the regulation of financial advisors can be important, as different types of financial advice serve different purposes and have different aims. However, such distinctions also raise numerous challenges to ensuring optimal consumer outcomes. In the best case, these distinctions can allow financial advice to meet the varying needs of consumers. In the worst case, an advice or protection gap can be created where certain types of advice are not readily provided or consumers are less protected. Policy makers need to be aware of the potential for advice and protection gaps to emerge as a result of the fragmented regulation of financial advice and take measures to reduce these gaps to the extent possible.

Defining the scope of regulation

The first issue that policy makers must address is what definition of financial advice is considered to be within the scope of regulation. The type of financial advice covered is generally classified based on the extent to which advice is a personalised recommendation and/or by the range of options considered in the advisor's recommendation.

The different types of financial advice can range from being objectively factual to being fully personalised to account for the individual's specific profile and circumstances. Factual advice or guidance is when factual information is provided with no recommendation, for example the provision of general information or education. General advice is the provision of a recommendation without consideration of personal circumstances. Personalised advice can be either simplified (scaled) or comprehensive. The former provides a recommendation for an

issue of limited scope for a specific individual, while the latter provides a recommendation taking into account all aspects of an individual's profile and personal circumstances.

Financial advice can also be classified depending on the range of options considered by the advisor. Execution-only services do not provide advice and simply take orders from the client. Restricted advice is provided based on a limited range of products or providers, while independent advice considers a wide range of product types from numerous providers.

There are differences across jurisdictions with respect to the type of advice that regulation of financial advisors considers to be in scope of its requirements. Generally, factual advice, guidance or education where no recommendation is provided to the consumer is excluded, as are brokers who provide an execution-only service. Some jurisdictions, as is the case in the United Kingdom, consider all advice where a recommendation is made to be in scope. Other jurisdictions, such as Australia and the European Union, consider only advice which is personalised to be within the scope of the regulation. A distinction is also often made between restricted and independent advisors, as is the case in the European Union and the United Kingdom, with different requirements imposed on each type of advisor. This distinction could be paralleled with the distinction between sales and advice, as proprietary advisors, who are restricted, arguably have the role of a salesman rather than an advisor. Following the recent introduction of the Conflicts of Interest Rule, the United States presents a case where requirements differ also depending on the purpose of investment, even for the same type of advisor. Broker-dealers providing recommendations for retirement plans are subject to more stringent duty of care standards than broker-dealers providing advice for other types of investments.

Regulation also generally differs depending on the type of product being recommended. The most common distinction is between retail investment products and insurance products, in part because the regulating bodies with jurisdiction over these sectors often differ. This distinction is especially relevant for retirement planning, where both investment products and insurance products, in particular annuity products, can play an important role in financing retirement. Some jurisdictions also make a distinction depending on the complexity or features of the product offered. This is the case for example in New Zealand, where not all types of advisors are allowed to recommend certain complex products,[2] and in the United States where variable annuities provided by life insurers are regulated as securities and are subject to specific suitability requirements.

Finally, regulation can differ depending on the type of client the advisor is providing recommendations to. The main distinction is between retail clients, usually individual investors, and wholesale clients who are presumed to have a higher level of financial knowledge. This distinction can result in different levels of protections offered to the different types of clients.

The importance of comprehensive and clear definitions of the different types of advice

First, the comprehensiveness of the definitions of what type of advice and advisors are covered by regulation is based is important to avoid protection gaps. For example, in Canada there is no real restriction on the use of the title of financial planner, and in general there is a lack of regulation concerning some aspects of financial planning. For example, in some provinces there are 'financial planners' who do not themselves sell financial products and are not overseen by the regulator or the other self-regulating bodies (Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives,

2016). This was also found to be a potential problem in the United States, where the existing regulation does not stipulate what activities financial planners are allowed to be engaged in (Financial Planning Coalition, 2014). Clients of financial planners may therefore be much less protected than they would otherwise expect.

Any ambiguity with respect to the definition of advice and the applicable regulation in a given situation can also result in a reluctance to provide advice. Employers, for example, would be the logical source of information for consumers with occupational pension arrangements. Yet in many cases, employers have been reluctant to provide any guidance or education with respect to investment within pension plans due to concerns over regulatory liability. The Financial Advice Market Review found this to be a concern for employers in the United Kingdom, and recommended to clarify the boundary of the regulation so as to clarify what assistance employers are able to provide (HM Treasury and Financial Conduct Authority, 2016). This was also found to be true in Canada and the United States with respect to the offering of annuity products within employer sponsored plans. The United States reacted by clarifying the obligations of the employer to assess the annuity provider's financial viability and has defined a statute of limitations after which legal action cannot be taken against the employer, and Canada has proposed guidelines for providing standardised product information. The United States also enables employers to shield themselves from liability for the consequences of individuals exercising control and making their own investment decisions provided that certain conditions are met.

The line between simplified/scaled and comprehensive advice has also proven to be a barrier for consumers to have access to advice for simple needs more limited in scope, such as the advice of which funds to invest in within a retirement plan. In the United Kingdom, for example, despite having regulation applicable expressly for simplified advice for issues of limited scope, the Financial Advice Market Review (FAMR) found advisors were still reluctant to provide it in part due to liability concerns. The FAMR therefore recommended that the regulator provide further guidance for advisors to provide 'streamlined' advice (HM Treasury and Financial Conduct Authority, 2016). In New Zealand, the lack of an explicit boundary between scaled and comprehensive advice made advisors providing personalised advice reluctant to simplify their due diligence with respect to the client. As a result they would only offer fully comprehensive advice, resulting in a more costly service than consumers with simple needs were willing or able to pay (New Zealand Ministry of Business, Innovation and Employment, 2016b).

Potential implications of differences in the application of regulation

Different applications of regulation to different types of advice also present a risk that an uneven playing field could result. Moreover advisors could cherry-pick the type of advice they provide to avoid more stringent regulatory requirements. This was found to be a concern in New Zealand, where an advisor could avoid higher costs of compliance by limiting their advice to general advice only and not providing personalised advice (New Zealand Ministry of Business, Innovation and Employment, 2016b). This was also found to be the case in the United States, where advisers could avoid fiduciary duty by side-stepping one of the five conditions defined by the 1975 rule under ERISA (US Department of Labor, 2015). While the recent Conflicts of Interest rule expands the application of fiduciary duty in the United States to all retirement accounts, an opportunity for broker-dealers to avoid these requirements by not serving the retirement market may still exist until the SEC follows through with its promised regulation for a more uniform fiduciary standard for all broker-dealers.

Regulation differing across types of products or channels also presents a risk of cherry-picking. For example, when disclosures were introduced for a specific product in India, advisors began recommending an alternative high-commission product which did not require disclosure (Anagol, et al., 2013). To the extent that investment and insurance products are regulated differently, clients could become over or under-annuitised depending on the profitability of recommending insurance or not. Australia recognised the uneven playing field between retail investment advice and insurance in its recently proposed Life Insurance Reform Legislation, which intends to level the playing field between retail investment and insurance products.

Another concern is the extent to which such differences across channels could potentially result in a shift in the structure of the market. Different regulation for proprietary (or restricted) advisors compared to independent advisors could result in a competitive advantage for the former, incentivising firms to vertically integrate their businesses (Lortie, 2016; Valentine, 2013).

Finally, differences in regulation of financial advice can lead to consumer confusion about what standards are applicable for the advice they receive. In the United States, consumers demonstrated a lack of awareness regarding the differences in the types of advisors and services they offer (Financial Planning Coalition, 2014). Furthermore consumers are unaware of the standards applicable to a given type of advisor. One study in the United States showed that only 3% of consumers were aware of which advisors were subject to fiduciary duty and only 5% were aware of which advisors were required to disclose any conflicts of interest faced (Burke and Hung, 2015). A review conducted by the Financial Conduct Authority in the United Kingdom revealed a lack of understanding by consumers of the difference between restricted and independent advice (Financial Conduct Authority, 2014).

The fragmentation of regulation across different types of advisors and products can result in certain types of advice not being available to consumers or a lack of consumer protection in certain situations. While differences in regulations may be necessary to a certain extent, these advice and protection gaps should be minimised. Policy makers should keep these issues in mind when implementing tools to regulate financial advice.

3.2. Regulatory developments in financial advice

Regulators across OECD jurisdictions have been making efforts to improve consumer outcomes from receiving financial advice and address the challenges raised in the previous section. Several regulators are also opening the discussion to the evolving role of technology to increase the accessibility and affordability of financial advice and to ensure that the regulation in place is sufficient to ensure consumer protection. This section provides some examples of recent measures that have been taken in several OECD jurisdictions to provide an overview of the types of policies which are being implemented.

The Future of Financial Advice (FOFA) regulation was passed in Australia in June 2012, with implementation mandatory from July 2013. The legislation focused on mitigating conflicts of interest through limits on remuneration from commissions and improving disclosure standards for retail financial advice. The Life Insurance Reform Legislation, published in December 2015, proposed to extend the regulation of remuneration to advice for life insurance products. The regulator also issued a regulatory guide to ensure consumer protection with respect to robo-advice in August 2016.

The Client Relationship Model – Phase 2 (CRM2) entered into force in Canada in July 2013 and was gradually implemented through July 2016. The regulation aimed to improve reporting and disclosure standards for clients particularly with respect to costs and fees, including advisor compensation. Rules established by the industry's self-regulating bodies have been harmonized to align with the new regulation. In addition, the Canadian Securities Administrators (CSA) published a consultation paper in April 2016, following the initial consultation in 2013, proposing regulation regarding the introduction of a statutory best interest duty towards retail clients.

The Danish Act on Insurance Mediation passed in 2006 targeted the remuneration of independent insurance brokers in Denmark, who serve as the main intermediaries for occupational pension schemes.

In the European Union, the revised Markets in Financial Instruments Directive (MiFID II) was approved mid-2014 and is planned to be implemented in member states from January 2018. It seeks to improve upon the original MiFID regulation implemented in 2007, particularly with respect to consumer protection issues and shortcomings revealed during the financial crisis. The Insurance Distribution Directive (IDD) was published in February 2016, with implementation planned for February 2018. It applies to all insurance undertakings and intermediaries who can sell directly to their customers. Both regulations put forward standards with respect to duty of care, qualification of intermediaries, remuneration and disclosure requirements. The European Supervisory Authorities have also issued a joint discussion paper on the automation of financial advice looking at the potential benefits and risks of such innovations. The objective of this paper was to determine any additional regulatory action needed to address automated financial advice (Joint Committee of the European Supervisory Authorities, 2015).

The Finnish Insurance Mediation Act, which targeted the remuneration of independent insurance brokers in Finland, came into force in 2005 and became fully effective in 2008.

In Germany, the Act to Strengthen Investor Protection and Improve the Functionality of the Capital Market became effective in November 2012 and addressed required disclosures and advisor qualifications. The Fee-Based Investment Advice Act, effective in August 2014, created a legal class of independent advisors who do not receive potentially conflicted remuneration (Burke and Hung, 2015b).

An Amendment Decree Financial Markets in the Netherlands, banning commissions for all financial advisors, entered into force in 2013.

In 2016, the New Zealand government proposed several modifications of the 2008 regulation of financial advisors in order to address the identified shortcomings. Planned changes include the simplification of advisor classifications, extending requirements to provide advice in the consumer's best interest and improving disclosure requirements. In addition, the changes seek to broaden the definition of advice in order to accommodate technological innovations, and require that entities providing such robo-advice be licensed and held to the same requirements as other types of advisors. (New Zealand Ministry of Business, Innovation and Employment, 2016).

The Retail Distribution Review (RDR) came into effect in the United Kingdom in January 2013, forbidding financial advisors from receiving commission payments and increasing qualification standards. The regulation on remuneration and transparency was extended to platforms in April 2014. The Financial Advice Market Review, completed in March 2016, made

several recommendations to continue to improve the affordability and accessibility of financial advice. To embrace the use of technology in providing advice, the regulator launched "Project Innovate" to encourage firms to develop lower cost advice models aimed at the mass-market, particularly with respect to simplified advice to help address the advice gap. Following this review the Financial Conduct Authority is establishing an Advice Unit to assist in the development of such models (HM Treasury and Financial Conduct Authority, 2016).

The Dodd-Frank Act of 2010 charged the United States Securities and Exchange Commission (SEC) with assessing the effectiveness of the current regulation in ensuring appropriate financial advice for consumers. The SEC was asked to consider making the regulation regarding fiduciary duty consistent for all types of financial advisors, though the SEC has yet to do so and any adopted framework would not change the existing requirements under ERISA for advice on tax preferred retirement investments. Beginning in 2009, the Department of Labor undertook a project to address the problems of conflicts of interest in financial advice for retirement, and in April 2016 it published a final Conflicts of Interest Rule which extends fiduciary duties to all types of advisors providing financial advice for all types of retirement plans. With respect to technological innovations, FINRA, the industry self-regulatory body, recently published a report to clarify the application of its rules with respect to digital investment advice and share effective practices (FINRA, 2016). A new rule proposed by the SEC would require developers of algorithmic trading to be registered as a securities trader, and be subject to the same qualification requirements as securities traders.

These policy measures have generally sought to improve and update existing regulation to account for the current financial realities. The discussion that follows will assess in more detail the advantages and challenges of each of types of tools implemented, drawing on examples from the measures taken in the various jurisdictions in addition to evidence found in the literature as a basis for this discussion.

3.3. Policy measures to improve consumer outcomes from financial advice

Policy makers have implemented several measures to make sure that financial advice leads to optimal outcomes for consumers. First, there are measures to mitigate any conflicts of interest that the financial advisors may face. These are duty of care standards, disclosure requirements and explicit limits on remuneration structures. These three measures are complementary and are generally combined when implemented in order to improve their effectiveness. Secondly, policy makers can ensure the competency of the advisor to provide quality advice by establishing qualification standards for financial advisors. Finally, dispute resolution facilitates consumers' access to redress in the event that poor financial advice is received, and can lead to the imposition of liability on advisors for failure to provide appropriate financial advice, which aids in the enforcement of the requirements.

Policy measures to mitigate conflicts of interest in financial advice

Mitigating the conflicts of interest in financial advice is of primary importance for improving consumer outcomes. The influence of the financial advisor on consumers' decisions can be significant, and consumers tend to trust the financial advice provided to them. Moreover, consumers often lack awareness of any potential bias in the advice they receive. A survey of eight EU member states found that 58% of investors felt that their investment decision was influenced by an advisor's recommendation, and the majority of investors reported high levels of trust in their advisor (Chater et al., 2010). Over half of the consumers felt that their advisor had no bias, and over a quarter of individuals did not even

consider any potential conflicts of interest that their advisor could face (Chater et al., 2010). Measures to ensure that advice is appropriate and to mitigate conflicts of interest must therefore be the foundation of any policy to improve consumer outcomes from financial advice. The main policy measures implemented to mitigate conflicts of interest are duty of care standards, disclosure requirements and limits on the remuneration that advisors receive.

Duty of care standards

Duty of care standards impose legal requirements on financial advisors to act ethically when providing a recommendation to a client. Basic requirements, including for general financial advice, usually include an obligation for the advisor not to mislead or deceive the client and to act with care, skill and diligence in providing a recommendation. On top of these requirements, an advisor providing personal advice is usually required to perform some sort of due diligence to ensure that the advice is appropriate for a particular client. This involves taking into account factors such as age, personal situation, financial situation, financial knowledge, investment experience, risk appetite and investment objectives. The specific factors required to be considered can nevertheless vary from one jurisdiction to the next. Generally speaking, however, the extent to which these factors need to be taken into account is defined through either a suitability requirement or a best interest requirement.[3]

Suitability requires a recommendation to be reasonable given the personal situation of a client, but not necessarily that it is the best product for their needs. Suitability does not require that advisors put the client's best interest above their own. As such, a product paying a higher commission could be considered as suitable as the otherwise equivalent lower commission product. Suitability also allows for a reduced option set to be considered, as the advisor is not required to consider all possible types of products, but to simply believe that the one recommended is appropriate.

Suitability requirements are more compatible with some type of advice than others. Sales-only or restricted advice is more often subject only to a suitability requirement, as are insurance agents. One reason for this is that the range of options they consider in their recommendation is limited.

However, providers of products can also be held responsible for insuring suitability rather than placing full responsibility on the advisor, mitigating somewhat this conflict of interest. In the United States, the insurance provider is responsible for making sure that the appropriate procedure is in place to determine suitability. The Insurance Distribution Directive (IDD) in Europe introduces an additional suitability check by requiring that providers ensure that the products developed are appropriate for market that the product targets given the typical risks this market faces.

Less common is a requirement that intermediaries ensure suitability even for non-advised transactions. The Mutual Fund Dealers Association (MFDA) in Canada requires that members should determine suitability even for unsolicited transactions, and where the transaction seems unsuitable they must inform the client.

Best interest, on the other hand, requires that advisors provide the best recommendation for the client given the client's needs, and that advisors put the client's interests ahead of their own. As such, best interest requirements inherently imply that advice be free from bias, making conflicts of interest an important issue to address.

The approach to address conflicts of interest can range from prohibiting conflicts of interest altogether to requiring the appropriate management of the conflicts in order to

prevent potential harm to the client. Written conflicts of interest policies may also be required to formalise the internal procedures for managing any conflicts of interest. Regulation in the United States prohibits conflicts of interest unless appropriate consumer protections are in place to mitigate the potential impact of the conflict of interest. The Investment Industry Regulatory Organization of Canada (IIROC) takes the reverse approach, and first requires that members have a written conflicts of interest policy requiring that advisors should address conflicts of interest in a fair and transparent manner in the best interests of their client, and then if this is not possible the conflict of interest should be avoided. The IIROC provides guidance on how conflicts of interest can be addressed, but the rule remains principle-based and flexible.

A best execution standard, required by MiFID II in Europe, takes another approach to addressing conflicts of interest. This standard is enforced in addition to a suitability requirement, and requires that all sufficient steps must be taken to obtain the best product for the client, considering all costs, including commission.

Regulation in many jurisdictions is currently moving towards a more uniform and broad application of a best interests standard and the establishment of formal procedures for mitigating any conflicts. Canada and New Zealand are considering implementing more uniform best interest standards for all types of advisors. The United States recently issued a rule extending best interest standards to all types of advisors providing advice for retirement, and are considering extending this to all broker-dealers. The IIROC in Canada and MiFID II in Europe both require a written conflicts of interest policy to be in place, and MiFID II requires that this policy be reviewed annually.

Enforcement of duty of care standards[4]

The success of duty of care standards to improve consumer outcomes will in part depend on the extent to which advisors fully comply with due diligence requirements and the effectiveness of the conflicts of interest policies to identify and mitigate all potential conflicts the advisors face. As the continuous monitoring and enforcement of standards on an individual or transactional basis is normally not feasible, targeted reviews using methods such as mystery shopping can be one tool for supervisors to use to ensure compliance. Such exercises can also help to identify where the regulatory requirements may not be sufficiently clear, and be used as an opportunity to provide feedback to advisors regarding the quality of their advice.

Several jurisdictions have performed investigations to assess how well financial advisors assess the suitability of their recommendations to clients. One such investigation employed mystery shoppers to assess the quality of advisors' recommendations given the requirements in place under the Markets in Financial Instruments Directive (MiFID) for European Union member states (Synovate, 2011). The study found that less than 10% of advisors gathered sufficient information to make a suitable recommendation, particularly with respect to the client's financial knowledge, experience investing and financial situation. Furthermore most advisors were not sufficiently comprehensive in assessing the risk profile of the client and did not clearly explain the risks of the recommended product. However, the due diligence of advisors tended to be more thorough in member states which were more financially developed. Nevertheless, the majority of recommendations were deemed to be unsuitable, primarily due to high levels of risk (Synovate, 2011). A more recent investigation carried out in the United Kingdom found that while in general advisors demonstrated good practices, this was not consistent across firms and there were

several instances of poor due diligence (Financial Conduct Authority, 2016b). A study in the Netherlands found that 40% of banks and investment firms did not collect sufficient information on their clients to be able to make a suitable recommendation (AFM, 2016).

Reviews of the effectiveness of policies to manage conflicts of interest have found similarly disappointing results. A review of IIROC members in Canada found that in many cases the conflicts of interest policies in place were not adequate to effectively identify and address conflicts of interest (IIROC, 2016). The Financial Conduct Authority found that advisors in the United Kingdom were often not effectively managing the conflicts of interest they faced, as demonstrated by their platform selection for clients (Financial Conduct Authority, 2016b).

Even where regulatory requirements are clear, however, another explanation for the lack of effectiveness of policies to manage conflicts of interest is the potential lack of awareness of advisors that they are acting in their own best interests. Bias is very difficult for individuals to correct, even when making a conscious effort to do so, and individuals are often not aware of the extent of their bias (Moore, et al., 2010). Furthermore, individuals often do not believe that they are biased even when their actions point to the contrary (Bazerman, et al., 1997). Self-interest is an automatic and unconscious process which is difficult to overcome with the controlled thought processes which are used to apply ethical and professional standards, and automatic processes tend to override those which are controlled.

Indeed evidence indicates that social norms and culture play an influential role in the effectiveness of policies to manage conflicts of interest. The Financial Conduct Authority found that firm culture plays an important role in the effectiveness of the due diligence process, and firms with a culture to challenge the status quo demonstrated better due diligence processes (Financial Conduct Authority, 2016b). A review by the Central Bank of Ireland on investment firms found that those with a stronger culture of compliance were more aware of the conflicts of interest and better managed these conflicts (Central Bank of Ireland, 2016). Another study on registered financial advisors in the United States found that firms who hired financial advisors with a record of misconduct were also more likely to have higher rates of past misconduct, and that misconduct at the top levels of the firm increases the likelihood of the misconduct of advisors (Egan et al., 2016).

The influence of culture and social norms implies that there should be a role for professional bodies to set standards that their members are expected to follow in order to establish positive social norms for the advisor profession. Because of a lack of awareness of bias, even the threat of legal consequences may need to be complemented with other mechanisms to be fully effective in mitigating conflicts of interest. Social norms influencing advisor and firm culture are likely to be more influential, as internalising ethical and professional standards would help these values to become a part of the automatic thought process to more effectively mitigate bias (Moore and Loewenstein, 2004).[5]

Challenges to the implementation of duty of care standards

Critics of extending the best interest standard cite concerns that more stringent duty of care standards would significantly increase the costs of compliance and reduce the availability of advice for low to moderate wealth consumers. Advisors would incur costs in terms of the additional time needed to perform the appropriate due diligence on clients to ensure that the advice is in their best interests. Second, administrative burden could increase, particularly with respect to conflicts of interest policies and other administrative

requirements. Advisors could also face increased risk of legal liability. The resulting increases in cost could make advice less affordable for lower wealth consumers. In addition, advisors may not be able to recommend products which pay commissions due to the conflicts of interest they present.

Compliance costs could indeed increase as a result of more stringent duty of care standards. One study in the United States showed that a larger proportion of broker-dealers in states imposing a best interest standard (fiduciary duty) felt that costs of regulatory compliance were significant (Finke and Langdon, 2012). As an indicator of the potential cost of increased due diligence, a study in Australia showed that comprehensive personal advice cost six times more than scaled advice which is limited in scope (ASFA, 2014).

Increased compliance costs could potentially limit the access to advice for low to moderate wealth groups. A survey in the United States by the National Association of Insurance and Financial Advisors reported that nearly two-thirds of members indicated that they would reduce their services to less affluent clients if compliance costs increased by more than 15%, and nearly one third would limit the types of products they recommended (National Association of Insurance and Financial Advisors, in Partnership with LIMRA, 2012). However, another study showed no difference in the proportion of clients served with incomes under USD 75 000 per year for broker-dealers in states imposing best interest requirements compared to other states (Finke and Langdon, 2012).

There is little evidence indicating the impact of increased duty of care standards on the ability to recommend products paying commissions. To the extent that a requirement to avoid all conflicts of interest is not implemented, which would effectively ban products paying commissions, advisors should still be allowed to recommend them provided that the conflicts of interest are managed. A study in the United States showed that broker-dealers in states imposing a best interest standard were just as able to recommend products paying commissions as advisors in other states (Finke and Langdon, 2012).

Nevertheless, the potential for increased compliance costs highlight the need for regulation to provide clear guidance as to the level of due diligence required in order to limit the impact on the affordability and availability of advice. This will allow financial advisors to know when they have satisfied the requirements and minimise the cost of the necessary due diligence. The distinction between comprehensive personal advice and scaled advice also needs to be very clear in order to keep advice affordable for requests more limited in scope, such as investments within a retirement plan. This will provide financial advisors assurance that they will not be held liable for financial circumstances of their clients which are outside of the scope of the advice they provide.

Duty of care standards should form the foundation of any policy aiming to mitigate conflicts of interest in financial advice. Standards need to be in place to ensure that appropriate due diligence is performed and self-interest is mitigated in order to ensure the suitability of recommendations for clients. Nevertheless the level of due diligence required needs to be clearly defined in order to ensure that the additional costs of compliance do not increase the cost of advice to unreasonable levels, particularly for requests which are relatively straightforward and limited in scope. Policy makers also need to be aware of the role of culture and social norms in the effectiveness of policies to mitigate conflicts of interest, and encourage the development of professional standards. In addition, cultures of compliance can be encouraged through targeted monitoring and enforcement. Such enforcement could also provide feedback to improve clarity in the regulatory requirements, facilitating overall compliance.

Disclosure requirements

Disclosure requirements complement duty of care standards and are often required as a means to manage conflicts of interest. Disclosure aims to make the existence of any conflicts of interest more transparent for the consumer as well as to ensure that consumers understand the limitations with respect to the advice they receive.

Disclosure has historically been the primary method used to address conflicts of interest and most jurisdictions have implemented some sort of disclosure requirement.[6] Most often disclosure involves revealing any conflicts of interest faced or the nature of the remuneration that advisors receive. While the amount of remuneration is also commonly required to be disclosed, some jurisdictions only require this information to be disclosed at the request of the client. MiFID II recognises the limitations of disclosure and treats it more as a last resort solution, not allowing firms to overly rely on disclosure to manage their conflicts of interest.

With recent reforms, advisors are increasingly being required to also disclose the type of advice that they provide; whether it is independent or not and the nature and/or scope of the service provided. Suitability reports may also be required explaining why the recommendation is suitable for the client. In the United Kingdom, suitability reports are required to be provided to consumers explaining why the recommendation from the advisor is suitable given the client's request and needs as well as information received from the client. The report must also explain any potential disadvantages to the client from following the recommendation. MiFID II, in addition, will require disclosure of whether the advisor will continue to assess the ongoing suitability of the recommendation.

Enforcement of disclosure requirements

Here again, clarity regarding regulatory expectations is important to facilitate the implementation and enforcement of disclosure requirements. Several reviews have shown that advisors often do not accurately disclose information even with disclosure requirements in place. In Europe, one investigation showed that less than 5% of advisors disclosed any conflict of interest to their clients, that there was a general lack of communication regarding remuneration and that fees did not seem to be fully and accurately disclosed (Synovate, 2011). The Financial Conduct Authority (FCA) found that following the implementation of the Retail Distribution Review in the United Kingdom, the majority of firms were not adequately disclosing the cost of advice. However, a follow-up review did see significant improvements in disclosure practices after the FCA had provided additional guidance on good practices (Financial Conduct Authority, 2014b).

Challenges to the implementation of disclosure requirements

Increased disclosure requirements can potentially increase the cost of providing advice, though this can be mitigated through efficient processes and procedures. For example, the Financial Advice Market Review in the United Kingdom found that firms were spending significant time on preparing suitability reports. As a result the Financial Conduct Authority will continue to work with the industry to better streamline this process and simplify the reports in order to minimise the additional burden of preparing the reports and the regulatory uncertainty regarding the information which is required to be included (HM Treasury and Financial Conduct Authority, 2016).

To reduce compliance costs and help consumer comprehension, there is also a trend towards simplifying the information disclosed, making disclosures easier for the consumer

to understand and more standardised across firms and products. In the United States, for example, the Department of Labor has issued detailed regulations and standards on fee disclosure and transparency of expenses by private pension funds. Germany requires that a brief and comprehensible disclosure regarding product features, risks and cost be provided to clients before the transaction is executed. In Canada, the CRM-2 legislation requires that all advisor compensation cost be broken down and reported in a transparent and standardised manner. Model reports have been developed to aid firms to do so, and provide a line-by-line breakdown of commissions by type along with clear explanations of each type. Planned changes in New Zealand seek to simplify disclosure requirements, making them easier for consumers to understand and helping them to understand the limitations of the advice they receive (New Zealand Ministry of Business, Innovation and Employment, 2016).

Increasing the simplicity and standardisation of disclosures is also a result of the acknowledgement that consumers have difficulty to understand the fees that they pay. A recent study of workplace pensions in the United Kingdom revealed a poor understanding of fees charged by the provider (Price Bailey and Ipsos MORI, 2016). A study in Australia showed that less than 15% of people paying for advice through commissions are actually receiving advice (Australian School of Business, 2010). Australia has since implemented a requirement that consumers must opt-in every two years to continue paying ongoing fees for advice, as well as a requirement to disclose the services that the consumer is entitled to. A survey in the United States revealed that 60% of clients did not understand how their financial advisor was charging them (Cerulli Associates, 2013). Furthermore, 31% believed that the advice they received was free (Ody, 2011).

Nevertheless, while simplified and standardised disclosure may help to improve consumer understanding and outcomes, it is likely not sufficient in itself. There is little evidence demonstrating the effectiveness of disclosure of potential conflicts of interest to improve consumer decision-making and outcomes.

First, consumers often demonstrate a lack of attention to such disclosures of conflicts of interest, even when presented in a simplified manner. One study in the United States revealed that consumers did not avoid loads on products, even when these loads were disclosed in a simplified way, and that this disclosure resulted in no change in investment outcomes (Beshears et al., 2009). Prior to the Retail Distribution Review reforms, the United Kingdom required that advisors provide clients with a menu detailing the cost of compensation and the average market price. This menu was also shown to be ineffective in improving consumer outcomes (Butterworth et al., 2007).

On the other hand, when consumers do pay attention, there is the risk that the disclosure of conflicts of interest may lead them to overweight this information in their investment decision. A study in Europe demonstrated that disclosure of conflicts in a face-to-face situation led to an automatic reaction of distrust in the advice, rather than a proper assessment of the advice itself (Chater et al., 2010). A study in the United States for mortgage disclosures showed that consumers placed too much weight on the information provided on the broker's commissions, leading them to choose a more expensive mortgage (Lacko and Pappalardo, 2004).

Consumers also demonstrate a lack of understanding regarding the implications of a disclosed conflict. Online subjects in a study in eight European Union member states did not react to the disclosure of the nature of the remuneration of the advisor unless the implications of the conflict of interest were explicitly spelled out, and even then a strong reaction was only elicited if this warning was provided in a bold red font (Chater et al., 2010).

Another study showed that individuals receiving disclosures regarding only the nature and amount of advisor compensation (and no explanation of the implications for the advice received) did not sufficiently discount the advisor's advice (Cain et al., 2005).

A potential unintended outcome of making the implications of the conflict of interest clear, however, may be a perception of increased pressure for the consumer to follow advice. Another study revealed that following a disclosure of a conflict of interest and an explanation of its implications, consumers felt increased pressure to follow the advice. Explanations provided for this phenomenon were that the consumers did not want to signal that they did not trust the advisor, and they felt a desire to help the advisor achieve a positive outcome and be compensated (Sah et al., 2013).

While disclosure does not necessarily improve consumer decision-making, it may provide an incentive for advisors to mitigate or avoid the conflicts of interest they face and therefore improve the quality of the advice provided. One study showed that advisors more often prefer to avoid any conflicts of interest when they are required to disclose them (Sah and Loewenstein, 2014). Another study showed that increased transparency of commissions that agents received for mutual funds helped to mitigate the conflict of interest of the agent and improved returns (Edelen et al., 2012).

However, disclosure may also have a negative impact on the quality of advice provided. One study showed that advisors provided more biased advice when disclosing a conflict of interest that they were unable to avoid, as they felt they had a "moral license" to be more biased because they had been honest to the client and fulfilled their obligations of transparency (Sah and Loewenstein, 2014). Nevertheless this was a case when the implications of the conflict were also explained rather than the conflict being simply disclosed. This highlights the importance and complementarity of duty of care standards in mitigating advisor bias, but also implies that providing more information or improving client understanding may not necessarily be more beneficial for the client in terms of outcomes. Where additional details are disclosed, they may be better disclosed in secondary statements which the consumer can review at their leisure, removed from any pressure to comply with the advice.

Despite disclosure requirements relating to conflicts of interest being ubiquitous, their effectiveness in improving consumer decision-making to follow advice seems limited. Nevertheless there still seems to be value in increased transparency, which can provide incentives for advisors themselves to mitigate the conflicts of interest that they face. However policy makers need to be sure that regulatory requirements are clearly communicated to facilitate the implementation of such requirements and limit the costs. Given the limitations of disclosure, however, additional measures are needed to mitigate the conflicts of interest in financial advice.

Remuneration limits

Limits on remuneration structures have been imposed where duty of care standards and disclosure requirements have been deemed insufficient to resolve the negative impact to consumers of conflicts of interest.[7] These limits can range from caps to complete bans on certain types of remuneration, or can impose other structural requirements or conditions on the compensation received by the advisor.

Caps on the allowable level of compensation can take the form of either hard limits or soft limits. The problems that these caps intend to address, however, vary from one jurisdiction to another. Chile imposed a hard limit on commissions of 2% for annuity sales

as a response to escalating commissions which seemed unresponsive to competitive pressure. Proposed legislation in Australia, on the other hand, would impose hard limits on both upfront and ongoing commissions that insurance intermediaries can receive in response to an investigation finding a correlation between high commissions and poor quality of advice (ASIC, 2015). Soft limits have been imposed in the Netherlands and in the United Kingdom, where fees charged for advice must be representative of the actual cost of advice, and intend to prevent vertically integrated firms from having a competitive advantage through the subsidisation of advice from its product charges. In the United States, the cost of advice and commission payments must be kept to a "reasonable" level.

Other jurisdictions have imposed outright bans on certain types of commission payments. Australia, the Netherlands and the United Kingdom have implemented some of the broadest bans by banning all conflicted remuneration for retail investment advice, which generally includes not only commission payments but also compensation based on volume targets as well as kickbacks. Denmark and Finland have limited commission bans to independent insurance brokers. More limited bans on specific types of remuneration have also been introduced, for example Australia has banned fees based on a percentage of assets under management for leveraged investments only, and Canada is considering a ban on trailing commissions paid beyond the period of initial investment.

Still other jurisdictions have imposed limits or conditions on the structure of the allowable compensation. Australia has introduced a claw back provision for insurance sales, where the advisor must pay back a portion of the commission in the event that the product is terminated within a certain period. In an effort to avoid excessive switching between pension providers, Mexico has introduced a conditional provision reducing the agent's compensation if the client switches pension providers within 30 months. Both the Netherlands and the United Kingdom have imposed limits with respect to the allowable time period that a client can pay the advisor fee for fee-based advice.

Challenges for the implementation of remuneration limits

The main goal of any regulation imposing limits on the remuneration of financial advisors is to better align the interest of the agent with those of the client, reducing the bias of the advisor and improving the quality of advice. Minimising the remuneration that the advisor receives from commissions in particular would reduce their incentive to recommend products paying higher commissions over those that do not.

Indeed, much evidence shows that the quality of advice is influenced by remuneration structures. One survey on independent financial advisors in Germany showed that advisors having a lower portion of their salary coming from commissions provided better quality advice (Bluethgen et al., 2008). Another study in Australia concluded that fee-for-service advice provides higher value to clients than commission-based advice (Rice Warner Actuaries, 2011). A study on advisors in the United States showed that advisors receiving compensation in the form of commissions or as a percentage of assets under management had higher rates of misconduct (Egan et al., 2016). Further evidence is shown following changes in regulation imposing certain remuneration structures. The implementation of the conditional reduction in the remuneration of agents in Mexico resulted in a reduction of switching pension funds by over 20%. Following the implementation of the Retail Distribution Review in the United Kingdom banning commission payments, there were significantly more flows to products which had paid lower commissions prior to the regulatory change (Financial Conduct Authority, 2014).

Trailing commissions in particular have been shown to go unnoticed by consumers, potentially resulting in higher total costs. Generally speaking, trailing commissions deduct a regular percentage of assets under management from the clients account, and are therefore less noticeable to the consumer than upfront fees which are usually larger and deducted immediately. One study in India showed that the cost of a closed end fund, where trailing commissions were allowed, was three percentage points higher compared to an open ended fund, where trailing commissions were prohibited (Anagol and Kim, 2012). In Australia, only 15% of consumers paying for ongoing advice through a regular fee deducted from their account were actually receiving advice (Australian School of Business, 2010). The opt-in clause required by the FOFA regulation to continue paying this fee sought to address this problem. Another study on mutual funds in Canada showed that trailing commissions are associated with an increase in inflows and a decrease in performance of the fund. Nevertheless, trailing commissions can reduce the incentive for the advisor to encourage churning; the same study in Canada showed that outflows were also lower for funds with trailing commissions (Cumming et al., 2015).

Fee-based remuneration presents an alternative to compensation based on commissions, and removes the incentive to recommend a product paying a higher commission. However, these remuneration structures also present their own challenges. Advisors charging fees based on a percentage of assets under management may have the incentive to cater only to higher wealth clients, perhaps one driver of the shift towards this market observed in the United Kingdom following the ban on commissions. Flat-fee advisors may also be less incentivised find the most appropriate product for their client given the additional effort required. One study in Europe showed that flat-fee advisors were less likely to recommend successful investment outcomes to their client than advisors receiving commissions, as they were more indifferent to the client's outcome (Chater et al., 2010). Finally advisors charging hourly fees may have the incentive to inflate the amount of time spent on a client, and additionally a flat or hourly fee may deter clients from seeking advice at all.

Nevertheless, most evidence shows that limits on the remuneration of financial advisors are likely to improve consumer outcomes for those who do seek advice. However, these types of limits may also result in unintended consequences of a reduction in the number of advisors, an unwillingness of advisors to continue to serve lower wealth clients, or consumer reluctance to pay upfront for advice.

The potential reduction of the number of advisors due to reduced profitability is a potential concern for the availability of financial advice. The overall number of advisors in the United Kingdom fell by nearly 10% from 2011 to 2015, though the number of advisors did increase during the second half of this period (APFA, 2016). Part of the reduction is also likely due to increased qualification standards imposed by the regulation. Changing business models also contributed to a reduction in the number of advisors, however; the number of advisors from banks decreased by nearly two-thirds from 2011 to 2014, coinciding with the exit of several banks from the advice channel (APFA, 2016). On the other hand, only 7% of firms reported a decrease in the number of advisors in Australia following the reforms (ASIC, 2014).

Limits on remuneration have not been shown to have a significant impact on profitability. There is some evidence that the commission ban in the United Kingdom reduced product costs beyond the level of the commission payment due to increased

transparency and competition (Financial Conduct Authority, 2014). Nevertheless, revenues for both investment and insurance business have increased since the reforms (APFA, 2016). As another example, in Finland where commissions were banned for independent insurance brokers, their market share of statutory pension insurance decreased from 16.2% in 2003 to 9.2% in 2014. However, while total broker compensation did decrease somewhat following the implementation of the ban in 2008, it has since recovered to previous levels (Makynen, 2015).

However, changing business models may lead advisors to be more unwilling to serve clients with lower levels of wealth. There is some evidence of this in the United Kingdom, where 69% of advisors said that they had turned away a client in the last year, usually due to the fact that it would have been uneconomical to provide the client advice. Many advisors also indicated that the client's sources of wealth other than retirement were also taken into consideration when deciding to accept the client. In addition, firms requiring a minimum level of wealth of 100 000 GBP to provide advice doubled within two years to 32% of firms in 2015 (HM Treasury and Financial Conduct Authority, 2016). However, 26% of clients of advisory firms surveyed at the end of 2015 had pension wealth of less than 30 000 GBP, indicating that there are still some advisors willing to serve lower wealth clients (Financial Conduct Authority, 2016c).

Fee-based advice, particularly in the form of fee-for-service or hourly rates, may lead to consumer reluctance to pay for advice. This seems to largely due to the lack of awareness by consumers as to how much they pay for advice through commissions, and the perception of an upfront fee as a sure loss regardless of the ultimate decision that they take. Several surveys assessing consumer's willingness to pay for advice confirm this. One survey showed that 47% of Australians prefer to pay for advice through commissions, compared to 26% who preferred upfront or hourly fees (Ody, 2011). Another showed that 75% of Australians were not willing to pay more than AUD 250 for advice, and that demand was higher for simplified advice; the actual cost of full personal advice was 1 AUD 190 for industry funds, and AUD 220 for simplified advice (ASFA, 2014). In the United Kingdom, only 8% of consumers were willing to pay over GBP 500 for advice, and only 14% willing to pay between GBP 200 and 500; the actual cost of advice is around GBP 150 per hour, and advice for pension investments requires on average nine hours of the advisor's time (HM Treasury and Financial Conduct Authority, 2016). As further evidence of consumer reluctance to pay for advice, non-advised sales in the United Kingdom have increased, representing over half of the transactions for personal investment firms in 2014-15, compared to around 25% in 2010-11 (APFA, 2016). In an effort to mitigate this reluctance to pay upfront for advice, the Netherlands and the United Kingdom allow for the client to take a 'credit' and pay the advisor fee over a limited period of time. The Netherlands has also taken additional measures, requiring that the consumer take a competency test before being allowed to invest directly without advice (Oxera, 2015).

Limits on remuneration aim to reduce the conflicts of interest that advisors face in receiving commission payments from the products they recommend, however such limits also present challenges to maintain the availability of advice and consumer demand for advice. While consumer outcomes for those who seek advice generally seem to improve with such regulation, the accessibility of advice could reduce if financial advisors change their business models to target higher wealth clients and consumers may be reluctant to pay for advice. As such, the appropriate limits will depend on the specific problems observed in a given market and measures will need to be taken to reduce the impact on the advice gap.

Qualification standards

Qualification standards need to be imposed on financial advisors to ensure the competency of the advisor to provide that advice. Generally, there are requirements for financial advisors to be registered with the supervisory body, which can include some minimum standards in order to obtain a license to operate. Standards meant to verify the competence of the advisor may include minimum levels of educational attainment, completion of exams or requirements to follow courses for continued professional development.

The registration of financial advisors is relatively common, and can be a valuable tool for the supervisor to monitor their behaviour. A study on registered financial advisors in the United States showed that 1 in 13 advisors have a record for misconduct, but a third of these have more than one instance of misconduct (Egan et al., 2016). Therefore past misconduct may increase the likelihood of future misconduct, and the supervisory body needs to be aware of these instances to improve future monitoring.

Beyond monitoring conduct, registration of advisors can serve to highlight their particular qualifications or competencies for consumers and can facilitate the search for a financial advisor appropriate for specific needs. For example, the Australian regulator has a register for financial advisors where consumers can search for advisors and see details of their qualifications and expertise. As another example, the Personal Finance Society in the United Kingdom has a special register for financial advisors who are better qualified to provide financial advice later in life (Financial Conduct Authority, 2016).

Educational standards for financial advisors seem to have been relatively low historically. Furthermore, standards are not generally consistent for different types of advisors, making it difficult for consumers to judge the competency of their financial advisor.

Many jurisdictions have been moving to not only increase educational standards for financial advisors but also to make them more uniform. Having a minimum uniform standard is important given the lack of consumer awareness of the different standards that advisors are held to. Australia, Canada and New Zealand are in the process of making efforts to increase qualification standards for advisors as well as increase uniformity. The Retail Distribution Review in the United Kingdom already increased the standards for advisors, and MiFID II is clearly defining the knowledge that advisors should have and demonstrate through experience and an appropriate qualification. Continued professional development (CPD) is also increasingly being required, and has already been implemented in the United Kingdom. MiFID II in Europe and the Professional Standards of Financial Advisors in Australia will also implement CPD requirements for advisors. Greece implemented new standards for insurance intermediaries in 2014, requiring that advisors complete a specified number of approved courses each year for the renewal of their professional license (EIOPA, 2015).

Evidence from the United Kingdom has shown that increased educational standards have impacted the professionalism of advisors. More financial advisors are going beyond the minimum standards set and there is increased focus on providing ongoing services to clients. Membership of professional bodies has also increased (Financial Conduct Authority, 2014).

However, some other jurisdictions have encountered challenges in enforcing professional standards of knowledge and education. An investigation in France found that insurance intermediaries were not receiving sufficient training to meet regulatory

requirements. Insurance providers in Spain have faced the challenge of maintaining sufficient levels of qualifications given the high turnover of the telemarketing sector, which they rely upon to reach out to consumers (EIOPA, 2015).

Qualification standards are necessary in order to ensure that financial advisors are competent to give appropriate financial advice to clients, and many jurisdictions have been aiming to increase these standards as well as make them more uniform for different types of advisors. The registration of advisors can play an important role in matching advisors to consumers and aiding supervisors in monitoring advisor conduct. However, once again, clear definitions of what constitutes advice and who is allowed to provide it are needed in order to overcome the challenges in maintaining these standards for the profession.

Dispute resolution

Mechanisms need to be in place to allow consumers to resolve any complaints related to the advice received.[8] Dispute resolution schemes are often put in place to offer a more timely and efficient resolution of consumer complaints than going through the court system.

Regulation often requires that financial intermediaries belong to a dispute resolution scheme that consumers can access in the event that they feel they have been harmed by financial advice received. Some jurisdictions have a centralised function that serves to resolve such disputes. In the United States, for example, consumers having a complaint against a broker-dealer can normally seek redress through an arbitration process managed by FINRA, who has the power to grant a monetary settlement as well as suspend or cancel the registration of the party providing the investment advice for non-compliance. In the United Kingdom, the Financial Ombudsman Service deals with consumer complaints. If the firm is unable to compensate the client for a valid claim against them, the client may be able to claim from the Financial Services Compensation Scheme. The European Commission has centralised a cross-border dispute resolution network called FIN-NET for the countries in the European Economic Area. The members of the network are responsible for handling disputes out of court between consumers and the providers of financial services, including investment firms and insurance companies, and they also facilitate cross-border complaints.

Other jurisdictions have several schemes operating with various financial intermediaries. Australia, for example, has three such schemes, one of which focuses specifically on complaints related to superannuation, the Superannuation Complaints Tribunal. New Zealand has numerous dispute resolution schemes, and advisors are required to be associated with one. In Canada, IIROC regulated advisors must have membership in an arbitration programme to resolve any potential disputes with clients.

The existence of numerous dispute resolution schemes can present challenges to ensuring the consistency of the process to handle consumer complaints and the rules applied. This seems to be a potential problem in Canada, where the process of pursuing a complaint varies across the different sectors, with each having a different approach and procedure (Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives, 2016). A review of the regulation in New Zealand also raised this concern. The review found that schemes do not necessarily apply rules consistently, which could provide opportunities for arbitrage and potentially reduced economies of scale (New Zealand Ministry of Business, Innovation and Employment, 2016b).

Transparency regarding the process to resolve complaints is also important from the perspective of the financial advisor. The Financial Advice Market Review in the United

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Kingdom found that some advisors were reluctant to provide advice due to future liability concerns coming from to the lack of a time limit within which consumers are allowed to file a complaint and uncertainty around the rules that would be applied. As a result, the review recommended that the process that the Financial Ombudsman Service follows should be made more transparent (HM Treasury and Financial Conduct Authority, 2016).

Dispute resolution schemes play an important role in facilitating consumer access to redress in the event that the financial advice received is not appropriate. Nevertheless, in order for these schemes to operate effectively, the process followed to resolve disputes needs to be transparent and consistent across the various schemes in operation. Consumers also need to be made aware of the process which they should follow in order to have access to redress from any harm inflicted from inappropriate financial advice.

3.4. Minimising advice gaps

While the policy measures discussed above can be effective in increasing the quality of advice, they may also inadvertently affect the availability and affordability of advice, increasing the advice gap. The drivers of this advice gap include a shortage of advisors supplying advice in certain markets, higher costs of compliance and/or the reluctance of consumers to pay for advice. Policy makers need to ensure that any potential reduction in the availability or affordability of advice does not outweigh the benefits of improved consumer outcomes from financial advice. There are several measures that policy makers can take to reduce the impact of regulation on the advice gap and encourage innovative solutions to address these issues, particularly for lower wealth consumers.

The potential shortage in the supply of advice in certain markets can be driven by uncertainty around regulatory liability, an un-level playing field and/or potential differences in the profitability of providing advice. Each of these can affect the willingness of advisors to serve certain markets thereby affecting the number of advisors that consumers have access to.

Uncertainty around regulatory liability can stem from a lack of clarity in the definitions of advice and the scope of application of the regulation. For example, uncertainty regarding the boundary between guidance and advice can lead to reluctance to provide any information to consumers at all. This has proven to be an issue in several jurisdictions when it comes to employers providing their employees information about their investment options for pension plans. Another advice gap observed in some jurisdictions has been the lack of provision of simplified advice for specific investment matters more limited in scope. The lack of clarity for the due diligence requirements for comprehensive versus simplified advice has led to a reluctance by advisors to provide simplified advice due to a concern over legal liability. Improving the clarity of definitions and legal requirements can reduce advisor's uncertainty around whether they are fully complying with regulations and reduce their concerns of future legal liability.

A lack of uniformity in the application of regulation can lead to an un-level playing field and present opportunities for cherry-picking by advisors to serve only some markets over others. For example, differences regarding duty of care requirements could lead advisors to only serve the markets where regulation is lighter and compliance costs lower. The lack of uniformity of duty of care standards has been raised as a concern, for example, in New Zealand and the United States. Where disclosure requirements differ, advisors may also be incentivised to only offer products which do not require disclosure of conflicts.

Increased uniformity of requirements for different types of advisors and products would reduce incentives to serve only less regulated markets.

Where profitability differs among consumers, advisors may be incentivised to serve only those which are potentially more profitable. This could result, for example, where advisors are compensated primarily from fees based on assets under management which result in higher fees from higher wealth clients. This has been a concern in the United Kingdom, for example, following the ban on commission payments. As such, the benefits of any limits on compensation must be weighed against the potential reduction in the access to advice for lower wealth clients, and innovative business models to serve these clients should be encouraged to be developed.

A second driver of the advice gap could be increased costs of compliance with regulation for advisors, which may also increase the cost of advice, reducing the affordability of advice for lower wealth clients. These increased costs can be due to increased due diligence requirements to fulfil the duty of care standard in place, increased administrative costs due to disclosure requirements, or increased risk of legal liability if regulatory requirements are not sufficiently met. For example, several jurisdictions such as New Zealand and the United Kingdom identified that advisors may have been performing higher due diligence than necessary for simplified advice, making the cost of providing such advice unreasonable given its limited scope. Again, the clarity of regulatory requirements is essential to ensure that advisors know when they have fulfilled requirements and do not spend excessive resources to exceed them, and the proportionality of regulation with respect to due diligence for simplified and comprehensive advice is needed to keep costs down for simplified advice. Regulators can also work with advisors to help streamline processes and ensure that requirements are met in an efficient and cost-effective manner.

Perhaps the most challenging driver of the advice gap for policy makers to counter is the reluctance of consumers to pay for advice, particularly fee-based advice in the form of fee-for-service or hourly rates. Many consumers are not aware of how much they pay for advice, particularly when advisors are compensated through more opaque remuneration structures such as commissions. Disclosure requirements for advisor remuneration and limits on more opaque compensation structures can make the price of advice much more transparent to consumers. However, making the cost more transparent may lead to reluctance by consumers to use financial advisors. The amount that consumers are willing to pay upfront for advice is often less than the cost of providing the advice. Flexibility around how the fee is paid could help to reduce the sticker shock of seeing the full price of advice. For example, the Netherlands and the United Kingdom allow the consumer to take a limited “credit” from the advisor and pay the fee over a specified period of time. Nevertheless, the undervaluation of advice by consumers is not an easy problem to overcome.

Given the reluctance of consumers to pay for advice, innovative solutions will need to be found to reduce the cost of advice, or at least the perception of high cost, particularly for lower wealth segments. Technology-based advice has the potential to increase the accessibility of advice as well as reduce the cost of providing it for basic retirement savings needs. In addition, technology-based advice avoids the problem of conflicts of interest by relying on objective and transparent models using generally accepted investment theories. However, policy makers need to ensure that the regulation in place encompasses these channels so that the same level of consumer protection is in place as for advice provided in person.

3.5. Regulation of technology-based advice

Financial advice that relies on technology has the potential to help bridge the advice gap which can result from measures taken to mitigate conflicts of interest and ensure the competency of advisors. The growth of technology can facilitate in particular the provision of simplified and streamlined financial advice at a lower cost. Furthermore, the use of objective and automated models provides an alternative to overcoming advisor bias. Regulators have been seeking ways to promote innovative solutions for the provision of advice while assessing how such advice platforms would fit within the existing regulation of financial advice and ensuring that appropriate consumer protections are in place.

Several jurisdictions have been encouraging technological solutions to help close the advice gap. The Financial Conduct Authority in the United Kingdom launched 'Project Innovate' to encourage firms to develop lower cost advice models aimed at the mass-market, particularly with respect to simplified advice. The Financial Advice Market Review further recommended that the regulator establish an Advice Unit to assist in the development of such models (HM Treasury and Financial Conduct Authority, 2016). Similarly, the Netherlands Authority for the Financial Markets and the Dutch Central Bank have launched an "Innovation Hub" to support financial innovation and answer questions regarding regulatory requirements. An Innovation Hub has also been established in Australia to support FinTech start-ups. In addition, Australia, Singapore and the United Kingdom are all introducing 'regulatory sandboxes' for businesses to experiment with innovative products and services in a controlled environment.

Such innovations do not always neatly fit into the existing regulation of financial advice, however. A review of the current regulation in New Zealand identified that the regulation as currently written may present a barrier to the potential role of technology in providing financial advice, as it requires that advice be provided by a "natural person". Planned changes seek to broaden the definition of advice in order to accommodate technological innovations, and require that entities providing such robo-advice be licensed and held to the same requirements as other types of advisors (New Zealand Ministry of Business, Innovation and Employment, 2016). Current regulation in Canada explicitly limits the acceptable role of technology in providing advice, as under the current regulation, fully automated services are not allowed, and any robo-advice service must also provide some access to personalised advice from an advisor (Lortie, 2016).

Regulators in several jurisdictions have been assessing how technology-based advice should be regulated going forward. In Australia, the regulator has issued a consultation document and a draft regulatory guide with respect to robo-advice. The proposed guide maintains that the qualification requirements for providers of robo-advice be the same as those for normal advisors, and lays out the requirements for testing the algorithms used and the governance controls and processes in place. In the United States, the Department of Labor has established conditions for which model-based asset allocations would not violate the fiduciary duty for pension plans under the ERISA regulation, which includes the independence of the financial expert developing the models (US Department of Labor, 2001). More recently, the financial advice industry's self-regulatory body published a report to clarify the application of its rules with respect to digital investment advice and share effective practices. It highlights the importance of the oversight of the algorithms used in digital tools to ensure that an appropriate governance framework is in place and that the resulting advice is appropriate for the client (FINRA, 2016). In addition, a new rule proposal

by the Securities Exchange Commission would require developers of algorithmic trading to be registered as a securities trader, and be subject to the same qualification requirements as securities traders. In Europe, MiFID II will require that firms engaging in algorithmic trading have effective risk controls in place and perform stress testing on the algorithms. The European Supervisory Authorities have issued a joint discussion paper on the automation of financial advice looking at the potential benefits and risks of such innovations in order to determine any additional regulatory action needed to address automated financial advice (Joint Committee of the European Supervisory Authorities, 2015).

Key themes raised in these regulatory assessments are the need for consistency with the regulation of face-to-face financial advice and the need for proper risk and governance controls to be in place. First, the type of advice being provided by the platform needs to be clear within the definitions provided by the regulation in order to determine which standards apply, for example to what extent the advice is general or personalised. If the advice is determined to be personalised advice, clear processes would need to be in place with respect to how suitability for the client is determined. The providers of these platforms should also be held to the same qualification standards in order to be sure that they understand the implications of the advice provided by their platforms and are competent to ensure that it is appropriate. Finally, the algorithms used for automation need to be extensively tested, and controls need to be in place to ensure that the procedures in place continue to function properly. With adequate consumer protection measures in place, technology has great potential to increase the affordability of and access to financial advice and help to close the advice gap.

3.6. Conclusions

The various measures which policy makers can take to improve consumer outcomes from financial advice for retirement are complementary as each addresses a different aspect which influences the quality of financial advice. Duty of care standards, disclosure requirements and remuneration limits aim to ensure that conflicts are appropriately managed, understood or eliminated completely. Qualification standards aim to ensure that the advisor has the appropriate knowledge to provide advice. Finally, mechanisms for dispute resolution are needed to facilitate consumers' access to redress in the event of a complaint. Policy makers must therefore consider how to implement these measures together.

Nevertheless, each of these policy measures presents challenges for policy makers to ensure their effectiveness in improving the quality of financial advice for retirement. Furthermore, these measures can potentially lead to an advice gap, reducing the availability and/or affordability of advice, particularly for consumers with low to moderate retirement wealth.

Enforcement is the key to making duty of care standards effective in improving the quality of advice. Periodic monitoring and enforcement of due diligence processes and procedures to identify and manage conflicts of interest can provide feedback to advisors where their processes are not in line with regulatory requirements and help to identify areas of improvement. This could be accomplished, for example, through mystery shopping exercises. Such reviews can also be used as an opportunity to clarify regulatory requirements and share best practices. The exposure to legal liability if poor advice is provided also helps to align advisors' incentives with their clients and helps with enforcement. In addition, enforcement can help to promote a culture of compliance within

firms. An increased role of industry bodies in setting standards for the profession could also help to establish positive social norms, helping advisors to internalise these values and overcome their unconscious biases.

Disclosure requirements are important to promote transparency. However, their value may lie more in their potential to influence advisor behaviour rather than the optimal use of disclosed information by consumers to improve their decisions to follow advice. Increased transparency can help incentivise agents to avoid and/or manage the conflicts of interest they face, helping to make duty of care standards more effective. However, more information is not necessarily better in terms of improving consumer outcomes. While the full cost that the consumer will pay should certainly be disclosed, a detailed breakdown of the amount of the advisor's compensation may not be necessary in the primary disclosure document. Secondary disclosure statements can provide detailed information which the consumer can review at their leisure, removed from any pressure to comply with the advice.

Limits on the remuneration advisors receive can help to better align the interests of the advisor and the client. The appropriate limits depend on the problems observed in the particular market and their complementarity with other policies to mitigate conflicts of interest as they change the incentive structure of the advisors. For example, moving towards a fee-based model may overcome the conflict of interest from commission payment, but it may also decrease the incentive for advisors to serve clients with lower wealth.

Qualification standards help to ensure that advisors are competent to provide advice to clients. Minimum qualification standards should be uniform across all advisor types in order to ensure adequate consumer protection. Beyond minimum standards of competency, however, advisors could specialise in certain areas to meet specific consumer needs, such as investing for retirement. A centralised register of financial advisors could facilitate consumers' search for an advisor, and could allow both a verification of their credentials as well as a filter to search for advisors providing advice for specific needs.

Consumers also need a consistent and transparent procedure to facilitate the resolution of their complaints. The process and rules of such schemes need to be consistent and transparent in order to ensure that all schemes are applying the same standards and that no arbitrage opportunities exist.

Policy makers will also need to consider how to limit the impact of these measures on the advice gap. First, to ensure the availability of advice for all markets, improving the uniformity in the application of regulation can help to reduce opportunities for cherry-picking by advisors to serve only less regulated channels over others. Clarity in the scope of regulation and the definitions and rules applied is also important to reduce advisors' uncertainty with respect to legal liability for providing advice, reducing advisor reluctance to provide advice in more ambiguous situations.

To minimise the costs of compliance with regulation and promote the affordability of advice, clarity in regulatory requirements is essential to ensure that advisors know when they have fulfilled requirements and do not spend excessive resources to exceed them. Regulators can work together with advisors to help streamline processes and ensure that requirements are met in an efficient manner. In addition, the proportionality of regulation with respect to due diligence for simplified and comprehensive advice is important to allow advisors to provide lower cost advice for more straightforward requests.

Consumer undervaluation of advice and their reluctance to pay for it is potentially the most challenging aspect of the advice gap for policy makers to address. Flexibility around

how upfront fees are paid could help to reduce the sticker shock of seeing the full price of advice. However more innovated solutions will need to be found to reduce the cost of advice, particularly for individuals with lower levels of wealth and less complex financial planning needs.

Policy makers should encourage and support innovative business models which can provide advice services for lower wealth clients. Technology-based advice in particular has the potential to increase the accessibility and affordability of advice for straightforward financial planning for retirement. Furthermore its objectivity presents an alternative to overcome the behavioural biases of advisors. However, policy makers need to ensure that the regulation in place encompasses these channels so that the same level of consumer protection is in place as for traditional channels.

While the policy measures discussed in this chapter can improve the quality of financial advice and consumer outcomes, there are numerous challenges to ensure their effectiveness and to minimise any impact on the advice gap. While not all of these challenges are easily resolved, the implications discussed here can help policy makers to implement policies that will be effective and promote the availability and affordability of financial advice for retirement.

Notes

1. The chapter does not focus on the evidence of the influence that conflicts of interest can have on financial advice, as this has been covered extensively in other research (e.g. Burke et al., 2015).
2. The Ministry of Business, Innovation and Employment of New Zealand has made recommendations to simplify the classification of advisors.
3. Jurisdictions may differ in the language used to refer to these two concepts and their exact definitions. As used here, best interest requirements are more stringent than suitability requirements and these terms will continue to be used as defined in this section throughout the chapter.
4. For a more general overview of enforcement frameworks see the Effective Approaches to Support the Implementation of the Remaining G20/OECD High-Level Principles on Financial Consumer Protection.
5. Professional standards are also an effective approach to implement the second OECD/G20 High Level Principle on Financial Consumer Protection on the Role of Oversight Bodies.
6. The fourth OECD/G20 High Level Principle on Financial Consumer Protection on Disclosure and Transparency recommends disclosing conflicts of interest.
7. The sixth OECD/G20 High Level Principle on Financial Consumer Protection on Responsible Business Conduct of Financial Services Providers and Authorised Agents states that "the remuneration structure for staff of both financial services providers and authorised agents should be designed to encourage responsible business conduct, fair treatment of consumers and to avoid conflicts of interest."
8. The ninth OECD/G20 High Level Principle on Financial Consumer Protection on Complaints, Handling and Redress states that "Jurisdictions should ensure that consumers have access to adequate complaints handling and redress mechanisms that are accessible, affordable, independent, fair, accountable, timely and efficient".

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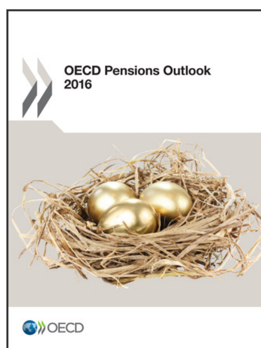

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