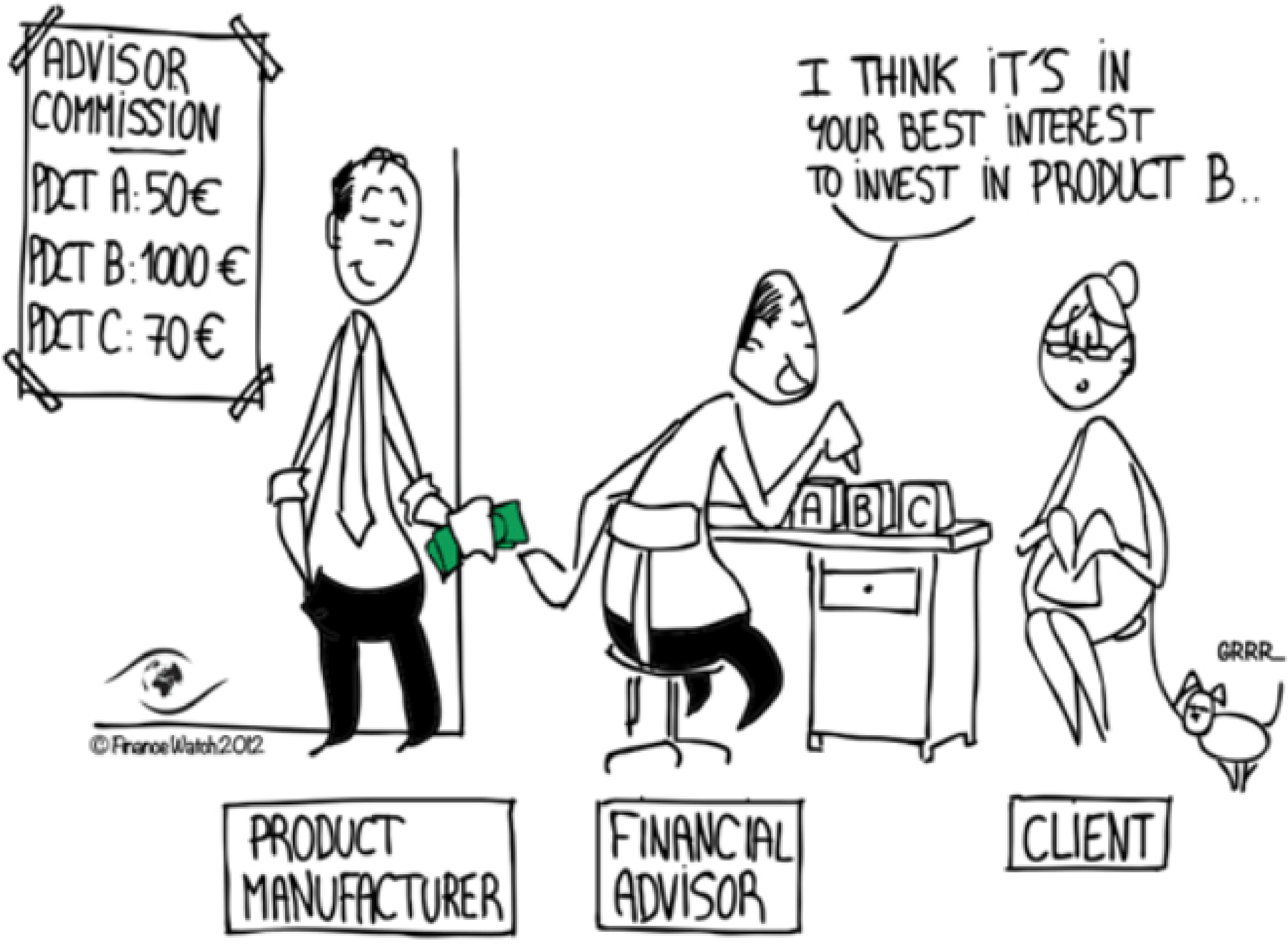

BAN KICKBACKS

Retrocession fees lead fund suppliers and advisers into temptation. The established fee structure in the funds industry leads to conflicts of interest and makes saving more expensive, regardless of how well consumers are informed.
(Cartoon credit: Finance Watch)

28.03.2019

FORBRUKERRÅDET

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1 *Protect consumers – ban retrocession fees*

The international funds industry uses an income model that actively encourages financial advisers and their employers to give consumers expensive and bad advice. The introduction of new regulations for securities trading (MiFID II) is an opportunity for the Norwegian authorities to put a stop to the entrenched fee structure that has led the industry into temptation for a generation now.

When an investment firm receives a fee or commission from a party other than the client (a kickback), the firm has a financial interest in the client investing in a certain product rather than other products that result in either a lower or no payment. The result of this conflict of interest is that clients frequently have been advised to choose more expensive savings products than neutral investment advisers would have done.

Key voices in the funds industry are strongly opposed to a ban on retrocession fees, but it is probably asking too much to expect the industry itself to saw off the highly profitable branch it sits on. It must therefore be the job of the authorities to reduce the effect of this conflict of interest.

In practice, the current regulations have made it possible for the industry to continue with an industry structure where forced tie-in sales are a key, competition-impeding part of the distribution system.

The authorities should not contribute to upholding regulations that permit an unhealthy and consumer-unfriendly fee structure. The Consumer Council therefore urges the Norwegian Ministry of Finance to prohibit the payment of fees or commission to parties other than the client in connection with the purchase and sale of financial products in accordance with the Securities Funds Act. [1]

[1] Section 10-12 of the Securities Funds Act concerns payments made by or to parties other than the client. Subsection 5 reads as follows: *'The Ministry may issue regulations containing provisions that in special cases either prohibit or set further requirements for the receipt of a commission or fee from or the payment of such commission or fee to parties other than the client. The Ministry may issue more detailed regulations supplementing this provision.'*

2 Background

The purpose of introducing MiFID (the Markets in Financial Instruments Directive) in 2007 was to strengthen the protection of investors, among other things through more stringent requirements as regards information, advice, transparency and the removal of barriers to competition between EU member states.

The review (MiFID II) in 2018 led to a further tightening of the regulations that will affect all parties involved in securities trading. One of the most disputed provisions is the treatment of commission or fees from parties other than the customer (also called retrocession fees or kickbacks) in connection with the purchase and sale of securities funds.

2.1 National freedom of action

MiFID II gives the authorities a choice between either introducing minimum rules for retrocession fees or stricter rules if extraordinary national circumstances call for this.[2]

> *Member States may, in exceptional cases, impose additional requirements on investment firms in respect of the matters covered by this Article. Such requirements must be objectively justified and proportionate so as to address specific risks to investor protection or to market integrity which are of particular importance in the circumstances of the market structure of that Member State.*

2.2 Minimum rules not enough

Minimum regulations prohibit independent investment advisers from receiving and keeping monetary payments from parties other than the client in connection with the provision of such services. There are few genuinely independent investment advisers in Norway, however. The rest of the non-independent (or dependent) advisers can continue to receive kickbacks on certain conditions. An investment firm can only receive a commission or fee from parties other than the client in connection with investment services if the commission or fee is designed to enhance the quality of the service and is not detrimental to the client's interests.[3]

The Norwegian funds industry believes that the more stringent regulations are sufficient to prevent unfortunate conflicts of interest.

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[2] MiFID II, Article 24.12
[3] MiFID II, Article 24.9

The new regulations raise the threshold for advisers, but the underlying conflict of interest persists, and clients are still advised to choose unnecessarily expensive investment products. In addition, retrocession fees put a strong damper on the emergence of efficient price competition in funds distribution. In this report, the Consumer Council will document why a total prohibition on retrocession fees is necessary.

3 *Why has Norway not already banned kickbacks?*

In 2015, the Government appointed the Securities Law Committee. In 2017, the committee presented its report on *Markets for financial instruments and the implementation of the EU directives MiFID II and MiFIR* (NOU 2017: 1).[4] The question of a general prohibition on retrocession fees was a small, but important part of the 338-page document.

3.1 The 'wait-and-see' committee

The committee observed that retrocession fees mean that the cost of advice is normally included in the product. This means that the client must pay for advice even though the client neither wishes nor receives advice. The committee therefore believed that a prohibition could lead to cheaper products for clients who manage without such advice. A more transparent price model could also lead to increased competition between self-service platforms and thereby to lower prices for clients.

The committee agreed unanimously that it could '*be questioned whether it is possible to receive retrocession fees, while at the same time complying with the requirement to safeguard the client's interests in the best possible way'*. The conflicts of interest could be reduced through appropriate procedures and control. In practice, however, the view taken in the report was that it is *'demanding for investment firms to comply with the rules on handling conflicts of interest when they receive retrocession fees'*. A prohibition could help to reduce conflicts of interest and thereby increase trust in the market.

This line of argument against kickbacks was nonetheless not sufficiently weighty for the majority of the committee, which pointed to the fact that the Norwegian funds distribution market is dominated by the big banks. Fund management is part of their corporate structures, and for such actors, *'a ban on retrocession fees would be unlikely to reduce potential conflicts of interest'*. The committee assumed, in what cannot be taken as a vote of confidence in the banks' advisers, that they would recommend their own products regardless of kickbacks, *'since the total profits would go to the same corporate group'*. On the other hand, the committee pointed out that a prohibition for other products than securities funds, including CDFs and unlisted derivatives, would prevent conflicts of interest to a greater extent than would be the case for funds.

Moreover, the committee unanimously believed that it would be expedient to first evaluate the effect of the new MiFID II rules, and to postpone a possible prohibition until after the introduction of new rules for insurance-based investment products (scheduled for 2019 at the latest).

At the same time, the majority took the view that endeavours should be made to ensure identical rules as in in the other Nordic countries because Norwegian

[4] NOU 2017: 1 from page 173: [Markeder for finansielle instrumenter]

companies primarily compete with companies in the Nordic states. The committee therefore did not wish to introduce stricter rules in Norway than in the other Nordic countries.

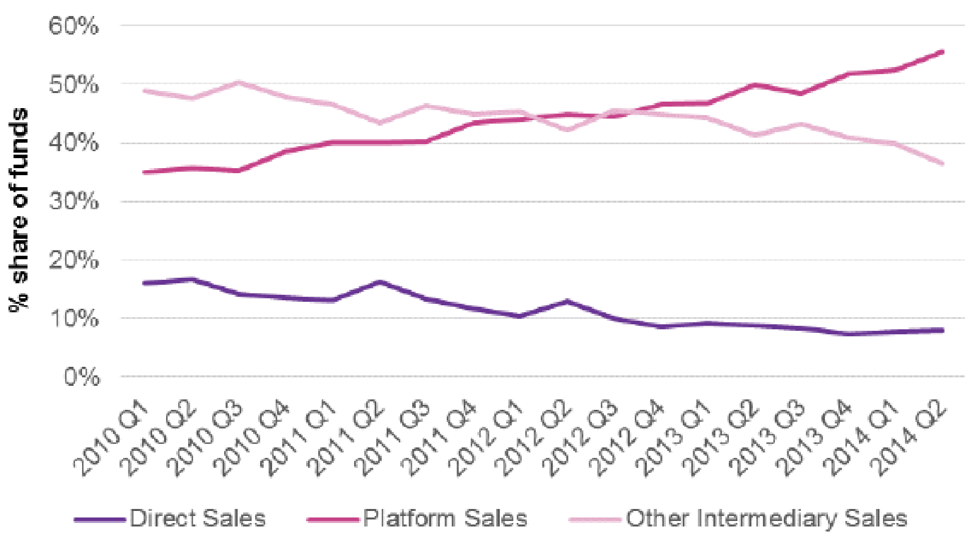
The majority did not take a stance on whether special circumstances existed in Norway that could justify stricter rules than the minimum requirements in MiFID II.

3.2 Successful bans in the UK and the Netherlands

The Consumer Council agrees with the committee that it is natural to assume that the distributors' financial advisers will be motivated to prioritise the group's interests over the clients' interests. However, the committee's opposition to a prohibition assumes a static industry structure that will remain unchanged by a prohibition. This implicit assumption ignores both the report's expectations of cheaper products and increased competition between self-service platforms and the experience from the UK and the Netherlands, which prohibited retrocessions several years ago.

In the UK, the ban led to a striking increase in volume in independent and self-service funds supermarkets,[5] at the expense of both direct sales channels and intermediaries motivated by retrocession fees.

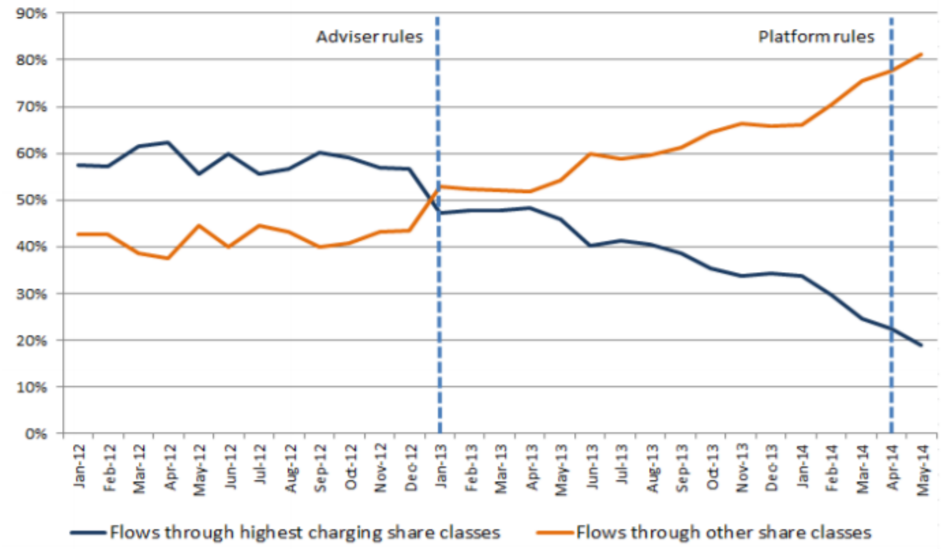
Figure 6.1: Share of gross retail sales by distribution channel of UK domiciled funds



[5] Europe Economics 16 Dec. 2014, page 69: [Retail Distribution Review Post Implementation Review]

The figures are equally clear when we look at the development in cash flows between the most expensive fund classes and the other classes.[6] In January 2012, the most expensive funds accounted for almost 60 per cent of investments. Just two and a half years later, this proportion was reduced to around 20 per cent.

Figure 6.2: Gross retail flows through highest-charging class shares and other shares



The Netherlands introduced a prohibition on retrocession fees on the sale of financial products in 2013. In 2018, the government concluded[7] that the prohibition had proved a success. The previous product-centred advice culture had been replaced by advice that takes more account of the clients' interests. The prohibition enjoyed strong support in the financial industry, even though a small minority were still strongly opposed to it. Nor did the clients have any difficulty finding financial advisers or had any particular objections to paying, provided that the advisers managed to explain their added value. To the extent that the clients manage to gain an overview of the cost of advice, they tend to choose the most reasonably priced alternatives.

3.3 Consumer interests set aside

The consumers' representative on the Securities Law Committee, Morten Grandal of the Consumer Ombudsman (now the Consumer Authority), was the

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[6] Europe Economics 16 Dec. 2014, page 74: Retail Distribution Review Post Implementation Review

[7] Letter of 23 Jan. 2018 from the Dutch Minister of Finance to parliament summarising the government's evaluation of the prohibition against the payment of retrocession fees

only member who argued in favour of a statutory prohibition on retrocession fees. He also represented the Consumer Council and the Norwegian Shareholders Association. Grandal doubted whether the more stringent rules would be sufficient in practice to reduce the inherent conflict of interest. There were three arguments in particular in favour of a prohibition:[8] *'the need to reduce conflicts of interest, increase trust in the market in Norway and facilitate a more transparent market with simpler and clearer pricing'.*

Grandal pointed to the UK's experience, which showed that a prohibition led to a decrease in the sale of products with high kickbacks, that it was easier to compare prices on different investment platforms, and that prices were lower.

The Consumer Authority's representative lost the fight for a prohibition, but won more support for his Plan B, to lower the threshold for introducing a prohibition in future. If a prohibition was not to be introduced immediately, Grandal proposed authorising either the Ministry of Finance or the Financial Supervisory Authority of Norway to issue regulations prohibiting retrocession fees if it were to turn out that '*MiFID II does not sufficiently solve the problem of conflict of interest'.*[9] This proposal was supported by the representatives of the Ministry of Finance and the Financial Supervisory Authority on the committee. The majority, who largely represented financial industry interest organisations such as Finance Norway, the Confederation of Norwegian Enterprise (NHO), the Norwegian Fund and Asset Management Association (VFF) and the Norwegian Society of Financial Analysts, said 'no'.

The amended Securities Trading Act, which was passed by the Parliament in June 2018, did not prohibit retrocession fees. However, Grandal's proposal to leave the decision on a possible future prohibition to the Ministry of Finance was adopted.[10]

The Swedish equivalent of the Securities Law Committee [11] unanimously recommended prohibiting retrocessions. The Swedish financial supervisory authority (*Finansinspektionen*) also recommended a prohibition. Its Director General, Martin Andersson, left no room for doubt about how he viewed retrocession fees in connection with the provision of financial advice. [12]

> *'Informed advice is a good thing; unfortunately, only a very small proportion of advice is informed. For example, they almost always*

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[8] NOU 2017: 1 page 179: Markeder for finansielle instrumenter

[9] NOU 2017: 1 from page 173: Markeder for finansielle instrumenter

[10] 10 Section 10-12 of the Securities Funds Act concerns payments made by or to parties other than the client. Subsection 5 reads as follows: *'The Ministry may issue regulations containing provisions that, in special cases, either prohibit or set further requirements for the receipt of a commission or fee from or the payment of such commission or fee to parties other than the client. The Ministry may issue more detailed regulations supplementing this provision.'*

[11] SOU 2015: 2: Värdepappersmarknaden MiFID II och MiFIR

[12] Dagens Industri, 4 Feb. 2015: 'En tickande bomb'

> *recommend managed funds with expensive fees, when a passive index fund would often suit the clients better. That is not advising, it's selling.'*

Unfortunately for Andersson, Sweden's then Financial Market and Consumer Minister, Per Bolund, was less enthusiastic about the Swedish committee's recommendation. He hoped that a solution could be arrived at that both strengthened consumer protection and was satisfactory to the industry.[13] In May 2016, the Financial Market Minister delighted the Swedish Investment Fund Association by opposing the clear recommendations of the Swedish Securities Law Committee and the financial supervisory authority.[14]

The Consumer Council's Swedish sister organisation, the Swedish Consumers' Association, was disappointed and called the proposal futile.[15] The organisation's Secretary General, Jan Bertoft, commented that, as long as fee-driven advice was permitted in Sweden, this would undermine independent financial advisers. It is difficult to compete against something that is presented as *'free'* advice[16]. Savings expert Joakim Bornold of Nordnet Sweden called for regulations that did not give advisers incentives to propose investments that result in higher commission for themselves.[17] Nordnet's savings expert believed that the Swedish government's proposal looked more like the work of a financial market minister than a consumer minister.

The Norwegian Consumer Council agrees that it would be sensible to have the same rules for retrocession fees for securities funds and insurance-based investment products. It might be sensible, therefore, to wait until the new regulations for insurance-based products have been introduced.

On the other hand, it should be unnecessary to wait until the rest of the Nordic countries have introduced a prohibition that demonstrably leads to increased competition, lower distribution costs and a strong reduction in conflicts of interest. Rather, our position should be that a Norwegian prohibition will probably force the other Nordic countries to follow suit in order to meet the stronger competition from the Norwegian market.

[13] Dagens Industri, 4 Feb. 2015: 'En tickande bomb' (A ticking bomb)
[14] [14] Swedish Investment Fund Association, 23 May 2016: Glädjande besked om provisioner och rådgivning
[15] Swedish Consumers' Association: Replik: 'Bolund borde varit mycket tuffare'
[16] *Svenska Dagbladet*, letter from Jan Bertoft of the Swedish Consumers' Association, 25 May 2016: 'Bolund borde varit mycket tuffare'
[17] Nordnet blog, 20 June 2016: Bornolds budord #3 Provisionsförbud – vi vill se mer

4 Previous national measures against conflicts of interest

The fight against conflicts of interest in the financial industry is not new. In 2000, for example, the Financial Supervisory Authority of Norway put a stop to the arrangement whereby investment firms that engaged in active management for individual customers were allowed to receive part of the fee charged to the client.[18] The Authority observed that:

> *'...agreements on sharing broker's commission increase the active manager's income as the number of transactions increases. Agreements on sharing broker's fees thereby give active managers an incentive to increase the turnover in the portfolio to a higher level than is in the client's interests.'*

This practice meant that active managers and brokers had a common interest in clients paying high fees, trading frequently and staying with the broker who paid the highest fee. However, distributors of securities funds were allowed to continue to receive such kickbacks.

In 2010, the Government and the Financial Supervisory Authority tightened the rules for sales-based remuneration of investment advisers and for commission or fees from parties other than the client.[19] The authorities concluded that a remuneration system for investment advisers where pay is directly linked to the client's investments was in violation of the Securities Trading Act. There was little opposition to this tightening of the rules, among other things because the social partners saw predictable pay as most expedient.

The Consumer Council believes that the prohibition against commission-based pay was a step in the right direction, but it does not remove the fundamental conflict of interest between the adviser's employer and the client. An employer has many other ways of steering clients to the most expensive funds besides commission-based pay:

- Limiting the selection, so that it only contains the most expensive funds.
- Guidelines and training of employees.
- Performance appraisal discussions.
- A higher fixed salary for the most profitable employees and reassignment or termination of the contracts of those who recommend the least profitable funds.

[18] Financial Supervisory Authority's circular 4/2000: [Aktiv forvaltning og avtaler om kurtasjedeling]
[19] Financial Supervisory Authority's circular 17/2010: [Verdipapirforetakenes avlønningssystemer og vederlag fra andre enn kunden]

- Giving expensive funds a prominent place and recommendation on the firm's website.

In the circular, the Financial Supervisory Authority pointed out that investment firms cannot as a rule receive payments from parties other than the client. There was an exemption provision in the Securities Trading Regulations, however, that applied if the following three conditions were met:

- The client shall be given information in writing about the nature and value of the payment before the service is provided.
- The payment must be capable of enhancing the quality of the service.
- The payment must not weaken the firm's duty to safeguard the client's interest in the best possible way.

In the Consumer Council's view, this exemption provision has unfortunately become the general rule, while the main rule is a rarely observed exception.

5 What does the industry say about kickbacks?

5.1 Trust and the client's interests?

In what they say and write, the Norwegian industry associations are concerned with counteracting conflicts of interest between advisers and clients. In 2018, Finance Norway put it as follows on its website:

> *'The financial industry depends on trust. It is crucial for the industry that clients can trust that the advice they are given on financial matters is given with integrity and without self-interest[20].'*

The financial industry's authorisation schemes (Finaut) are one of the industry's most important means of ensuring that sales and advisory services are of good quality. The organisation is owned by Finance Norway and the Norwegian Fund and Asset Management Association. One of Finaut's main tasks is to develop and administer the industry standard Code of Good Practice.[21] One of the ten rules contains a point about conflicts of interest:

> *'The customer's interests shall come before those of the business and its employees. Conflicts of interest shall be identified and counteracted. If that is **impossible**, the customer shall be clearly informed about the conflict of interest before an agreement is entered into.'*

In the Consumer Council's view, the current system of retrocession fees is the biggest source of conflicts of interest in the funds industry. Introducing a prohibition on such fees is undoubtedly ***possible***, and it will effectively counter such conflicts. In the Consumer Council's experience, however, Finaut's owners do not share this view.

Parts of the Norwegian financial industry score high on customer satisfaction. The EU Commission publishes an annual Consumer Markets Scoreboard[22] based on a survey of consumers' assessments of how well different markets function. The survey measures 1) how easy it is to compare offers, 2) trust in suppliers to comply with consumer regulations, 3) the proportion of consumers who experienced problems or lost money, 4) whether the market lives up to customers' expectations, and 5) satisfaction with the number of players in the

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[20] www.finansnorge.no: Forbrukerspørsmål (https://www.finansnorge.no/politikk/finans-norge-mener/forbrukersporsmal/) – document removed from website.
[21] www.finaut.no: Code of Good Practice (https://www.finaut.no/god-skikk/)
[22] The EU Commission: Consumer Markets Scoreboard 2018

market. The Norwegian markets for both bank accounts and home mortgages scored high compared with both Europe and other service sectors in Norway. This high customer satisfaction in the financial services field has not carried over to the market for investment products, however. This segment was near the very bottom of the table, with only television and internet services scoring lower, and well below second-hand cars, which was the lowest scoring sector in the retail segment.

5.2 Retrocession fees do not contribute to genuine price competition

In Finance Norway's consultation submission on the implementation of MiFID II in 2017[23], the industry association stated that retrocession fees in *'the so-called non-independent advice segment'* help to ensure that there are many distributors of securities funds. They *'will ensure genuine competition that has a self-disciplining effect. In this way, we ensure that the general public, small savers or small investors have access to financial advice without having to pay for it directly.'*

The Consumer Council cannot see that there is any evidence to support the claim that such fees help to ensure that there are many distributors of securities funds. It would be more true to say that the result of this business model is that there have been few out-and-out funds supermarkets in the Norwegian market. Before the introduction of share saving accounts, the distribution of funds largely took place through exclusive sales channels, where DNB branches sold DNB funds, Sparebanken 1 sold Odin funds, the Eika group sold Eika funds and Nordea sold Nordea funds.

Some channels, such as Nordnet, Sbanken and Netfonds, have offered a broad selection of funds. Because of the model based on retrocession fees, however, there has only been a limited possibility to challenge the industry's own brand sales through lower prices. It has not been in the fund suppliers' interest to allow a competition-minded distributor to undermine the price they themselves ask from direct purchase clients. We can also ask how financially interesting it has been for the distributors to contribute to price competition that would have led to a strong reduction in the industry's profitability.

It is only in recent years that the banks' own brand stores have begun to sell reasonably priced index funds. Moreover, the introduction of "share savings accounts" has created a new competitive dynamic that has resulted in most distributors also offering external funds. The Consumer Council assumes that fund clients prefer to gather all their equity investments in the same account with a distributor that offers a broad selection. Now that the introduction of share savings accounts has made it possible to move and switch funds without triggering tax on the realisation of gains, there is little to prevent clients from

[23] www.regjeringen.no: Consultation submission from Finance Norway on NOU 2017: 1

moving their assets from the local 'country store' to the big national funds market. If a client's assets disappear to a competitor, their salary account, housing loan and insurance policies could follow suit. A broad selection of funds has therefore taken over from the limited range of in-house brands and become the new industry norm.

While this trend has been favourable for consumers, the underlying source of conflicts of interest is still smouldering below the surface. When consumers access an online sales outlet, it is probably funds with good sales margins that are on display. If the client uses the automatic funds guide, it will probably suggest a 'home-made', actively managed funds package. It is primarily clients who have share savings accounts who will benefit from a broad assortment, however. For savings products with high barriers against moving, such as fund accounts, defined contribution pensions, IPS and unit-linked paid-up policies, the choice is still largely limited to 'local' funds.

5.3 Cross-subsidisation?

Finance Norway believes that it is logical that retrocession fees are not permitted in the case of independent investment advisers or active management. However, the industry association warns against a prohibition for non-independent advisers, and believes that '*ordinary people without a high income or wealth may not be very willing to pay for this type of advice'.* [24]

For Finance Norway, the purpose of such fees is to *'ensure that the general public, small savers or small investors have access to financial advice without having to pay for it directly'.* [25]

The Norwegian Fund and Asset Management Association (VFF) takes an equally gloomy view of clients' possibility of receiving advice in Norway if retrocession fees are prohibited. [26]

> *'If a total ban on retrocession fees were to be introduced, the distribution of funds through external distributors would probably be limited to wealthy clients who are willing and able to pay separately for all advice.'*

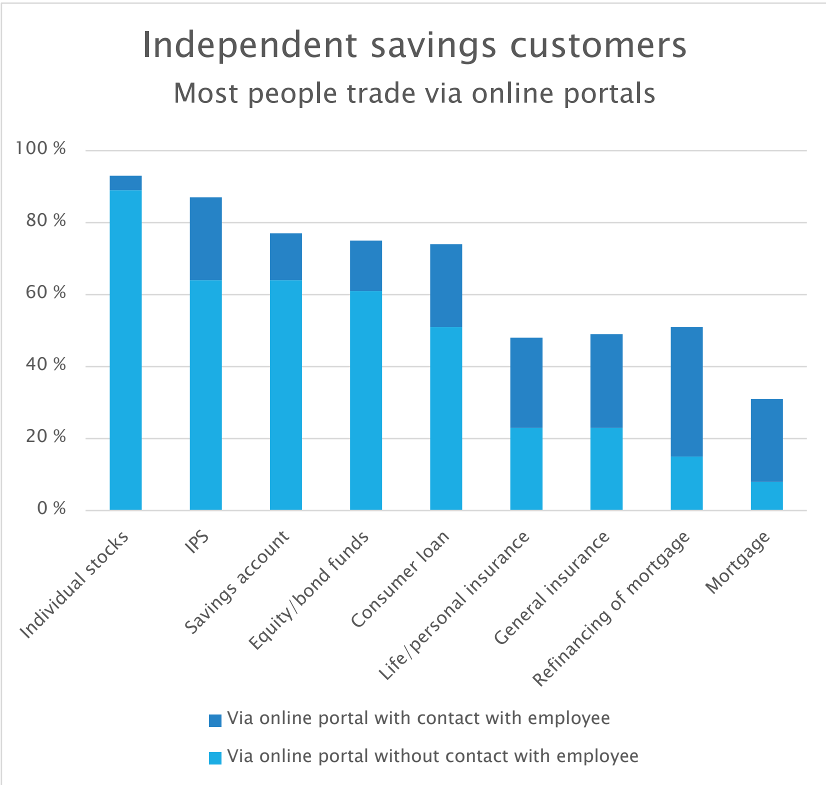
In the Consumer Council's opinion, what Finance Norway is actually arguing in favour of is cross-subsidisation or, ultimately, forced tie-in sales.[27] The clients must pay for an advisory component, whether they wish to or not. Clients who

[24] www.regjeringen.no: Consultation submission from Finance Norway on NOU 2017: 1
[25] www.regjeringen.no: Consultation submission from Finance Norway on NOU 2017: 1
[26] www.regjeringen.no: VFF:Markeder for finansielle instrumenter
[27] A forced tie-in sale is when a consumer has to choose between purchasing two (or more) products/services or none.

purchase funds on self-service platforms will also be forced to pay for the industry's sales personnel. Moreover, there is much to indicate that the industry associations overrate both client demand for inclusive advice and the industry's ability to deliver what it promises.

In the Consumer Council's funds survey in August 2018,[28] only 23 per cent stated that they had contacted a bank adviser or a fund manager the last time they had put money into a fund. Eight per cent stated that they had been contacted by an adviser.

The industry associations' own market survey [29] from 2018 paints a similar picture. Sixty-one per cent purchased funds via an online portal without having contact with an employee, compared with 53 per cent the year before. A further 14 per cent managed their purchase via an online portal, but had human contact via chat, phone or a video meeting during the purchase process. Only 23 per cent of fund clients mainly made purchases through dialogue with an employee.



Source: Finaut – Consumer and finance trends 2018

This trend has not gone unnoticed by the head of the personal banking market in the bank DNB[30]:

[28] Consumer Council, August 2018: Consumer survey on funds
[29] Finaut.no, 2018: Consumer and finance trends 2018
[30] DN.no, 28 Jan. 2019: Spareroboter erstatter bankrådgivere

> *The adviser's role has changed a lot. Personal advisers do not receive as many queries any more.*
>
> ***Ingjerd Blekeli Spiten to DN.no, 28 Jan. 2019***

Nor does having contact with an employee automatically mean that the client receives in-depth advice. It can just as well be a case of the adviser simply passing on orders or taking short-cuts in relation to client and product assessments. Two supervisory visits by the Financial Supervisory Authority of Norway in 2017[31] found, for example, that neither DNB nor Nordea's own advisory tools required information about the client's financial situation to be obtained. The Consumer Council does not have an exact overview of how many fund clients actually receive satisfactory investment advice. However, a 'mystery calling' survey from 2018 indicates that even a client with NOK 400,000 to invest can expect to be given superficial advice.[32] More than 40 per cent of clients were not asked whether they had a housing loan. Only a third were asked about their income. Only 30 per cent of the advisers recommended on their own initiative clients to invest all or part of their capital in index funds.

It seems clear that, in practice, a large majority of clients subsidise conflict of interest-motivated advice for a small minority. The Consumer Council fails to see how this system entails putting the clients' interests first.

5.4 Forced tie-in sales?

The report from the Securities Law Committee does not explicitly call the industry's practice forced tie-in sales. It does, however, describe the fee model in a way that makes it difficult to distinguish from forced tie-in sales: [33]

> *Retrocession fees mean that the cost of advice is normally included in the product. This means that the client must pay (indirectly) for advice even though the client neither wishes nor receives advice. If such fees are banned, the client can choose whether or not he or she wishes to pay for advice. A prohibition could thereby lead to cheaper products for clients who purchase financial instruments without receiving prior advice.*

[31] Letter from the Financial Supervisory Authority of Norway, 13 April 2018: Comments following a supervisory visit to DNB Bank ASA Personmarked and Letter from the Financial Supervisory Authority of Norway, 9 April 2018: Comments following a supervisory visit to Nordea Bank AB (publ) branch in Norway

[32] The Consumer Council's mystery calling survey, 14 March 2018: The bank's advice could easily prove expensive

[33] NOU 2017: 1 page 177: Markeder for finansielle instrumenter

The most discussed case of a forced tie-in sale in Norway dates from 2013, when TV provider RiksTV filed a complaint against Get and Canal Digital Kabel with the Consumer Ombudsman (now the Consumer Authority). RiksTV argued that its competitors were in violation of the Marketing Control Act Section 22, which reads:

> *Terms and conditions which are applied or are intended to be applied in the course of trade with consumers may be prohibited if they are deemed to be unfair to consumers and if general considerations call for such a prohibition.*

RiksTV argued that it was unreasonable that its competitors insisted on a mandatory link between broadband services and TV subscriptions. In this way, they prevented customers from choosing other TV providers or choosing not to have cable TV at all.

The then Consumer Ombudsman, stated in 2014 that *'it is unreasonable that consumers are unable to choose not to pay the extra costs of TV signals'*.[34]

[34] E24, 13 Nov. 2014: Consumer Ombudsman believes that Canal Digital and Get are breaking the law

6 *International experience of a ban on kickbacks*

The funds industry's interest organisations fear that a total ban will lead to a situation where external funds distribution is limited to a few wealthy clients. Little support for this fear is to be found in the Netherlands and the UK, which prohibited retrocession fees in 2012 and 2014, respectively. On the contrary, these prohibitions have resulted in the emergence of self-service funds supermarkets, robo-advisers and lower fees.

According to a relatively recent study from the EU Commission,[35] these prohibitions led to major changes in the national investment landscape. Clients chose not to use the industry's non-independent advisers, choosing instead to make their own choices on self-service platforms or to seek advice from independent investment advisers. The EU Commission concludes that investors in the Netherlands and the UK have become generally more cost-conscious and better informed about investment products. At the same time, the clients in these countries enjoy the lowest prices for equity funds in Europe.[36]

6.1 Groundless fear that the distribution market will dry up

The experience from countries that have banned kickbacks shows that the Norwegian Fund and Asset Management Association's (VFF) undocumented fear that the distribution market will dry up is groundless. It is understandable, on the other hand, if the industry association fears the loss of income that will arise when clients are able to choose between expensive advice from product-guided advisers and the low costs of self-service solutions.

Fund advisers motivated by kickbacks are probably in the same position as stockbrokers and travel agents were 15–20 years ago. It is not very probable that many retail investors want to return to the personal conversations they had with their stockbroker, and a broker's commission of 0.5 per cent. When it became possible for the clients to choose for themselves, the road to self-service equity trading and a commission of 0.05 per cent was short.

In the Consumer Council's opinion, the funds industry's price model is a relic of the previous millennium, when the purchase of funds was usually the result of a meeting with the client's personal banking adviser. Since then, fund trading has been digitalised and the number of bank branches has been greatly reduced. The big savings made in the distribution system have largely gone to the distributors. In recent years, we have seen a certain decrease in management fees, but the decrease probably does not mirror the distributors' cost savings.

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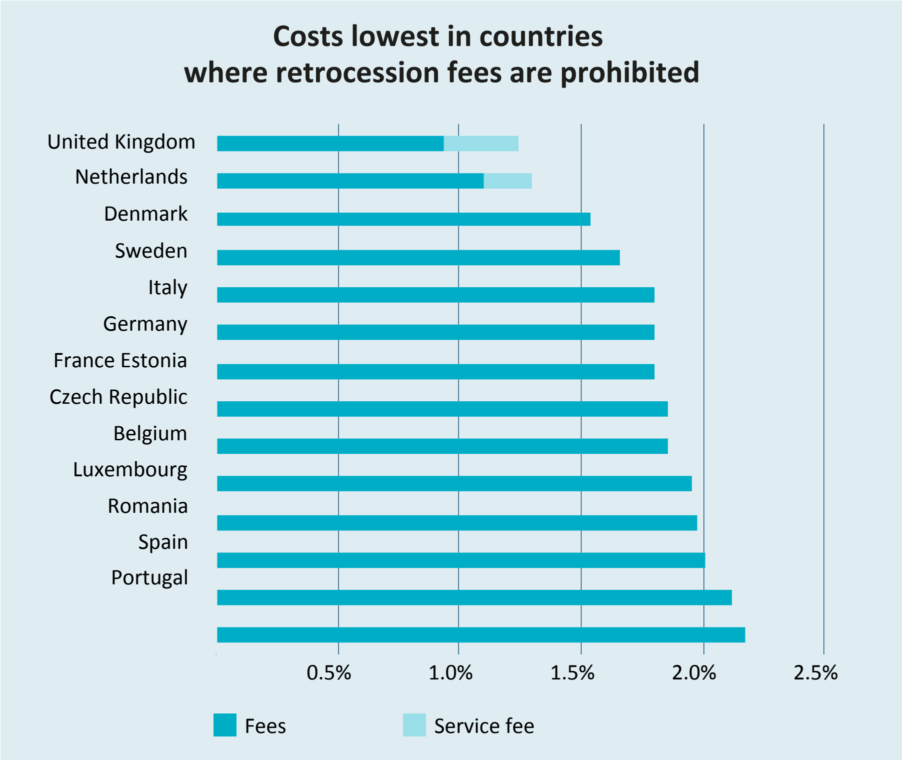
[35] European Commission, 24 April 2018: Distribution systems of retail investment products across the European Union

[36] European Commission, 24 April 2018: Distribution systems of retail investment products across the European Union

The Consumer Council fails to see that there are weighty reasons why the funds industry should enjoy state-regulated protection from clients who show little willingness to pay.



Percentage. Source: The EU Commission

7 *Overwhelming evidence*

Finance Norway claims that retrocession fees contribute to lower prices for the end customers.[37] There is no support for this claim in independent research, which, on the contrary, documents that the opposite is the case.

7.1 Cheap advice is expensive

A study in the Journal of Finance[38] confirmed that kickbacks lead to higher fees and a resultant welfare loss for the investors. In addition, kickbacks led to increased demand for advisory services because the clients get the impression that the advice is free. The study found that funds with a negative excess return were largely only sold indirectly through kickback-motivated advisers. Active funds with a historical excess return, on the other hand were sold both directly and indirectly.

In 2015, President Barack Obama's Council of Economic Advisors published the report: *The effect of conflicted investment advice on retirement savings.*[39] It estimated that US retirement savers made annual losses of USD 17 billion on advice that had inherent conflicts of interest. The report, which is based on independent research reports, found that clients who are given advice of this kind receive an annual return that is one per cent lower on average than they would otherwise have achieved.

7.2 Self-service is good service

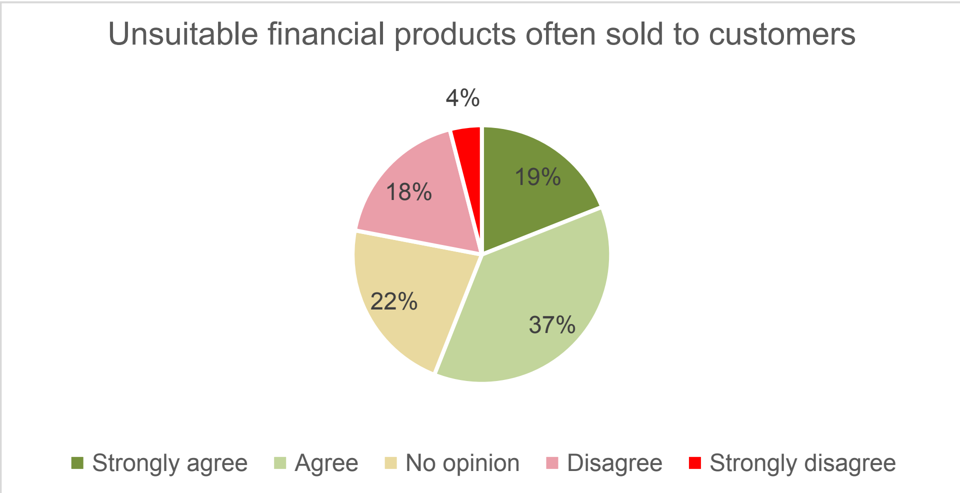
A report from the Swedish consumer council[40] concluded that consumers who were placed in different advisory situations made the smartest choices when they were forced to make independent assessments.

> *Finally, it is particularly thought-provoking that the situation in which the clients make the best choices is the case with no advisers at all. The experiment cannot explain what the driver for this is. One conceivable explanation is that the clients are capable of making good choices if they are forced to think them thoroughly through themselves. According to this explanation, advice entails clients*

[37] Consultation submission from Finance Norway, page 6, 6 June 2018: Consultation – Norway's implementation of the Insurance Distribution Directive (IDD)
[38] Journal of Finance, 23 May 2011: Intermediated Investment Management (NEAL M STOUGHTON YOUCHANG WU JOSEF ZECHNER)
[39] The White House, February 2015: THE EFFECTS OF CONFLICTED INVESTMENT ADVICE ON RETIREMENT SAVINGS
[40] Konsumentverket Rapport 2014:14, page 91: Långsiktiga finansiella spartjänster till konsument

> *leaving part of their responsibility for thinking through their choices to another party, with the result that they end up worse off.*

The CFA Institute, the global organisation for chartered financial analysts, which has more than 140,000 members, canvassed executives in the investment industry about how they saw the future of the profession. As many as 56 per cent of them either strongly agreed or agreed that the industry often sold unsuitable financial products to clients.[41] Only 22 per cent either disagreed or strongly disagreed.



Source: CFA Institute – questionnaire survey of 1,145 executives in the investment industry

An anecdotal, but nonetheless illustrative comparison from the Norwegian funds market indicates the same view. We have compared the ten biggest equity funds on Nordnet's trading platform with the Norwegian Fund and Asset Management Association's (VFF) market statistics. Nordnet receives retrocession fees from fund suppliers, but does not give advice on individual investments.

[41] CFA Institute report, April 2017, page 69: [Future state of the investment profession]

The comparison shows that five of the ten biggest fund investments are in passive funds with low management fees. In addition, the list contains a factor fund that is also relatively cheap compared with actively managed funds. The high share of passive investments among Nordnet's self-service clients is in line with recommendations from independent financial scholars.

Nordnet's Top 10 Equity Funds (May 2018)					
Rank	Assets under management	Type of Fund	Market Share	Morningstar rating	Yearly fee
1	Nordnet Superfondet Norge	Passive	10,6 %	Not rated	0,0 %
2	DNB Nordic Technology	Active	9,2 %	*****	1,5 %
3	Alfred Berg Gambak	Active	4,4 %	*****	2,0 %
4	Delphi Nordic	Active	3,2 %	*****	2,0 %
5	KLP Aksje Global Indeks	Passive	2,8 %	Not rated	0,3 %
6	KLP Aksje Norge Indeks	Passive	2,3 %	**	0,2 %
7	Storebrand Global Multifaktor	Factor	2,3 %	*****	0,75 %
8	KLP fremvoksende markeder	Passive	2,1 %	****	0,3 %
9	KLP Aksje Global Indeks	Passive	1,9 %	****	0,2 %
10	Delphi Europe	Active	1,8 %	****	2,0 %
	Top 10		40,6 %		

Source: Nordnet

Researchers find less to be pleased about in VFF's country statistics. There is only one passive fund on VFF's list of the ten biggest funds. Naturally, there is more than one reason why a majority of Norwegian fund savers have invested their capital in unnecessarily expensive funds. For example, some of them have, on an independent basis, chosen funds based on historical returns and have, for tax reasons or through laziness, chosen to keep them despite poor results. It is likely, however, that a large proportion of them have been led into expensive investments by financial advisers with an interest in steering clients to expensive funds.

Norway's Top 10 Equity Funds (May 2018)					
Rank	Assets under management	Type of Fund	Market Share	Morningstar rating	Yearly fee
1	DNB Norge	Active	6,0 %	**	1,4 %
2	SKAGEN Global	Active	5,9 %	**	1,0 %*
3	ODIN Norden	Active	5,7 %	**	2,0 %
4	SKAGEN Kon-Tiki	Active	5,4 %	***	2,0%*
5	DNB Nordic Technology	Active	4,6 %	*****	1,5 %
6	SKAGEN Vekst	Active	4,3 %	**	1,0 %*
7	ODIN Norge	Active	3,4 %	**	1,5 %
8	DNB Global Indeks	Passive	2,9 %	****	0.3%
9	DNB Global	Active	2,7 %	****	1,4 %
10	DNB Aktiv 100	Active	2,6 %	***	1,4 %
	Top 10		43,6 %		

**These funds have success fees that are not included in the "yearly fee"*

Source: The Norwegian Fund and Asset Management Association (VFF)

7.3 Looking out for number one

Unfortunately, it is unrealistic to believe that the average financial adviser will be unaffected by the size of kickbacks when giving advice. The example below illustrates the inherent conflict of interest (the choice of Storebrand as an example is random):

What advice is most profitable for an adviser?		
	Active	**Passive**
	Storebrand Verdi	Storebrand Indeks - all markets
Investment (NOK)	100 000	100 000
Management fee	1,10 %	0,16 %
Retrocession fee	0,90 %	0,14 %
Total cost	**2,00 %**	**0,30 %**
Annual fee (NOK)	**2 000**	**300**
Share to manager	1 100	160
Share to adviser	900	140

* Nordnet's overview of retrocession fees

Given the choice between 900 and 140 kroner in annual commission, it will be too tempting to choose the most expensive alternative. An adviser who consistently recommends the most reasonable, and probably most rational, alternative for the client is unlikely to generate enough income over time to justify his own salary. Nor is it difficult to lead the client up an unnecessarily expensive path. Finaut's annotated edition of the Code of Good Practice makes the same observation.[42]

> *In day-to-day contact with clients, we know that, using communication techniques, it is often easy to get the client to choose a solution that is acceptable to him or her, and maybe even good, but that is very good for the firm. If the client is actually best served by a different alternative, e.g. a different fund, it must be recommended.*

The authorisation scheme for financial advisers instils the principle that the client's interests come before the firm's and the employees' interests. It is one thing to learn an ideal in a classroom, but something else altogether to live up

[42] Finaut's website, 28 Jan. 2019: Code of Good Practice for Advisory and other Customer Services – Rule 6 Conflict of Interest

to it in day-to-day situations with a fee model that appears to have been custom designed to lead advisers into temptation.

THE CONSUMER COUNCIL BELIEVES THAT:

Prohibiting kickbacks will lead clients to transparent and cost-efficient self-service platforms. Or to genuinely independent advisers. The Consumer Council therefore believes that it is natural to view the disappearance of advice-driven sales as an advantage rather than a disadvantage for clients.

8 Free or included?

8.1 Kickbacks do not lead to lower prices

Finance Norway believes that most people's willingness to pay for financial advice may be low. The interest organisation uses this as an argument in favour of maintaining the kickback system. Moreover, Finance Norway claims that retrocession fees fill an important function in the current distribution models, and that they contribute, among other things, to lower prices for end customers.[43]

The Consumer Council finds no evidence that kickbacks lead to lower prices. On the contrary, there is much to indicate that the opposite is the case. When sales personnel are motivated by the highest possible fees in their dealings with less knowledgeable clients, the main competition factor shifts from low prices to high fees. The effect is therefore artificially inflated sales costs.[44]

Nor has the Financial Supervisory Authority observed that kickbacks contribute to lower prices for end customers. In 2014, the Supervisory Authority mapped the use of retrocession fees in Norway and failed to see that competition in the market leads to such fees levelling out or becoming lower.[45]

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[43] Finance Norway, 6 June 2018, page 6: Consultation – Norway's implementation of the Insurance Distribution Directive (IDD)
Moreover, in this consultation submission, Finance Norway cites the Financial Supervisory Authority of Norway in support of its claim that retrocession fees contribute to lower prices for end customers: *'At the same time, it is important to remember – as the Financial Supervisory Authority also recognises in its discussion of a possible prohibition on fees on pages 42–42 of its consultation paper – that such fees fill an important function in the current distribution models and contribute, among other things, to lower prices for end customers.'*
This is a highly selective interpretation of the Financial Supervisory Authority's consultation paper The passage that Finance Norway's cites in support of its view reads as follows:
'It cannot be ruled out that the discontinuation of retrocession fees could result in a higher share of distribution costs having to be covered by the clients through higher prices for administration or management of the pension capital.'
Firstly, the Financial Supervisory Authority does not **recognise** that such fees contribute to lower prices. On the contrary, the Supervisory Authority writes that **it cannot be ruled out**. Secondly, it is natural to assume that the discontinuation of such fees will lead to an increase in other fees. However, the question it is relevant to ask here is whether the increase in other fees will be higher than the discontinued retrocession fees. The Financial Supervisory Authority does not state an opinion on that issue in its consultation paper.
Experience from the UK and the Netherlands indicates that the price paid by self-service end customers will be lower after a prohibition on kickbacks has been introduced.

[44] Mark Armstrong, Department of Economics, University of Oxford, November 2011: Economic models of consumer protection policies.

[45] Financial Supervisory Authority of Norway, 15 Dec. 2014: Mapping – retrocession fees

8.2 The moment of truth

The credibility of the industry's defence of tie-in sales has been subjected to a reality check in another area of MiFID II that has turned the banks' and brokers' commission model on its head. The new regulations prohibit tie-in sales in equity trading, and they require that different cost types be paid separately and no longer be included in the broker's commission on the purchase. This means that brokers and banks have to charge directly for analyses and advice that were previously 'included in the purchase' in the form of higher commission. People therefore had the impression that analysis services were free, while 'included in the price' would be a more accurate description.

> *So far, analyses have been a **free** service for all clients, who only pay for the equity trade.*[46]
>
> ***Jacob Trumpy in Dagens Næringsliv (25 July 2017)***

> *If the transaction costs do not decrease, the total costs for us managers will increase, since this analysis was previously **free**.*[47]
>
> ***Maria Granlund of Alfred Berg Kapitalforvaltning (DN letter to editor 18 Jan. 2017)***

After this politically imposed ban on tie-in sales, the European industry's commission income fell by as much as 30 per cent in the first quarter of 2018 compared with the same period in 2017.[48] This loss has not been compensated by an equivalent increase in income from the sale of analysis services. Until MiFID II put a stop to the tie-in between equity trading and analysis services, the bill was sent to funds clients in the form of higher commission on purchases and sales of securities in the funds. Demand for third-party analyses has fallen dramatically now that these costs can no longer be passed on to the consumers on the quiet.

The prohibition on tie-in sales in connection with securities transactions has turned the spotlight on the huge overproduction of financial analyses.[49] According to an article in Financial Times, more than 40,000 emails containing investment analyses are sent every week from banks and brokers. The article pointed out that, in some industry insiders' estimate, only two to five per cent of the analyses were actually read. Questions are also raised about the quality of a lot of the analyses that are prepared. Banks and brokers also have an interest in writing positively about companies that they either carry out

[46] DN.no, 25 July 2017: Leading broker believes big funds will halve the number of analyses
[47] Letter to the editor in dn.no, 18 Sept. 2017 from Maria Granlund: More information wanted
[48] Financial Times, 2 June 2018: Banks and brokers suffer 'dramatic' fall in commissions
[49] Financial Times, 7 Feb. 2017: Final call for the research analyst?

investment assignments for or hope to land as clients in future. That the analyses are no longer 'free of charge' or paid for by someone else has led to demand becoming both more quality and cost-conscious.

The Consumer Council believes that the experience so far, of the prohibition on tie-in sales in securities trading, demonstrates how such income models create welfare losses, put normal market mechanisms out of play and send the bill to unsuspecting end customers, while giving the impression that they are free.

Nor does Finance Norway shy away from using the 'F word'. In a comment on a critical report on Australian banks, Finance Norway highlights the authorisation scheme for Norwegian advisers and how it was established in 2009 as a reaction to unscrupulous sales of structured savings products in Norway:[50]

> *Today, around 17,000 authorisations have been issued to advisers in Norwegian banks and insurance companies who have passed the exams. They are employees who give **free advice** all over Norway.*

However, financial advisers are not missionaries who travel around the country on a voluntary basis to improve the financial know-how of ordinary people. Their advice is free is the same way as advice from sellers of cars and white goods is free. The purpose of these apparently free services is to convert as much as possible of the advice into lucrative sales for the employer.

> *Things that appear to be free are most often not.*[51]
>
> ***Idar Kreutzer, Managing Director of Finance Norway***

[50] Finance Norway, 5 Feb. 2019: Strong criticism of Australian banks
[51] Finance Norway, 1 March 2016: The financial industry is ready for the fintech revolution

9 Uninformative duty of disclosure

The funds industry's interest organisations argue that clear information about conflicts of interest is an acceptable alternative to eliminating the underlying problem. According to the Code of Good Practice[52] for authorised financial advisers, the customer's interests shall *'come before those of the business and its employees. Conflicts of interest shall be identified and counteracted. If that is impossible, the customer shall be clearly informed about the conflict of interest before an agreement is entered into.'*

In Sweden, the Swedish Investment Fund Association believes that information is better medicine against conflicts of interest than a prohibition. VFF's Swedish sister organisation was delighted when, in 2016, Sweden's Financial Market Minister decided to reject the Swedish financial supervisory authority's recommendation of a total ban on kickbacks.[53] The industry association believed that new regulations would provide stronger client protection in connection with both advisory and other financial services, among other things through increased transparency about kickbacks. The association emphasised that this was a measure it had proposed itself.

Before the introduction of MiFID II, investment firms had a duty to inform clients about possible conflicts of interest.[54] Pursuant to the new regulations, the firms are also obliged to inform clients about '*the measures that have been taken to reduce this risk*'.[55]

The Consumer Council doubts whether this stronger duty of disclosure will prove to be an effective remedy against the harmful effects of kickbacks. It is understandable that fund suppliers prefer stricter information requirements to a prohibition that will probably reduce their profitability. In practice, however, a stronger duty of disclosure has proved to have very little effect. Paradoxically, it can in many cases lead to weaker consumer protection. [56] This applies not least when the stricter duty of disclosure is used as a substitute for or a diversionary manoeuvre to avoid more effective regulation.

9.1 Ineffective consumer protection

A US research report, The Failure of Mandated Disclosure,[57] explores the effects of what it calls the spectacular prevalence and failure of mandated disclosure in the consumer protection context. The report concludes that:

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[52] www.finaut.no: Code of Good Practice (https://www.finaut.no/god-skikk/)
[53] Swedish Investment Fund Association, 23 May 2016: Glädjande besked om provisioner och rådgivning
[54] Securities Trading Act Section 10-10
[55] Securities Trading Act: Conflicts of interest, Section 10-2.2
[56] The White House Council of Economic Advisors, February 2015, page 24: THE EFFECTS OF CONFLICTED INVESTMENT ADVICE ON RETIREMENT SAVINGS
[57] University of Pennsylvania Law Review, Omri Ben-Shahar & Carl E. Schneider, 2011: The Failure of Mandated Disclosure

- First, disclosers do not always provide, and disclosees do not always receive, information.
- Second, disclosees often do not read disclosed information, do not understand it when they read it, and do not use it even if they understand it.
- Third, mandated disclosure does not improve disclosees' decisions

The report describes how consumers are overloaded daily with what is intended to be consumer protection information. Few of them bother to read this information, however, and even fewer understand it.

Behavioural research indicates that the duty to disclose conflicts of interest can actually be counterproductive.[58] For example, it can increase trust if the information is interpreted as a sign of honesty. The client may also be reluctant to reject advice for fear of insinuating that he or she believes that the conflict of interest has corrupted the adviser. The perhaps biggest pitfall, according to the research article, is that industries that are required to disclose conflicts of interest can take this as a moral licence not to do anything about the underlying problem.

The above-mentioned reports from the Financial Supervisory Authority's supervisory visits to DNB, Nordea and Gjensidige in 2017 show that the inability or unwillingness to comply with the duty of disclosure is not just an American phenomenon. In a master's report from NHH in 2017, *Utlånspraksis for forbrukslån (Lending practice for consumer loans)*,[59] informants from 10 out of 11 banks answered either 'no' or 'unsure' to the question of whether the duty has the intended effect. Most people who have seen or heard ads for consumer loans have probably noticed the huge increase in the reading speed towards the end of the ad when the duty of disclosure is fulfilled. This illustrates how firms can meet formal statutory requirements without complying with their intention.

The funds industry makes less use of speeded-up speech, but not all firms make the effort to live up to the intentions of the regulations. In its consultation submission on MiFID II in May 2017, Finance Norway stated that there was a '*large degree of transparency about management fees, including retrocession fees'*. In the Consumer Council's view, this statement was not true then and it is still not. While it is true that it is now possible for clients to find information about retrocession fees, the difficulty of accessing it indicates that many firms have chosen to just provide the minimum level of information. On several platforms, consumers have to navigate via non-intuitive links to long downloadable PDF documents in order to find tables showing the different funds' fees.

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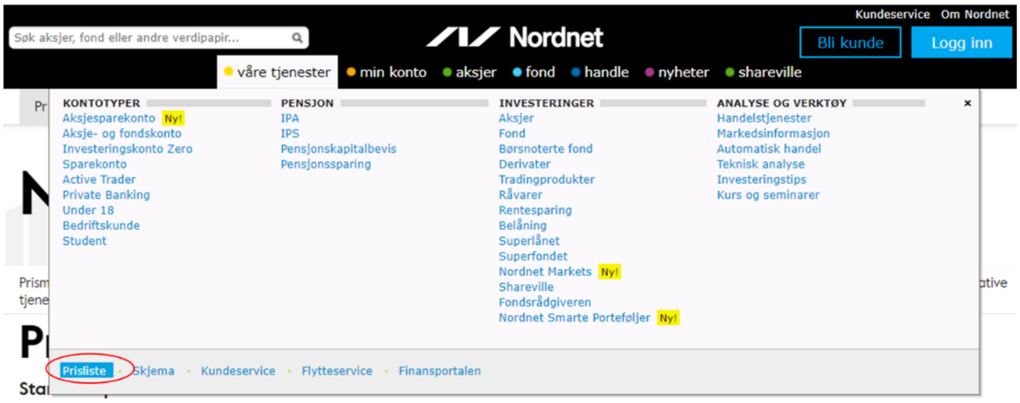
[58] American Economic Review, Loewenstein, Cain & Sah (2011): The Limits of Transparency: Pitfalls and Potential of Disclosing Conflicts of Interest

[59] Master's thesis from the Norwegian School of Economics (NHH) in 2017 by Lena Strand and Mia Sveen (pp. 110/111): Utlånspraksis for forbrukslån

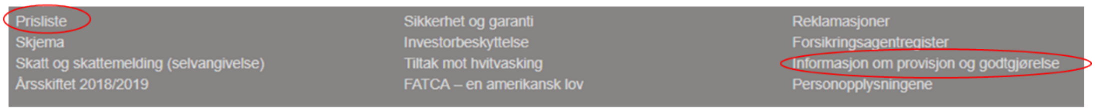
9.2 A Retrocession Odyssey

The screenshots below, which were taken from Nordnet's website in January 2019,[60] can serve as an illustration of how (in)accessible such lists often are on many of the fund suppliers' websites.

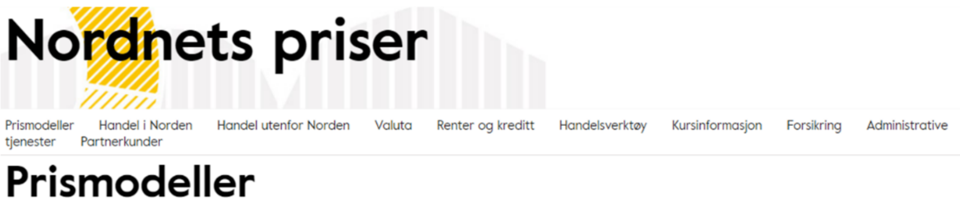
Step 1: Find the pricelist in the pull-down menu on the home page



Step 1: Or in the bottom field on the home page

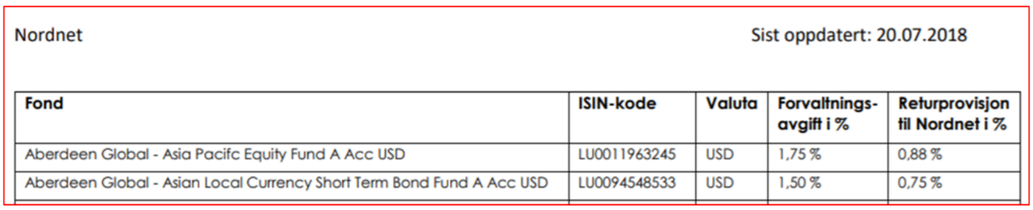


Step 2: Access a list of all prices



Step 3: Scroll past three price models before arriving at funds

Step 4: Find the overview and scroll through a PDF-file listing almost 700 funds



Nordnet Sist oppdatert: 20.07.2018

Fond	ISIN-kode	Valuta	Forvaltnings-avgift i %	Returprovisjon til Nordnet i %
Aberdeen Global - Asia Pacifc Equity Fund A Acc USD	LU0011963245	USD	1,75 %	0,88 %
Aberdeen Global - Asian Local Currency Short Term Bond Fund A Acc USD	LU0094548533	USD	1,50 %	0,75 %

[60] Source: Nordnet, website: https://www.nordnet.no/tjenester/prisliste.html

In addition to being difficult to find, Nordnet's price list does not reflect price changes made after July 2018. Specially interested clients therefore cannot be certain that the information is actually correct.

There is little to indicate that Nordnet is one of the worst operators as regards information. On Sbanken's website, for example, there is no overall overview of retrocession fees. On the bank's chat service, the customer service officer did not know what retrocession fees were when the Consumer Council asked. After having consulted the bank's securities department, the customer service officer said that it was possible for a client to access information about commissions if they first put the fund in the shopping cart and then pressed 'purchase fund'. If the client then pressed 'information about costs', the breakdown between management fees and retrocession fees was shown in an informative graph. If, on the other hand, the client purchases more than one fund at the same time, he will only be informed about the total commission, not the amount of commission per fund. In the Consumer Council's view, it is a bit too late to inform clients about retrocession fees when they already have their wallets out at the cash desk.

THE CONSUMER COUNCIL BELIEVES THAT:

The Consumer Council disagrees with Finance Norway's claim that there is great transparency about retrocession fees. We also believe that the duty of disclosure has a limited effect on consumer behaviour. This applies in particular in cases where the supplier's main goal is to satisfy the minimum regulatory requirements rather than making a wholehearted attempt to inform the client.

9.3 A model of transparency

Vanguard, the world's second biggest fund manager, can serve as an example worth following for the Norwegian industry. The US investment management giant and pioneer of index funds has a price structure that leaves virtually no cost elements to the imagination. The company does not use kickbacks, but collects an account charge in the form of a transparent mark-up to the client. In addition, the company discloses the funds' transaction costs in a separate item. Before the introduction of MiFID II, costs of this type were not reported to the client. MiFID II has turned the spotlight on these concealed costs, which, for example in the UK, can double the annual management costs.[61] As late as 2016, however, the British industry association for investment managers, the Investment Association, stated there was no evidence of hidden charges and

[61] Financial Times, 22 Jan. 2018: Large hidden fund charges revealed by MiFID II rules

costs in the funds industry.[62] In the same year, a survey carried out by the Norwegian Consumer Council revealed that several banks and investment managers failed to show the price when recommending equity funds on their websites.[63]

If the Norwegian funds industry is genuinely concerned with transparency, it should be a reasonably easy matter for it to report costs in the same way as Vanguard.

Vanguard's price structure: an exemplary role model

Fund	Purchase /sales fee	Management fee	Transaction costs*	Success fee	Account charge**	Total investment cost***
Vanguard FTSE 100 Index Unit Trust	0,00 %	0,06 %	0,00 %	0,00 %	0,15 %	**0,21 %**
Vanguard FTSE UK All share index Unit T	0,00 %	0,08 %	0,15 %	0,00 %	0,15 %	**0,38 %**
Vanguard LifeStrategy 100% Equity Func	0,00 %	0,22 %	0,08 %	0,00 %	0,15 %	**0,45 %**

*All costs relating to buying or selling the underlying investments. Includes broker's fees, purchase and sales fees, spread etc.

** Corresponding cost type as an external distributor will charge.

***As a percentage of assets under management

The Consumer Council's own consumer survey on funds (2018)[64] shows that costs are not a prominent topic among advisers. To the question of what the bank's adviser placed most emphasis on when the respondent purchased the fund, only two per cent answered charges.

[62] Financial Times, 9 Aug. 2016: Fund managers dismiss claims of hidden fees

[63] Consumer Council, 22 Nov. 2016: Sparebank1 and Nordea concealing the prices of funds

[64] Consumer Council, August 2018: Consumer survey on funds

10 *The ingrained conflict of interest*

'We fool our customers every day,' an anonymous financial adviser told the online newspaper *Nettavisen* in 2015.[65] In his experience, his bosses reprimanded him if he recommended reasonably priced funds.

> *'Some of the funds pay as little as 0.5 to 0.6 per cent commission, while others pay as much as 1.5 per cent. We don't tell our customers that. Which funds do you think we push most then? The answer is self-evident.'*
>
> *Anonymous financial adviser to Nettavisen*

10.1 Persistent breaches of the regulations

Naturally, a statement from a lone financial adviser does not apply to all of them. It does indicate, however, that self-interested advice did not disappear with the introduction of the authorisation scheme for financial advisers in 2009. Even as late as in 2017, the Financial Supervisory Authority uncovered serious violations of the regulations during three supervisory visits to some of the country's biggest financial institutions.

- **DNB**'s personal banking department was strongly criticised in several areas.[66] Inadequate training of advisers and insufficient collection of information about customers' income situation and total financial obligations were among the findings. The supervisory visit also discovered that the bank's predominant channel for the sale of securities funds, the insurance platform (89 per cent of net subscriptions up until August in 2017), primarily advised customers to choose actively managed funds instead of more reasonably priced index funds. This was not the case on the bank's funds platform, where the choice of index funds was better and the customers mainly chose passive funds. This platform only accounted for 11 per cent of new subscriptions, however.
- Nor did **Nordea** emerge with honour from the Supervisory Authority's visit.[67] The bank's advisory tool did not require that necessary information about the customer's financial situation be obtained. In addition, Nordea sold complicated bond funds that the Financial Supervisory Authority has previously described as unsuitable investment products for consumers. The Financial Supervisory Authority also pointed out that such sales were in breach of Nordea's internal procedures. Nordea was criticised for having played down the risk and costs associated with the sale of complicated

[65] Nettavisen, 25 June 2015: 'Vi lurer kundene våre hver dag'
[66] Letter from the Financial Supervisory Authority of Norway, 13 April 2018: Comments following a supervisory visit to DNB Bank ASA Personmarked
[67] Letter from the Financial Supervisory Authority of Norway, 9 April 2018: Comments following a supervisory visit to Nordea Bank AB (publ) branch in Norway.

credit certificates to customers who were not qualified to purchase such products. The Financial Supervisory Authority concluded that Nordea's practice was in violation of the Securities Trading Act.

- **Gjensidige Bank's** securities business and its distribution of insurance savings products were strongly criticised by the Supervisory Authority.[68] Several clients were given insufficient information about retrocession fees and exaggerated expectations of future returns. The Financial Supervisory Authority discovered that, in a significant number of cases, the bank had breached generally accepted business practices by advising clients to waive high investment guarantees on their individual pension agreements (IPA) in order to convert to unit-linked investment options without guarantees. Nor had Gjensidige documented its recommendations and it had, in part, provided contradictory information in its responses. The Supervisory Authority pointed out that the bank's compliance function had been incapable of performing key tasks.

10.2 Conflicts of interest trump expertise

The authorisation scheme for financial advisers was established in 2009, after the financial crisis and a large number of instances of unscrupulous sales of unsuitable financial savings products. Competence-raising measures combined with stricter legislation and control were soon identified as two measures that were necessary in order to ensure better functioning markets. There is reason to believe, however, that conflicts of interest carry more weight than expertise. Moreover, the Financial Supervisory Authority's conclusions indicate that, despite the competence-raising measures that were implemented, it is difficult for many of those involved to comply with the regulations in a reassuring manner.

It is difficult to give neutral advice based on a business model that systematically leads both advisers and employers into temptation. The institutionalised conflict of interest can result in advisers feeling pressured into either recommending expensive funds or risk losing their jobs.

10.3 Misleading advice starts from the top

In the Consumer Council's opinion, it is the companies' managements that are ultimately responsible for their sales personnel, websites and which funds are offered. It will not help to prohibit commission-based pay if the advisers can either only sell expensive active funds from the group's own management company or are expected to recommend expensive funds. In addition it is not helpful if the management propounds views that would have led to them failing the exam for authorised financial analysts. Statements made by four

[68] Letter from the Financial Supervisory Authority of Norway, 31 May 2018: [Comments following a supervisory visit to Gjensidige Bank ASA]

communications executives in the Sparebank1 system to pengenytt.no in 2017 indicate that the company's own revenues are given priority over correct and neutral investment advice.[69]

All the four communications executives took the view that, over time, actively managed funds yield a higher return than index funds. This means that they are either being deliberately untruthful or that they are ignorant of the fact that 99 per cent of all global equity funds in Europe have yielded a lower return than the reference index over a period of ten years.[70]

The Consumer Council's own report from 2018, which sets out historical figures for funds distributed in Norway for the previous 20 years, points to the same tendency for global, European and Nordic funds.[71] For funds exclusively composed of Norwegian securities, however, the analysis showed that active funds had beaten the index during the same period. For long-term equity saving, however, it is recommended that most of the investment should be managed globally, and here it is index funds that are the winners.

In a study comprising 9,400 funds in Europe, Morningstar found that active funds had only managed to beat passive funds in two out of 49 categories during the ten-year period from June 2008 to June 2018.[72] One of these categories was Norway funds (funds exclusively composed of Norwegian securities), where 60 per cent of the active funds performed better than the passive alternatives during the period.

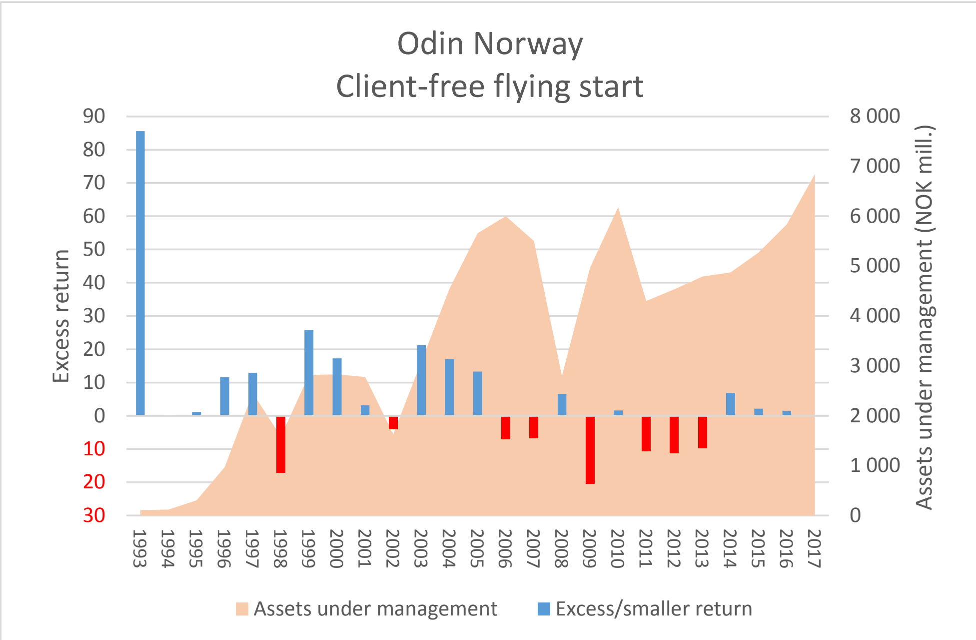
> *We do not offer index funds because we believe that, over time, actively managed funds yield a higher return than index funds. The historical data also confirm this. There is little demand for index funds among our customers, and we therefore see little reason to change the composition of the funds products we offer to our customers.*
>
> ***Thor-Christian Haugland (Pengenytt.no, 26 May 2017)***
>
> ***Executive Vice President, Communications and Sustainability, at Sparebanken1 SR Bank***

Two of the communications executives pointed out that the clients could note with satisfaction that eight of ten Odin funds had beaten the index since they were launched. This claim has little relevance, however, for the majority of today's Odin customers. Generally speaking, funds that perform well in the first

[69] Pengenytt.no, 26 May 2017: Why the banks won't recommend you to invest in index funds
[70] S&P Dow Jones Indices: SPIVA Europe Scorecard 2017
[71] Consumer Council, 13 February 2018: Choose active funds or index funds? – a 20-year analysis
[72] Morningstar, October 2018: European Active/Passive Barometer

few years after their inception survive, while funds that get off to a poor start are either wound up or merged with another fund to avoid being weighed down by a poor historical record. In any case, very few clients reap the benefits of a flying start, because the number of clients and the assets under management are limited during the funds' infancy. In theory, it is possible to launch two funds with diametrically opposite strategies at the same time. After three years, the fund that 'won the bet' is continued, while the one that backed the wrong horse is wound up. This reduces the risk in relation to the reference index, and the fund can live on its good historical record and attract large amounts of investment capital.

Odin Norge is an interesting example of just how little relevance a flying start has for the clients' return. In the first full year the fund existed, in 1992, it delivered an excess return of 86 per cent. At the end of the year, however, the fund only had assets of NOK 110 million under management.



Source: Morningstar and the Consumer Council

The funds industry has found that the road to the top has become much more congested since the 1990s. From 1989 to 2017, for example, the number of US equity funds increased from around 1,000 to around 4,000.[73] During the same period, the number of listed companies in the USA decreased from around 7,000 to just over 4,000. In other words, there are roughly as many US equity funds as there are stocks. Naturally, that also makes it much more difficult for managers to find under-analysed and undervalued stocks.

[73] QUARZ, 9 May 2018: There are now almost as many equity funds as there are stocks for them to invest in

Clients can find financial advisers' sales arguments based on the return since start-up convincing since the advisers have more information than they do, but 'old returns' are not particularly relevant to future returns.

In the Consumer Council's view, selectively choosing investment periods is not compatible with good advice, whether it comes from an authorised adviser or a communications executive.

For several decades now, the current kickback-based incentive structure has caused the funds industry to let the size of the commission decide what advice is given. While it is a firm's management that is responsible for the poor advice, it is ultimately the industry's income model that is the primary source of the conflicts of interest.

11 *A rigid business model and a cash cow for the industry*

The experience from the UK and the Netherlands tells us that changing the industry's fee structure requires regulatory intervention. The current model is so lucrative and ingrained that both investment managers and the distribution system have had a clear self-interest in maintaining the status quo.

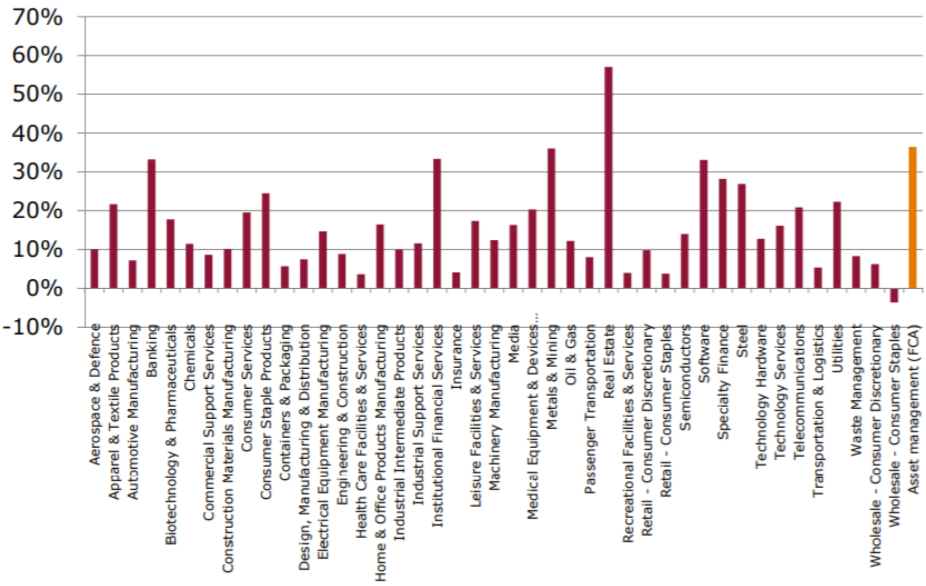
11.1 A business model for mutual enrichment

Lars Sørgård, the current Director General of the Norwegian Competition Authority, wrote a textbook on competition strategy in 2003.[74] In general terms, he describes what are referred to as tacit or implicit cartels.[75] In cartels of this kind, firms have not entered into agreements with each other, but they have a mutual interest in keeping prices high. Such cartels are a milder type of cartel than secret cartels, where firms have entered into verbal or written agreements that are kept secret from outsiders. In practice, the effect on competition is often the same, and it is difficult to judge from the outside whether a cartel is secret or implicit. While the Norwegian funds industry is not a cartel, there is little doubt that the industry's distribution model has helped to perpetuate an artificially high level of fees.

High profitability can be a sign of market failure. The industry's margins do not indicate that there is cut-throat price competition between companies. During the decade between 2006 and 2016, the British investment management industry had the second highest operating margin in the country.[76]

[74] Lars Sørgård, 2003: Konkurransestrategi
[75] Lars Sørgård, 2003, presentation: Kartelladferd – hva er lov?
[76] The British Financial Conduct Authority (FCA), November 2016: Asset Management Market Study – Interim Report Annex 8: Profitability Analysis

Figure 5: 10 year operating margins by industry % (H2 2006 - H1 2016)



We lack a corresponding overview for Norway, but the profitability – and not least wage costs – are very high for an industry that, with the exception of funds exclusively composed of Norwegian securities, over time delivers a return that is below the equity market average. The overview below of a selection of Norwegian investment management firms shows that the average operating margin in 2017 was 19 per cent. This exceptionally good profitability is not the result of underpaying employees. The average payroll cost per employee was NOK 2.4 million. Even after deducting employer's National Insurance contributions and the special finance tax, the average is more than NOK 2 million. The operating margin and the payroll costs do not indicate that the Norwegian funds industry suffers from excessive price competition.

Norwegian investment managers 2017 – high pay and profitability (NOK mill.)

	DNB	Skagen	Odin	KLP	Alfred Berg	Eika	Holberg	Total
Operating expenses	**1 652**	**1 020**	**738**	**456**	**315**	**251**	**183**	**4 614**
Commission to distributors	437	237	359	11	196	90	33	1 363
Payroll expenses	261	375	158	129	91	64	58	1 136
Depreciation	0	12	12	0	1	11	1	37
Other operating expenses	504	187	109	273	51	42	45	1 211
Operating profit/loss	**450**	**208**	**99**	**43**	**(24)**	**45**	**46**	**867**
Operating margin	*27%*	*20%*	*13%*	*9%*	*(8%)*	*18%*	*25%*	*19%*
Number of employees	121	138	57	70	36	24	28	473
Payroll expense per head (NOK mill.)	**2,2**	**2,7**	**2,8**	**1,8**	**2,5**	**2,7**	**2,1**	**2,4**

Sources: The companies' annual financial statements for 2017

Individual companies have to ask themselves whether it would pay to break out of their peaceful co-existence with high prices. Breaking out could lead to a short-term increase in volume, but there is a high risk that the benefits would be short-lived if the competition responds by reducing prices correspondingly.

The illustration below explains why it can pay to maintain the current distribution model:

The funds industry's dilemma

		Bank A		
		A removes kickbacks	A retains kickbacks	
Bank B	B removes kickbacks	A: 0,5%/B:0,5%	A: 1,0%/B: 0,5%	*Commission*
		A: 50%/B: 50%	A: 0%/B: 100%	*Market share*
	B retains kickbacks	A: 0,5%/B:1,0%	A: 1%/B: 1,0%	*Commission*
		A: 100%/B: 0%	A: 50%/B: 50%	*Market share*

Source: Schematic diagram created by the Consumer Council

The model shows that attempts to increase volume by reducing distribution fees would be copied by competitors. The end result would probably therefore be a long-term financial loss due to lower margins and an unchanged market share. Consequently, the industry has a common interest in maintaining the current model for as long as possible.

11.2 *What can replace retrocession fees?*

Industry representatives claim that kickbacks are a precondition for distributing funds through external distributors. Given that the majority of today's clients purchase funds via online platforms, the Consumer Council questions the realism of this description. It is sufficient to look at what actually happened in the Netherlands and the UK after kickbacks were prohibited.

The norm in most industries that use an intermediary is that the distribution or sales outlet pays the supplier, calculates a mark-up and charges the end customer the full price of the product. The mark-up can, for example, be calculated as a percentage of the cost price, or as a fixed amount per transaction. Having more distributors of the same products can create competition that will benefit the clients in the form of lower distribution costs.

THE CONSUMER COUNCIL BELIEVES THAT:

The Consumer Council understands that the funds industry is concerned that increased competition will reduce its profitability. There are no weighty national reasons, however, for the authorities to help the funds industry to continue with a business model that hampers competition and dynamic price formation.

After the prohibitions were introduced in the UK and the Netherlands, a new class of funds was established without built-in kickbacks. Prior to the prohibition, for example, the client paid two per cent to the fund manager, who, in turn, paid one per cent to the distributor in commission. Since the prohibition, the client still pays one per cent to the fund manager, but the commission (kickback) has been replaced by a mark-up that the client now pays directly to the distributor. At the same time, the client is free to choose whether he wants to pay for independent financial advice. A search of British funds supermarkets shows that their distribution fees are between 0.25 and 0.45 per cent. Not all funds will be cheaper in the new structure. Expensive and actively managed funds will become cheaper if a uniform mark-up replaces retrocession fees (kickbacks). Reasonably priced passive funds and bond funds, on the other hand, may be more expensive because they previously paid retrocession fees that were lower than the new mark-up.

Up until the end of 2018, the introduction of MiFID II in Norway had not led to the launch of fund classes without kickbacks. A prohibition will make such funds unavoidable, however, and lead to a new and much healthier competition in the industry that will benefit Norwegian consumers and their savings. If kickbacks are not prohibited, a requirement to offer kickback-free fund classes could have the same effect. It would make it technically possible for independent and cost-efficient funds platforms to challenge the established distribution model.

11.3 DNB throws a spanner in the works

In 2018, there were few signs of instability in the Norwegian funds industry's fee model. In 2019, however, one of Norway's biggest banks, DNB, has announced that it plans to launch a new distribution model that is similar to the system in the Netherlands and the UK. This big Norwegian bank plans to remove retrocession fees on its own funds and replace them with a flat platform charge of 0.15 per cent. DNB is also inviting external fund suppliers to sell net-priced funds via the bank's platform. The new structure eliminates the incentives to sell expensive external funds instead of reasonably priced ones.

The bank will still earn more by selling its own funds, but that problem would not be solved by a prohibition on kickbacks either.

In the Consumer Council's opinion, DNB has made a bold decision that will probably force other industry players to follow suit in one way or another. However, DNB's plan is that the platform charge of 0.15 per cent will be paid by the fund supplier. The Consumer Council believes that it would be better if the fund managers instead stripped the net fund class of all kickbacks and did not pay DNB for the shelf space. It will be more transparent if the clients pay the platform charge in the form of a mark-up, in line with the practice in the Netherlands and the UK. If this is not done differences can, for example, arise over time in the negotiated platform charge that can result in some suppliers paying more than others. That would reintroduce conflicts of interest with the clients.

The industry associations have seen it as important to maintain kickbacks, but in the wake of the changes introduced by DNB, it no longer seems to be the case that all the suppliers share this view.

Håkon Hansen, Group executive vice president for Wealth Management in DNB, puts it as follows:

> *'In countries like the UK and the Netherlands, the prices of funds have already changed dramatically. I believe that the same will happen in Norway as well, and we want to be first.'*[77]
>
> ***Håkon Hansen, Group executive vice president for Wealth Management in DNB***

He believes it is fair to reduce the prices now that more customers are trading digitally and doing the job themselves.

Rune Selmar, Managing Director of the Odin funds, believes that DNB's price cut is a consequence of the trend away from kickbacks.[78] The trend now is that distributors are instead paid directly by the clients for the advice provided, he told *Dagens Næringsliv* in February 2019.

> *Historically speaking, around half of the management fee has been used to cover the retrocession fee, and when that is removed, it is also easy to halve the fee.*
>
> ***Rune Selmar, Managing Director of the Odin funds***

[77] DN.no, 3 February 2019: DNB kutter kraftig i fondsgebyrer

[78] DN.no, 4 February 2019: 'Folk har betalt altfor mye. Det man betaler, står ikke i forhold til det du får igjen'

It is a large step in the right direction if DNB’s change leads to genuine price competition in the distribution of funds. However, it does not remove the need for a general prohibition on kickbacks. Clients must be able to trust that the financial advice they are given is not motivated by third-party payments.

12 Robots to the rescue?

This report has established that the number of fund clients who in practice receive 'free' advice in direct dialogue with their adviser is small and decreasing. The vast majority trade digitally. If kickbacks are prohibited, access to today's sales-motivated advice will be further limited. Clients who still want personal advice will either have to accept paying an hourly rate or pay an annual fee for access to it. We know from experience, however, that many clients do not want to pay for advice if they are given the option of opting out.

To fill this 'financial advice gap', several actors have launched robo-advisers that, in a reasonably priced and fully digitally process, guide clients to make sensible investment choices. Robo-advisers must not be confused with self-service online trading solutions for buying and selling funds, which have already become the most common way of buying funds.

12.1 Robots v. human beings

In principle, the competition between a human adviser and a robot is an uneven match in humanity's favour. In Finaut's annual questionnaire survey from 2018, 74 per cent of the respondents answered that they had very strong or strong trust in advice given by a competent adviser.[79] Trust in advice from an intelligent robot scored considerably lower, at only 26 per cent.

Finaut's question is a good point of departure for understanding the public's attitudes to financial advisers. In methodological terms, it must be assumed that these answers will change markedly if the wording of the question contains assumptions about costs and conflicts of interest. In January 2019, we therefore put our own questions to a panel of almost 400 consumers who had private investments in equity or bond funds.[80] The Consumer Council asked the same questions as Finaut, and 58 per cent of the respondents trusted a human adviser, as opposed to 23 per cent for a robot. Only 18 per cent were willing to try savings advice from a robot. Only 2 per cent of the respondents in the Consumer Council's survey had already tried a robo-adviser.

However, the human adviser's head start disappeared when the respondents were told that the employer earns more from selling expensive funds than reasonably priced funds. At the same time, they were told that the regulations require firms to safeguard the client's interests. With this information on board, only 23 per cent now had strong or fairly strong trust in the human adviser.

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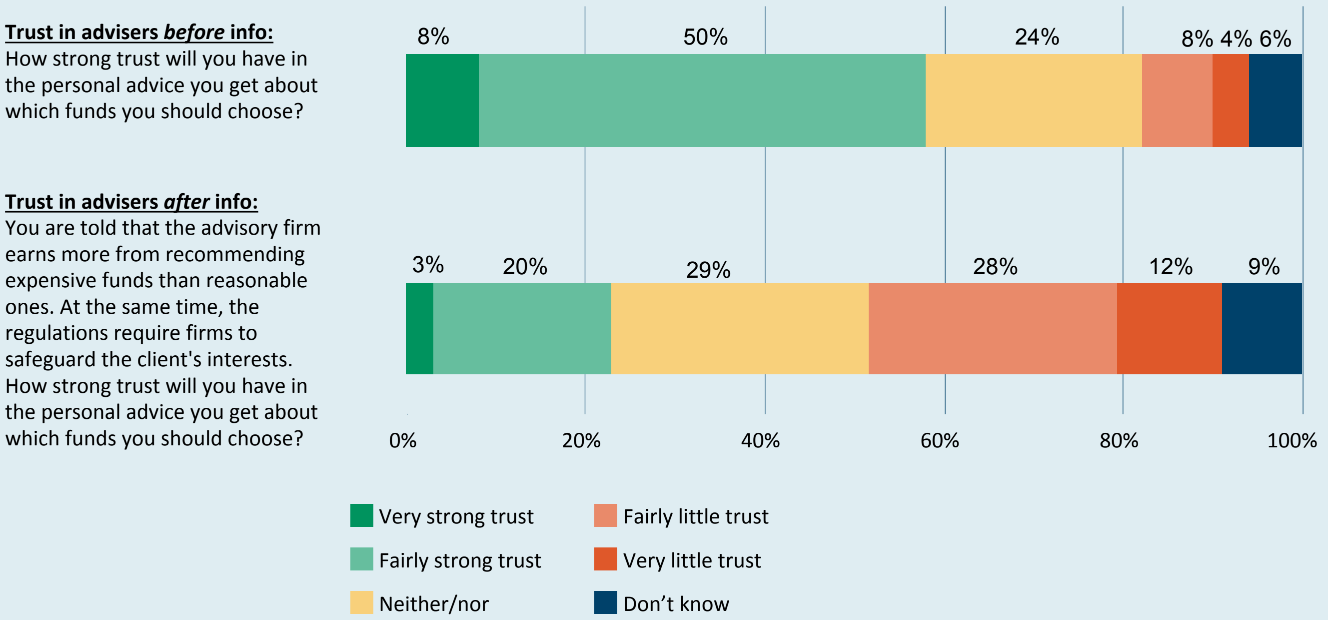
[79] Finaut's questionnaire survey 2018: Consumer and finance trends 2018: Robots v. human beings

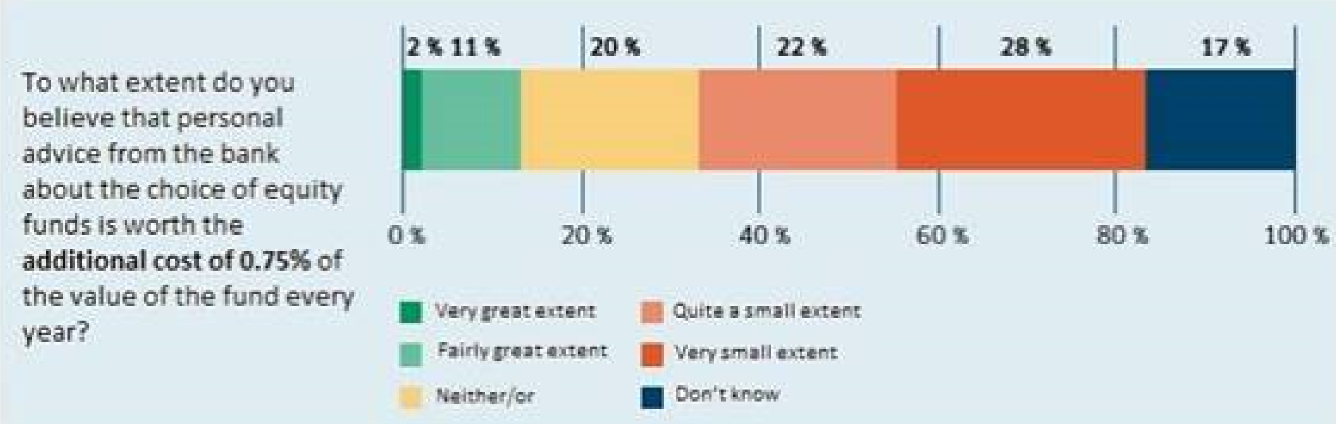
[80] Consumer Council, January 2019: Survey on retrocession fees and robot advice

Interest in personal financial advice is also considerably lower when the clients are told that the advice entails an additional cost of 0.75 per cent of the value of a fund every year. Only 13 per cent believed that the service was worth the price 'to a great extent'.[81]

Information about commission arrangements challenges trust in personal advisers.

Trust is more than halved even though this information is balanced by information about the regulatory requirement to safeguard the client's interests.





[81] Source: Finaut's questionnaire survey 2018: Consumer and finance trends 2018: Robots v. human beings

If it turns out that a robot-created portfolio has an annual cost of 0.6 per cent compared with a man-made portfolio with a cost of 1.2 per cent, 18 per cent would choose the robot and 12 per cent the human being. The robot has little reason to rub its virtual hands in glee, however. It is in fact outcompeted by a self-composed portfolio at an annual cost of 0.25 per cent. Of the respondents, 41 per cent preferred the self-service alternative, which was also cheapest, while 30 per cent did not know what to answer.

Question

Imagine that you are going to save in equity funds. If these advisory alternatives were possible, which would you choose?

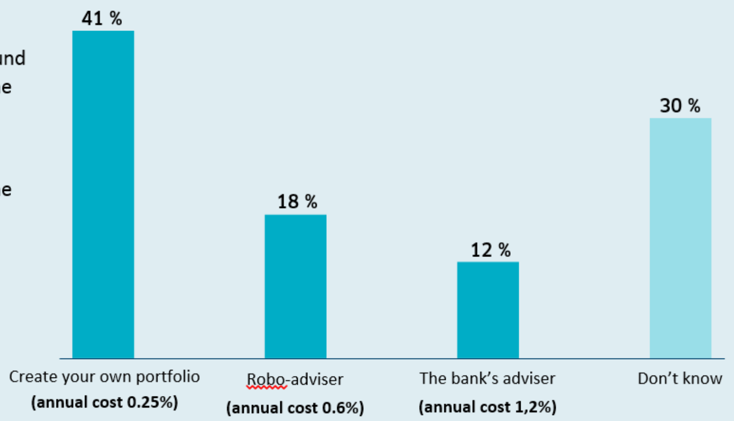
Response alternatives

The bank's adviser recommends a fund portfolio for you. You pay 1.2% of the value of the portfolio per year.

A robo-adviser recommends a fund portfolio for you. You pay 0.6% of the value of the portfolio per year.

You create your own portfolio of reasonably priced funds and pay 0.25% per year.

Don't know.



12.2 Robots with personality

Automated advisory services are still in their youth, as they first popped up between 2008 and 2010.[82] In the initial phase, it was mainly independent start-ups that offered robo-advice. The established firms are following suit, however, and are increasingly offering robo-advice as an integral part of their services. In 2016, there were already more than 350 robo-advisers worldwide. International management giants such as Vanguard, BlackRock, Fidelity and Schwab offer automated advice in order to deliver cost-efficient solutions that were previously reserved for professional investment advisers.

Robo-advisers are a relatively new phenomenon in Norway, but established players such as Sbanken, Nordea, Nordnet and Kron have all launched savings robots. DNB has announced that it will launch one in the first half-year 2019. It does not require much stretch of the imagination to foresee that robo-advice will become an important means of serving clients who do not want to pay for personal advice, but who nevertheless need a helping hand.

It is understandable that the epithet 'robo-adviser' does not score very high on the trust scale. In practice, it is the result of merging modern portfolio theory

[82] Line Bjerknes & Ana Vukovic of NTNU, June 2017: Automated Advice: A Portfolio Management Perspective on Robo-Advisors

with digital tools that one encounters in other virtual arenas. The robot is a financial adviser that uses algorithms to build, optimise and manage a client's investment portfolio.[83] The client is guided through a process consisting of questions about savings targets, appetite for risk and financial position. The end product is usually a proposal for a portfolio allocation with an automatic rebalancing option based on a limited selection of predefined portfolios.

In this report, we have pointed out that there are large variations in the quality of human advice. It would be good if today's robo-advisers had conferred more with each other, because their advice is highly divergent. A 2018 report from Better Finance on robo-advice reveals big differences in both the expected return and the recommended allocation between investment classes.[84]

Better Finance studied eleven robot platforms from seven European countries and five from North America. The aim of the study was to find out to what extent automated financial advisory services managed to deliver personal investment advice to consumers with limited financial competence. Better Finance therefore created two client profiles and sent them out as 'mystery shoppers'. On a general level, the study shows that the different platforms gave sufficiently individual investment advice in the same way as a human adviser would have done. The automatic services were also considerably cheaper than traditional advisers. They could therefore help to attract more private investors to the equity market.

At the same time, Better Finance observed a disconcertingly large spread in both the expected return that was indicated and the recommended allocation between equities and other assets. There were also several examples of a poor match between the desired risk profile and the proposed equity share or expected return.

As regards user friendliness, the robots have to tread a fine line between the need for simplicity and providing enough detail to both satisfy the regulations and give relevant advice. In addition, the robots have to take the clients' generally low financial competence into account by providing definitions and explaining the contents during the process.

Low costs and accessibility are the robots' primary competitive advantages. Most platforms offer a simple fee structure. The fees are mostly easy to find on home pages, but around half of the 16 robo-advisers that were tested did not present information about costs on the last page, where the investment proposal was presented to the client.

[83] Line Bjerknes & Ana Vukovic of NTNU, June 2017: Automated Advice: A Portfolio Management Perspective on Robo-Advisors

[84] Better Finance research report, 4 July 2018: ROBO-ADVICE: EUROPEAN INDIVIDUAL INVESTORS TAKE A LOOK UNDER THE HOOD

12.3 Norwegian robots

The Consumer Council has tested the Norwegian robo-advisers. The test is less extensive than Better Finance's report, but is shows that Norwegian robo-advisers also have trouble keeping in step.

So far, it is only Nordnet, Sbanken, Kron and Nordea that offer digital funds advisers in the Norwegian market. All the robo-advisers ask questions about the clients' financial competence, risk tolerance, personal finances, savings horizon and savings capacity. However, only Nordea and Sbanken check clients' debt situation. Both these robo-advisers advise clients with consumer debts not to save in funds because the interest expenses are normally higher than the expected return. In the Consumer Council's *mystery calling* survey of financial advisers in 2018, only around half the respondents asked clients whether they had consumer loans or credit card debt.[85] In this sense, well designed robo-advisers can serve as a guarantee that it will not be the adviser's expertise or how they are feeling on any particular day that decides whether the advice given is correct or not.

It is not easy to define whether a robo-adviser is actually an advanced funds package selector rather than a funds adviser. Finaut has taken the initiative, however, to authorise savings robots in the same way as they authorise human advisers.[86]

It is no simple matter to compare robots with different personal preferences and thoroughness. To make the survey as comparable as possible, we have selected the most risk-seeking client profiles with all the savings robots. There is therefore a preponderance of equities in the portfolios.

Norwegian robo-advice with maximum risk profile

Savings robot	**Annual fee**	**Automatic rebalancing**	**Percentage equities**	**Percentage Norway/ Nordic**	**Expected annual return before costs**	**Expected annual return after costs**
Sbanken - Sparerobot	0,61 %	No	90 %	44 %	8,4 %	7,8 %
Kron - Indeks	0,29 %	Yes	90 %	0 %	7,2 %	6,9 %
Kron - Utvalgte	0,99 %	Yes	90 %	33 %	7,9 %	6,9 %
Nordnet - Fondsrådgiveren	1,01 %	No	100 %	30 %	NA	NA
Nordnet - Smarte Porteføljer	0,99 %	Yes	NA	NA	NA	NA
Nordea - Nora	0,92 %	Yes	75 %	Under 20%	7,8 %	6,9 %

Source: The Consumer Council, with figures from robo-advisers' websites

Costs: Kron's index portfolio is the most reasonable alternative by far. It costs 0.29 per cent a year and is thereby not much more expensive than purchasing index funds individually. Sbanken's robo-adviser is the second

[85] The Consumer Council's mystery calling survey, 14 March 2018: The bank's advice could easily prove expensive
[86] Finaut, 1 February 2018: Checklist for digital solutions aimed at clients in the savings and investment category

cheapest with an annual fee of 0.61 per cent for its portfolio of index funds. The other robo-advisers have chosen a larger proportion of active funds and end up with an annual cost of around 1 per cent.
It is worth noting that it may be more expensive to purchase funds through a savings robot than buying the same funds directly from a funds platform established by the banks. Smart clients can therefore use a savings robot to get advice and then purchase the recommended funds via another channel. Sbanken's robot clients can save 0.24 per cent in annual fees using this method. All the robots disclose the annual costs as both a percentage and in NOK in a transparent way. In the Consumer Council's experience, transaction costs are also included in the annual costs. SBanken clearly states in the same place as the total cost how large a part of the fees are retrocession fees. Nordnet makes it a bit more difficult to find information about such fees and gives them three different names in three different places: intermediary commission, distribution cost and commission. These different designations mean it is not immediately clear that they all refer to payments made to a third party.

- **Expected annual return:** While it is not easy to predict the future correctly, it is not difficult to make predictions. Little emphasis should therefore be placed on who holds out expectations of the highest future return. What the robots that have taken the chance of predicting the future have in common is that the expected return is higher than the expectations of both Finance Norway[87] and the Government Pension Fund. SBanken takes the brightest view of future prospects with an annual return before costs of 8.4 per cent. In comparison, Finance Norway's industry agreement recommends using an inflation-adjusted return expectation of 5.75 per cent.
- **Portfolio allocation:** The Consumer Council's overview illustrates that portfolio composition is not an exact science. Even for our client with a big appetite for risk, the equity share varies from 75 to 100 per cent. There is also great variation in the geographical spread. At one extreme, we find Kron's index portfolio with only global equities, while, at the other end, we find SBanken with 44 per cent in Norwegian and Nordic equities. That is well above what is normally recommended as a sensible geographical diversification.
- **Automatic rebalancing:** Some of the robo-advisers recommend variations of balanced funds with a different allocation between equities and bonds, while others suggest individual purchases of several funds. One of the key things about robo-advisers is that they should make investing as easy as possible for the clients, so that they do not, for example, have to keep track of whether the asset allocation in the portfolio changes. In the Consumer Council's opinion, periodic rebalancing of the portfolio should therefore be included in the service. If not, the client might as well take the robot's advice and purchase the funds directly. Sbanken does not offer automatic

[87] Finance Norway, 13 September 2018: Agreement on return forecasts

rebalancing yet and the clients can reduce the annual fee from 0.61 per cent to 0.37 per cent by purchasing directly from the bank's funds marketplace.

- Individual adaptation of portfolios: Nordea and Nordnet's robots limit the selection of funds to either a family of balanced funds with different equity shares/volatility or a small selection of equities and bonds with a varying mix. Sbanken offers a little less variation in its portfolios. Kron gives clients a choice between as many as seven thematic variants, such as index, equality, environmentally awareness, technology, the Government Pension Fund Global, property and Kron's selection. A broader selection can be important for some clients, but it can also be a way of charging clients more. Kron's index portfolio is the most reasonably priced in the test, but the costs of Kron's other portfolios are on the same level as the most expensive robots, even though there is a large share of reasonable index funds in the portfolios. There are also big differences in the geographical risk spread that are not clearly shown when choosing a theme.

12.4 No hard act to follow

Robot advisory services will undoubtedly become more common, but they will not eliminate self-service clients or the need for personal advice. Instead, they will be one item on a menu from which clients can choose based on how much assistance they need and are willing to pay for. We note both that established investment managers are launching robo-advisers and that automated platforms are offering human advice for an extra fee. It is a 'both the one and the other' situation rather than a case of 'either or'. The transformation travel agencies have undergone is a natural comparison here. Simple trips have been taken over by online travel agencies' algorithms. There is a market for more demanding assignments, however, and that is where human advisers still have a competitive advantage.

It is easy to find errors and shortcomings in the present generation of robo-advisers, but they don't exactly have a hard act to follow. They are intended to fill a vacuum left by a business model that has systematically under-communicated conflicts of interest, given the impression of giving free advice and misled naive clients to choose unnecessarily expensive funds.

Like electric cars, robo-advisers have some way to go before they reach their full potential. They manage for the most part to put together good portfolio proposals for clients, but they are only as good as the human beings that have programmed them. Naturally, their employers still have an interest in charging as much as possible for their services. Unless they are overseen by the supervisory authorities, the press and competitors, there is a risk that robo-advisers will fall into the same temptations as their human colleagues.

It is much easier, however, to keep tabs on what ten robo-advisers do than 1,000 human advisers. The funds distributors cannot blame human error when the Financial Supervisory Authority makes a virtual supervisory visit. The Supervisory Authority will not have to delve deep into archives and listen to countless phone conversations. It will be enough to sit in the client's chair and carry out a virtual advisory session.

13 Conclusion

The funds industry believes that there are no special reasons why Norway should introduce stricter rules that deviate from the main rule in MiFID II.

THE CONSUMER COUNCIL BELIEVES THAT:

The Consumer Council believes, and has documented, that a total ban on kickbacks is the most important single measure that can be taken to reduce the inherent conflicts of interest between fund suppliers and non-professional clients.

The industry's own standard states that '... *conflicts of interest shall be identified and counteracted*. *If that is impossible, the customer shall be clearly informed about the conflict of interest before an agreement is entered into.'* In Norway, it is both perfectly *possible* and absolutely necessary to counteract the conflict of interest by prohibiting kickbacks.

The decision rests with the Ministry of Finance, which, under the authority of the Securities Trading Act, can issue regulations containing provisions that, in special circumstances, prohibit the receipt of payments from parties other than clients. The Consumer Council recommends the Ministry to take this opportunity to ban kickbacks.