EMERGING CHALLENGES IN RETAIL FINANCE AND CONSUMER POLICY

Conference

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This steering note is to provide participants with background information on the topic and to stimulate questions to be addressed during the conference. It does not reflect the opinions, views or policy positions of the European Commission. Neither the European Commission nor any person acting on its behalf may be held responsible for any use of the background information contained therein.

Agenda point 1: Safer and simpler financial products – presentation of the topic for discussion

1. Brief introduction

In recent years, we have witnessed a number of significant mis-selling scandals across the EU. These scandals covered a wide range of financial products from mortgage credit to insurance or investment products, which sometimes were very complex or simply not suitable to the needs of retail consumers and investors, or which were offered automatically regardless of the customer's profile. The increasing complexity of financial products probably explains part of these mis-selling scandals which were highly detrimental to consumers in several Member States and led to an overall loss of trust in the financial industry. A number of regulations have been introduced both at European and national levels in response to these incidents, and to make financial markets safer and more accessible for consumers. While the objective of this session is to look at the areas where further policy action might still be needed, the discussions will take full consideration of the existing and recently adopted EU measures, including those which are either in the negotiation or implementation stage.

2. State of play and possible ways forward

In order to restore consumers' confidence in the financial services area, European policy makers introduced new requirements enhancing consumer protection by means of sectoral and cross-sectoral legislative initiatives recently adopted in the financial services area, e.g. Mortgage Credit Directive (MCD), Market in Financial Instrument Directive II (MiFID II), on-going review of Insurance Distribution Directive (IDD) and Regulation on a new Key

Information Document for packaged retail and insurance-based investment products (PRIIPs).

These rules established new disclosure requirements aimed at giving consumers clear and simple information on the financial product they intend to purchase. They will enable consumers to choose financial products more effectively and easily, and compare similar products available on the market. Besides, the new legislative acts aim to improve the business practices in the financial industry, clearly identifying the specific needs of retail consumers and investors, in particular during the selling process.

In addition to tackling important weaknesses related to the sales of financial products, European policy makers also introduced some rules with regard to the product development process as an additional measure to limit the risk of mis-selling (e.g. UCITS legislation, MiFID II, and ongoing review of IDD). While these principles are quite general at this stage, the upcoming level 2 measures for MiFID II should provide for more concrete organisational requirements on manufacturers. Besides, the European Supervisory Authorities issued in November 2013 a joint position[1] on Manufacturers' product oversight and governance processes, which establishes a set of high-level, cross-sectoral principles on financial institutions' internal product approval process. Lastly, some supervisors, including at European level, have been attributed powers to intervene and withdraw from the market the products which are detrimental for consumers.

To regain consumers' trust, European policy makers also decided to make access to the most essential banking product for citizens – payment accounts – easier and more competitive. In this context, the recently adopted Payment Accounts Directive (PAD) establishes the right for all European consumers to access a basic payment account, irrespective of their place of residence and financial situation. Indeed, 58 million European citizens are still unbanked and do not have access to this essential banking product for everyday life. Like other recent legislation adopted in the financial services area, the PAD also introduces new transparency requirements as regards fees charged by providers and easier switching process for payment accounts to the benefit of all retail consumers.

Following this legislative initiative, which will strengthen both financial inclusion and competition in the retail banking sector, it would be worth assessing whether access to other essential financial products such as saving accounts, loans or insurance products – necessary for the vast majority of consumers once in their life – should be further facilitated.

3. Aspects of the topic to be addressed during discussions

Product governance can intervene at different stages in the life of a financial product and can take various forms.

[1] http://www.eba.europa.eu/-/eba-eiopa-and-esma-publish-joint-position-on-product-oversight-and-governance-processes

As underlined in the previous section, a number of issues related to product intervention powers for supervisors and product governance have been already addressed or are under discussion for the development of EU measures regulating the sale of investment and insurance products. It might nevertheless be worth looking at those principles of product governance which could be relevant for other sectors or which could have a more horizontal application. The topics to be discussed could include: the types of procedures to be implemented and their traceability, the need for prior approval of financial products, the allocation of tasks and responsibilities between manufacturers, distributors and supervisors. While taking into account the existing or incoming rules (e.g. MiFID II and the level 2 legislation), should such processes potentially apply to financial products across all or just selected sectors? Based on what criteria could the eventual selection of sectors or products be made? How far should product oversight and governance rules cover the people involved in the sale of the product?

Once the product is available on the market, and as envisaged by MiFID II, specific oversight mechanisms should also be implemented to verify whether the product is performing according to the initial scenario.

The Netherlands for example adopted in January 2013 a new decree[2] which requires financial institutions to include a balanced consideration of consumers' interest in their product development process. The scope of these new rules is very broad and covers savings, insurance and lending. Whereas there are also other Member States which have already introduced product governance rules, the scope of these national provisions will have to be assessed with an eye to the new and upcoming EU legislation as mentioned earlier.

While trying to ensure that safer products are launched on the market, policy makers may also want to reflect about the actual needs of retail consumers and investors as regards financial products. Indeed, most of consumers will buy a limited number of financial products during their life. They will first need to manage their finances for their essential needs, such as buying a property and saving, in particular for their pension. Making these choices should be straightforward for consumers, who should be able to rely on simple products and simple processes.

Following the initiative on Payment Accounts, it would be useful to discuss the potential need for further basic financial products that could serve the interests of a vast majority of consumers. At the same time, it would be interesting to ask whether simple financial products could also represent a viable commercial proposition for the industry.

The UK government has been working on these issues since 2011 and asked a steering group to define a set of simple financial products that could suit the essential needs of the majority of consumers. As a result, the Sergeant Review of simple financial products [3] was published

[2] Section 32 of the Market Conduct Supervision Decree

[3] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/191721/sergeant_review_simple_products_final_report.pdf

in March 2013, including six pragmatic recommendations covering the following topics: the types of products that should be targeted first, the distribution channels for these products, the setting up of badges to inform consumers about these products and the needs for an accreditation scheme.

4. Potential challenges in terms of policymaking

The introduction of rules and principles concerning simpler and safer financial products would have to face two main challenges:

1. Choosing the most effective policy approach

2. Co-ordinating with existing rules and initiatives

4.1 Choosing the most effective policy approach

Implementing product governance rules or even more specifically, introducing and promoting simple financial products on the market could be achieved in many different ways, e.g. using binding measures such as direct market intervention or softer approaches including industry codes or guidelines from supervisory authorities.

As regards the introduction of simple financial products, it should be assessed whether direct market intervention is preferable to a softer policy action. The softer approach could take the form of certification or labelling of products, for which criteria to comply with would have to be precisely defined. Market intervention could take various forms including tax relief to incentivise consumers to buy these products.

The option of direct market intervention (i.e. forcing banks or insurance companies to offer certain products) may pose issues with respect to the legal basis of the Commission action as well as its proportionality. In principle, only a major market failure could justify a direct intervention on products offered by financial institutions.

An alternative to direct market intervention would be the certification or labelling of products that comply with certain criteria of transparency, simplicity and safety. The EU could develop a set of principles to identify products that should be considered adequate to a certain category of consumers and provide means to make them easily identifiable, such as an accreditation or a "simple/safe product" label. This would reflect the approach taken in the UK.

While this policy approach would be more appropriate in relation to proportionality and subsidiarity, the actual offer of such products on the market would ultimately be left entirely to the banks' or insurers' initiative. This means that simple products would find their way to the market only if banks or insurers consider them sufficiently profitable. The definition of the criteria to identify simple products should take these aspects into account. At the same time, the labelling itself could act as an incentive if properly implemented: if consumers trust the label sufficiently, this would increase the purchase of financial products by retail customers, which in turn could result in a substantial increase in revenues for the banks offering such products.

The choice of instrument (i.e. non-binding vs. legislative/binding measures) would also be relevant in this respect, depending on which policy approach is considered preferable and more viable.

4.2 Co-ordination with existing rules and initiatives

As highlighted above, existing measures already provide a high level of consumer protection in the area of financial services. Any new policy to introduce product governance rules or promote simple financial products should be co-ordinated with existing rules.

It is important to assess whether the existing rules leave gaps in terms of consumer protection which may need to be filled. What would be the areas where an intervention may be needed? For example, both MiFID and MiFID II contain provisions related to product governance. In particular, MiFID II rules aim to guarantee that an investment firm identifies the target market of clients for a financial product, its channel of distribution and that it assesses the risks related to such a product. Also, it aims to ensure that distributors are provided with sufficient information about the product and therefore are able to better serve the interests of their clients. The IDD similarly would aim to match the target market with the relevant customers of insurance products.

We will only be able to assess the effectiveness of these new principles once they are in force. However, could additional action be already envisaged in other sectors or for other group of products, to ensure that consumers can clearly identify the products which are suitable for them? If so, in which direction should it go?

Furthermore, if action is ultimately taken with respect to simple financial products, the specific rules should not overlap, contradict or even undermine the provisions contained in other relevant legislative acts. For example, the identification of a product as "simple/safe" should not imply a more relaxed regime with respect to transparency and risk assessment that that devised under MiFID.

5. List of possible questions for the discussion

As regards product governance principles:

- Are the eight principles included in the Joint Position on Manufacturers' product oversight and governance processes[4] sufficient to make financial products safer and more adequate for consumers?

- How could one adapt them to the different types of financial products (exercise currently launched in EBA for banking products for instance)?

- Are there horizontal measures as regards product governance in your Member State?

- If yes, how is consistency ensured between horizontal and sectoral requirements as regards product governance rules?

[4] http://www.esma.europa.eu/system/files/jc-2013-77_pog_-_joint_position_0.pdf

- Which specific sectors of financial services or financial products are addressed with product governance rules in your country?

- Given cross-border nature of some of the financial products, and taking into consideration the already existing measures (e.g. MiFID II, PRIIPs), where should we aim in terms of product intervention at EU level? Should these measures be extended to other sectors or products?

- In case there is a new initiative proposed on product governance or simple financial products, how the existing or upcoming EU rules can inform this process and ensure cross-sectoral consistency where appropriate?

As regards simple financial products:

- How would you define simple financial products? What criteria should they follow? Are there already any definitions that have been applied in Member States?

- Are you aware of examples of existing simple financial products in your country or elsewhere in the EU? What kind of simple products are offered?

- Based on your experience, do these products work for consumers? Did the introduction of rules on simple products increase consumers' interest in them? Was there criticism on the way such policy was taken? If so, what was the main criticism?

- Do the existing measures already sufficiently address the needs of consumers? Is there a need for further action?

- If further action is needed, what and how added value could be provided? Do consumers need more protection against risks? Do they need more transparency? Do they need more clarity?

- What policy approach appears preferable to tackle the issue of simple products? Market intervention or accreditation/labelling? Could a 29^{th} regime be introduced for the development of a product on a voluntary basis? Would you have other suggestions?

- Which criteria would be the most relevant for consumers to identify a simple/safe product? And how could these criteria be combined with sufficient incentives to banks to propose these products?

- What kind of approach would be preferable? Horizontal (all products or a large category of products) or vertical (following the UK model)?

- Is there an incentive for the financial industry or insurance companies and pension funds to offer simple financial products? What advantages can this approach bring to the industry?