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Green Paper on retail financial services: better products, more choice, and greater opportunities for consumers and businesses

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Response of:

European Investors' Association IVZW

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Introduction

The European Investors' Association (**"European Investors"**) was founded in July 2015. It is a unique association with individual membership that aims to strengthen the representation of retail investors and their interests in the EU, both in and out of court.

Since retail investors are greatly affected by EU legislation but are often not in the position to exercise any influence on its making, we always welcome the opportunity to comment on EU regulatory initiatives on their behalf, including Green Papers which often form the basis for further legislative work.

General remarks

European Investors fully supports the objectives of the Green Paper on Retail Financial Services, i.e. to make it easier (i) for companies based in one EU Member State to offer retail financial services in other EU Member States; (ii) for consumers to be able to buy retail financial services offered in other EU Member States; and (iii) for citizens to take their financial service products with them if they move from one Member State to another, whether to study, work or retire.

The Green Paper on retail financial services is mentioned as one of the action points in the Action Plan on the Capital Markets Union (**"CMU"**) under the heading "increasing choice and competition for retail investors". When talking about 'better products, more choice and greater opportunities', we believe the investment services and products market is indeed one where quick wins can and should be made:

- The EU Consumer Scoreboard of 2014 shows that the market for investment products, private pensions and securities is performing very poorly and is ranked at the last position of the 31 services markets that are analysed.
- Generally speaking, the nature of investment products and services is not to the same extent influenced by cultural factors as, for example, insurance, mortgage and pension products (although also for funds, national taxation is a major issue).
- There is clearly an increased importance of retail investment in light of the demise of collective schemes for financing, for example, retirement provision, social security and education (especially at the moment, taking into consideration the low-interest rates on savings deposits).

General concerns

When reading the Green Paper, and also when listening to the discussions during the Public Hearing on March 2, one gets the impression that retail investment as such is not within the scope of the Green Paper. Considering our aforementioned general remarks, we believe that would be regrettable.

While we are aware that some of the issues in the retail investment products and services market will be dealt with through the CMU, particularly the consultation on the main barriers for the cross-border distribution of funds (Q4 2016) as well as the EU retail investment product markets assessment (2018), we believe retail investment should be at least as much in the focus of the Green Paper as other retail financial services, such as insurance, payments, mortgage etc.

Questions

1. ***For which financial products could improved cross-border supply increase competition on national markets in terms of better choice and price?***

In the packaged retail investment products market (i.e. investment funds), cross-border activity is quite limited and market fragmentation is still a prevalent issue, despite the success of the undertakings for collective investment in transferable securities (**"UCITS"**) framework. Research by Better Finance shows that, as a result of this fragmentation, the number of funds in the EU is extremely high as compared to the US (32.750 versus 7.886), that their size is considerably smaller (the average fund in the US is almost 7 times larger than the average fund in the EU) and the fees charged by managers is much higher (170 vs 74, equity funds only, bps)[1].

We are therefore very supportive of the European Commission's plan to consult in 2016 on the main barriers to the cross-border distribution of investment funds. This will, according to the CMU Action Plan, include in particular disproportionate market requirements, fees and other administrative arrangements imposed by host countries and the tax environment.

It is important to note in this regard that a considerable portion of the funds sold to retail investors are Alternative Investment Funds (**"AIFs"**). While the AIF Managers Directive (**"AIFMD"**) framework was meant to provide managers of hedge funds, real estate funds etcetera with a passport to be able to market these funds to professionals across the EU, it is also used by managers to market UCITS-like 'regular' funds to retail investors on a national basis. For these retail AIFs no passport is available and national requirements (often less stringent that those that apply to UCITS funds) apply.

Considering the sheer number of funds in Europe, one would say choice is not a problem. However, the problem is that this high number of funds does not generate the type of demand-led competition that would lead to lower prices and an increase in the quality of products offered. Two important reasons:

- Lack of transparency on fees and charges, past performance figures and the fund manager's investment strategy (see Q9) which makes it difficult to compare products.
- Closed intermediation channels, limiting the range of funds offered to retail investors by banks and other investment firms (see Q15). Even though there are many funds on the market, this does not mean a retail investors has access to them. Those that are offered by a certain bank are not necessarily the most suitable ones for a particular investor.

2. ***What are the barriers which prevent firms from directly providing financial services cross-border and consumers from directly purchasing products cross-border?***

Apart from language, we believe the following barriers that prevent consumers from directly purchasing investment products cross-border are worth mentioning (random order):

i. Closed distribution networks. National markets in the EU are often dominated by a limited of distributors (mostly banks) who offer only a limited range of products to their clients, regardless of whether there are cross-border (or third-party) products available that might be more suitable. As consumers are often not aware of these more suitable products offered in other Member States, they do not ask intermediaries for it.

[1] http://betterfinance.eu/fileadmin/user_upload/documents/Position_Papers/Financial_Markets_Infrastructure/en/CMU_Briefing_Paper_-_For_Print.pdf

ii. No possibilities for individual (and collective) redress. Where substantive EU rights are infringed, citizens and business must be able to enforce the rights granted to them by EU legislation. The lack of adequate redress possibilities in some Member States and the problems one faces in cross-border situations might deter consumers from purchasing products abroad.

iii. Difference in national legislation and supervisory practices. These differences make it costly for providers to operate in multiple Member States. These differences might also deter consumers from going cross-border as they do not know whether they enjoy the same set of rights as in their home Member State. In case a passporting mechanism applies, the existence of might lead to a 'race to the bottom', where providers operate from the Member State where investor and consumer protection rules are least stringent.

3. Can any of these barriers be overcome in the future by digitalisation and innovation in the FinTech sector?

Digitalisation and innovation in the FinTech sector will reduce reliance on the traditional providers (i.e.. banks) of investment services (and other retail financial services). This might lead to more open distribution networks with accessibility to a wider range of products for retail investors, including those who were traditionally only offered by distributors in other Member States. It is important though that the protection granted to retail investors and other financial consumers who take advantage of the new opportunities provided by digitalisation and innovation is sufficient and solid. Regarding barriers (ii) en (iii), regulatory action at EU level is definitely needed. Please allow us to refer you to our answers to Q16/17 and Q9 respectively for our comments on these issues.

4. What can be done to ensure that digitalisation of financial services does not result in increased financial exclusion, in particular of those digitally illiterate?

It seems inevitable that, as digitalisation in financial services becomes more widespread, certain providers will cease to offer services in the traditional manner and fees will go up because of the reduced demand for these kind of services (providers might also deliberately raise the price to push consumers to move to digital services and products).

For some consumers this might pose a problem, simply because they do not own or have access to a device with internet access, or because they do not know or are not comfortable using them. It is important that regulators, industry and consumer organisation work together to increase the digital literacy (in relation to finance) of European citizens, especially among older generations.

Apart from digital illiteracy, which we hope is a temporary and transitional issue, initiatives should also focus on the more structural issue of financial illiteracy. Financial education should complement and reinforce regulation focusing on investor and consumer protection. Among other things, consumers need to know what questions they need to ask to a provider, what information the provider is required to provide them, how they should interpret this information and what they need to look at when comparing products in order to come to an optimal (investment) decision.

5. What should be our approach if the opportunities presented by the growth and spread of digital technologies give rise to new consumer protection risks?

Besides all the benefits, there are unfortunately ample new consumer protection risks associated with digital technologies. We would like to highlight the following risks, which are similar to the ones

mentioned by the European Supervisory Authorities (**"ESAs"**) in their joint discussion paper on automation in financial advice, published on the 4th of December 2015[2].

- Risks related to consumers having limited access to information, and/or limited ability to process that information
- Risks related to flaws in the functioning of the technology;
- Risks related to a widespread use of the technology.

We are aware that regulating digital innovations from the outset is not desirable. However, we would suggest the Commission and ESAs to closely monitor developments and intervene if new risks emerge that are unacceptable in terms of intensity and/or scale and if investors do not benefit from sufficient protection (e.g. lack of disclosure, conflict of interests). Once innovative digital financial services reach a certain level of maturity, we believe the Commission might choose to set EU-wide standards to ensure certain minimum security and consumer protection standards are adhered to by all providers in the EU.

6. ***Do customers have access to safe, simple and understandable financial products throughout the European Union? If not, what could be done to allow this access?***

There are certainly safe, simple and understandable financial products available, but consumers do not always have access to these products. This seems to have to do with distribution. There is an economic motive for distributors to refrain from offering simple financial products because the margin on more sophisticated and complex products is often higher. Inducements also play a major role in this regard. As an example, we have seen a considerable increase in the offer of passive funds in the Netherlands and the UK, after the ban on inducements was introduced (see answer to Q9).

Sometimes, there is access, but consumers themselves choose the more complex products (without necessarily understanding how the product works and what the risks are). Some consumer organisations suggest that, in order to protect such consumers, their access to these more complex products should be restricted. We do not support this. Instead, we prefer "soft" measures aimed at changing the (online) environment in which consumers make their decisions. For concrete suggestions, we would like to refer you to a report of the Autoriteit Financiële Markten (**"AFM"**), published in December 2015[3].

7. ***Is the quality of enforcement of EU retail financial services legislation across the EU a problem for consumer trust and market integration?***

Yes, there are considerable differences in how EU rules and regulations are applied and enforced across Member States. This means that retail investors and other financial consumers are under different levels of protection depending on the home Member State of the provider.

We therefore very much value the supervisory convergence work that is and will be done by the European Securities and Markets Authority (**"ESMA"**) in this regard, especially in the framework of the implementation of the Markets in Financial Instruments Directive II (**"MiFID II"**) and the CMU-project. This is urgently needed as, due to the passporting mechanisms enshrined in UCITS and MiFIDII, inadequate enforcement in one Member States might put consumers across the whole EU at risk.

[2] https://www.esma.europa.eu/sites/default/files/library/jc_2015_080_discussion_paper_on_automation_in_financial_advice.pdf

[3] https://www.afm.nl/en/consumenten/nieuws/2015/dec/eob-rapport

Example: In 2015, the Dutch financial regulator (**"AFM"**) received 200 complaints from Dutch consumers about providers of binary options. These providers are not registered in the Netherlands (but often in Cyprus), but can offer their products on the Dutch market on the basis of an EU passport. While the AFM is aware of the grave misconduct of some of these providers, it can do nothing to protect Dutch consumers apart from issuing warnings.

8. ***What would be the most appropriate channel to raise awareness about the different retail financial services and insurance products available throughout the Union?***

EU-wide comparison websites could certainly help raise awareness about different products and providers available throughout the EU. However, there seems to be an overgrowth of website comparing, for example, funds and brokers. It is important that European and national regulators evaluate these websites on the basis of the following criteria:

- A sufficient range of products must be shown;
- For a meaningful comparison, the main product features must be taken into account (comparison websites that, for example, merely look at price might be misleading).
- The information that serves as input for the comparison should be correct and up-to-date.
- The website should be transparent about its business model and owner (comparison websites that are owned or have commercial or other links with the providers of the products that are compared on the website should explicitly mention such links).

9. ***What more can be done to facilitate cross-border distribution of financial products through intermediaries?***

Independence of intermediaries is key. Important to note in this regard is MiFID II, the implementation date of which is unfortunately postponed to January 2018. MiFID II creates a two-tier regime in investment advice: i) independent and ii) non-independent.

Where an investment firm provides independent advice, the firm must assess a sufficient range of financial instruments available on the market which must be sufficiently diverse. Also, any payments received by third parties must be passed on to consumers. This will have a positive impact on the cross-border distribution of financial products.

Firms providing non-independent advice, however, have no obligation in terms of the range of products they assess and can continue to accept and retain inducements, provided that they enhance the quality of the service. Taking into account that non-independent advice takes up of a large portion of retail distribution in the EU, this is a missed opportunity.

The new rules on inducements in the framework of the distribution of investment-based insurance products, as laid down in the recently adopted Insurance Distribution Directive (**"IDD"**) are even less stringent. Insurance intermediaries can continue to accept and retain inducements as long as they do not have a detrimental effect on the quality of the service provided to customers.

We believe it is also important to raise the issue of affordability here. MiFID II, the new rules on inducements and costs disclosure in particular, will improve the protection offered to retail investors using investment services. But this also brings with it new challenges. Retail investors are not used to pay for advice since it is presently paid for by product providers.

This may lead to an increase in low-costs, execution-only business models, also because other regulatory requirements in MiFID II might drive up the costs of providing advice. While this might increase the

cross-border purchase of investment products, it will be a problem for small investors who do not have the necessary knowledge and experience to invest in a self-directed manner, but whose investment amount is not sufficient to compensate for the costs of advice.

European Investors therefore supports some of the recommendations made in the Financial Advice Market Review (**"FAMR"**) in the UK, where there is already a ban on inducements. The FAMR highlights not all consumers can afford access to the advice they need at a price they are willing to pay. The report, published on March 14 2016 states: "The market currently delivers high-quality solutions to those who can afford advice. However, not everyone wants or needs a personal recommendation in respect of every decision, nor do they always need a comprehensive assessment of all of their financial circumstances and requirements.". The report states that the lack of clarity on regulatory obligations acts as a barrier for firms that wish to offer services that help consumers to make investment decisions without a personal recommendation[4].

We hope this issue is also dealt with in the EU investment products market assessment.

10. Is further action necessary to encourage comparability and / or facilitate switching to retail financial services from providers located either in the same or another Member State? If yes, what action and for which product segments?

In an execution-only relationship, there are basically two options to switch broker, either (i) by liquidating all assets (either all at once at the moment of switching, or gradually after switching has already taken place) or (ii) by transferring the portfolio directly to the another broker.

Research performed by the VEB in 2013 showed that some of the major Dutch banks charge significant fees when transfer assets to a competitor (up to €27,23 per position line). Apart from these costs, it can also take up to ten days for the bank or broker to actually transfer the assets.

14. What can be done to limit unjustified discrimination on the grounds of residence in the retail financial sector including insurance?

As a consumer organisation, we are naturally opposed to any (unjustified) discrimination on the grounds of residence. For example, a retail investor residing in Germany should have no problems opening an investment account in Spain. However, discrimination on the grounds of residence is a peculiar issue. Why would a provider of financial services deliberately limit the size of its own market? Sometimes it is clearly used to artificially maintain price differentials between Member States for which there is no justification. We believe the Commission should act fiercely on this matter.

But, admittedly, sometimes there are structural underlying causes, stemming from EU level or national regulations. We believe the Commission should identify these underlying causes. As a starting point, we would suggest **to create a notification centre**, maybe as part of the Commission service Your Europe-advice. This would allow the Commission to see in what retail financial services markets and Member States residence requirements are particularly common.

15. Is further EU-level action needed to improve the transparency and comparability of financial products (particularly by means of digital solutions) to strengthen consumer trust?

[4] https://www.fca.org.uk/your-fca/documents/financial-advice-market-review-final-report

Much progress has been made over the last years when it comes to the quality and standardization of (pre-contractual) disclosure to retail investors and other financial consumers, both on product-level (Key Information Document (**"KID"**) and Key Investor Information Document (**"KIID"**)) and on service-level (MiFIDII, IDD). This will enable consumers to compare financial products more easily.

On product-level, the Key Information Document (**"KID"**) for Packaged Retail and Insurance-based Investment Products (**"PRIIPs"**) will come into effect shortly. European Investors strongly urges the European Commission to not give into demands from Member States or industry groups to postpone the application date of this important piece of legislation.

The KID is a great step forward in in terms of costs disclosure. Consumers will be presented with a Total Costs of Ownership (**"TCO"**)-figure which includes transactions costs. Unfortunately, UCITS (and retail AIFs sold on a national basis in accordance with UCITS rules) will be exempted from the KID Regulation till 2019 and will, as a result, continue to only publish the ongoing-charge figure mandated by the KIID (which does not include all costs incurred by the client). This will moreover present a challenge for distributors who have to provide a TCO-figure to their clients.

Unfortunately, there will be no obligation to include past performance figures in the KID (in contrast to the KIID, which does require such disclosure). Instead, three forward-looking performance scenario's will be presented. We would like to refer the letter of the Securities and Markets Stakeholder Group (**"SMSG"**) of ESMA on this matter[5].

While it certainly not advisable to extrapolate past performance, forward-looking scenario's rely on assumptions and are difficult to grasp for the average consumer. Historical data have already materialized and are easy to understand. If a fund has structurally underperformed an objective benchmark in the past and/or has destroyed value for investors, an investor would think twice before investing in that fund and quite rightly, we believe. Depriving the retail investor of such information, if available, would in our opinion lead to less informed investment decisions.

Apart from information on costs and performance, more information should be available on the experience and expertise of managers of actively managed funds and the way they manage the assets of the clients. The recently published update of ESMA on its work on index hugging highlights the fact that actively managed funds should account more for the higher fees they ask from consumers.

16. Should any measures be taken to increase consumer awareness of FIN-NET and its effectiveness in the context of the Alternative Dispute Resolution Directive's implementation?

Yes, we would first of all like to refer to the EC Consumer Scoreboard of 2015, which analysed the functioning of Alternative Dispute Resolution mechanisms (**"ADRs"**). However, not in particular for the financial sector. It concluded that (i) retailer's awareness of ADRs is very limited; (ii) the majority of retailers who are aware of ADRs are also willing to use it; and that (iii) the public sector in many Member States do not use all tools available for the promotion of the use of ADRs by the public sector. The conclusion is that there is a lot of potential for improvement.

The FIN-NET should also be strengthened. FIN-NET is of crucial importance for the single market in retail financial services. ADRs normally only cover financial service providers operating in and from the country where the schemes exist. This means that if consumers complain about a foreign financial service provider, the complaint would normally be handled by an ADR operating in the Member State

[5] https://www.esma.europa.eu/sites/default/files/library/2015-smsg-028-smsg_letter_priips_past_performance.pdf

where the provider is established. This may prove complicated for the consumer who would have to know of the existence and details of such foreign ADRs.

Through FIN-NET, the ADR in the home country of the consumer provides him her with the necessary assistance in pursuing such cross-border complaints. However, at the moment, as indicated in the Green Paper, there is no full coverage, geographically as well as sectorally. There are no FIN-NET members from Bulgaria, Cyprus, Latvia, Romania, Slovakia and Slovenia. And members from the 22 Member States do not always cover all financial services sectors. There is also a significant number of existing financial ADR schemes in the EU that are not members of FIN-NET, meaning that they are not committed to cooperate with ADRs in other Member States in cross-border cases.

European Investors suggests it is indeed necessary to upgrade the network. In particular, all financial ADRs in the EU (i) should meet the binding quality requirements under the ADR Directive, (ii) should be a member of FIN-NET and (iii) be legally bound by its MoU which outlines the mechanisms according to which to facilitate out-of-court settlement of cross-border disputes.

There has even been some support for making the participation in ADRs mandatory for financial services providers. While ideally consumers should have access to an ADR regardless of the provider whose services they make use of, European Investors believes making participation mandatory may go at the expense of the success of ADRs, the strength of which lies in the commitment financial service providers have made to it by signing up to it voluntarily.

European Investors does believe however that once a financial service provider decides to resolve a dispute with a consumer using an ADR scheme, the decision by the ADR should be binding on it (whether or not after a first round of mediation). This is currently not the case for all members of FIN-NET. In Finland, for example, the Finnish Consumer Disputes Board only issues a recommendation that the financial service provider is free to follow or not. A number of ADRs do not even make a formal recommendation. Instead, they merely try to help parties to come to an agreement without making any formal proposals for solution.

As stated in the Green Paper, awareness among consumers of the network´s existence is low. FSUG believes there should be an obligation for ADRs as well as the financial service providers that have signed up to them to clearly inform consumers about the network´s existence (and benefits). Also, it is important to note that the FIN-NET website is currently only available in three languages (English, French and German). The website should be made available in all official languages of the EU.

17. Do consumers have adequate access to financial compensation in the case of mis-selling of retail financial products and insurance? If not, what could be done to ensure this is the case?

An adequate collective redress framework in the EU is of crucial importance. While individual actions are the usual tools to address disputes to prevent harm and also to claim for compensation, the possibility of joining claims and pursuing them collectively may constitute a better access to justice, in particular when the costs of individual actions would deter the harmed individuals from going to court.

Developments in Member States suggests that the impact of the Commission's Recommendation on Collective Redress has been limited. Only the UK (in respect of competition damages actions only) and Belgium have introduced new collective redress mechanisms, and not entirely in line with the principles in the Recommendation. This suggests that many of the problems observed in the Evaluation Study of August 2008 are still present, and a significant proportion of consumers who have suffered damage do not obtain redress.

European Investors believes more binding measures at EU level are called for. Furthermore, we would like to urge the Commission to assess the extent to which redress could be improved in the EU through opt-out collective redress regimes (instead of the opt-in regimes currently promoted by the Commission through its Recommendation).

The main benefit of opt-out actions is that they can be brought on behalf of a class of unnamed, and initially unidentified claimants. This affords representatives the opportunity to ascertain the full class as the proceedings progress, rather than at the outset, making it easier for claimants to commence collective proceedings on behalf of potentially injured parties. With an opt-in action, claimants must affirmatively join the action in order to be considered a member of the class and share in any recovery[6].

In the Netherlands, the Dutch Collective Settlement Act (**"WCAM"**), an opt-out settlement regime, has allowed the Dutch Investors´ Association VEB to gain large amounts of compensation for a significant number of investors in multiple cases. A perfect example is the Fortis settlement of over €1,2 billion that VEB reached with Ageas on Monday 14 March. Under the WCAM, the fairness of this settlement is checked by a judge and, if considered fair, declared binding on all participating as well as non-participating parties. Non-participating parties have the opportunity to opt-out (for at least three months following the court ruling). In two previous cases, Shell and Converium, the settlement was declared internationally binding. As a result, compensation was gained for all investors that did not fall under the US settlement.

22. What can be done at EU level to support firms in creating and providing innovative digital financial services across Europe, with appropriate levels of security and consumer protection?

European Investors is aware that strictly regulating such digital technologies from the outset is not desirable. However, we would suggest the Commission and the ESAs to closely monitor developments and intervene if innovations bring a new risk that is acceptable in terms of intensity and/or scale or if consumers are not sufficiently protected (e.g. lack of disclosure, conflicts of interests).

Once innovative digital financial services reach a certain level of maturity, European Investors believes the European Commission might choose to set EU-wide standards to ensure certain security and consumer protection standards are adhered across the EU.

32. For which retail financial services products might standardization or opt-in regimes be most effective in overcoming difference in the legislation of Member States?

European Investors is wary about standardization of product characteristics as this would go at the expense of diversity of product offerings in the EU. Product standardization implies a one-size-fits-all approach. Such an approach does not pay respect to the differences in needs and wishes of European financial consumers. We do believe that rules regarding disclosure and conduct for economically comparable products and services should be standardized as much as possible. This allows for a level playing field on which fair competition on the basis of essential product (or service) characteristics (e.g. costs structures, risk and performance) can take place.
If product standardization is used, we believe it should be an opt-in regime. An example of the success of such an opt-in regime is provided by the UCITS framework.

[6]. Under the opt-in system in the UK, only one action has been brought, on behalf of a group of consumers who were overcharged for replica football jerseys. he case eventually settled, and each consumer who joined the action was compensated £20. Some believe this settlement failed to provide consumers with "meaningful" compensation and highlights the ineffectiveness of opt-in litigation, which has since been deemed unworkable and unsuccessful.