



DIRECTORATE-GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT
ECONOMIC AND SCIENTIFIC POLICY **A**

Consumer Protection Aspects of Financial Services

Presentation to the IMCO Committee of the European Parliament

Brussels

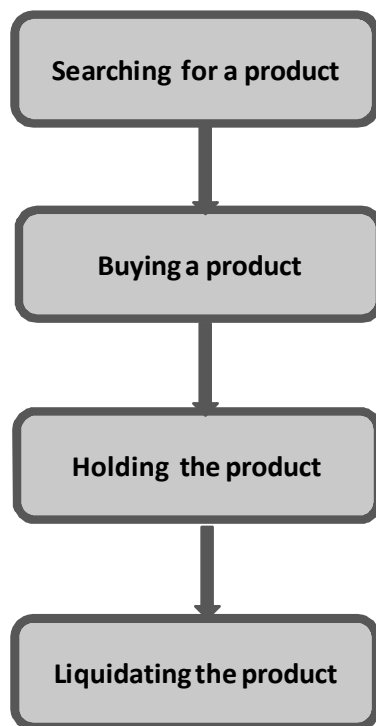
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LE
London
Economics

Background

Typical customer journey in financial markets



Problematic features of financial markets/products for consumer

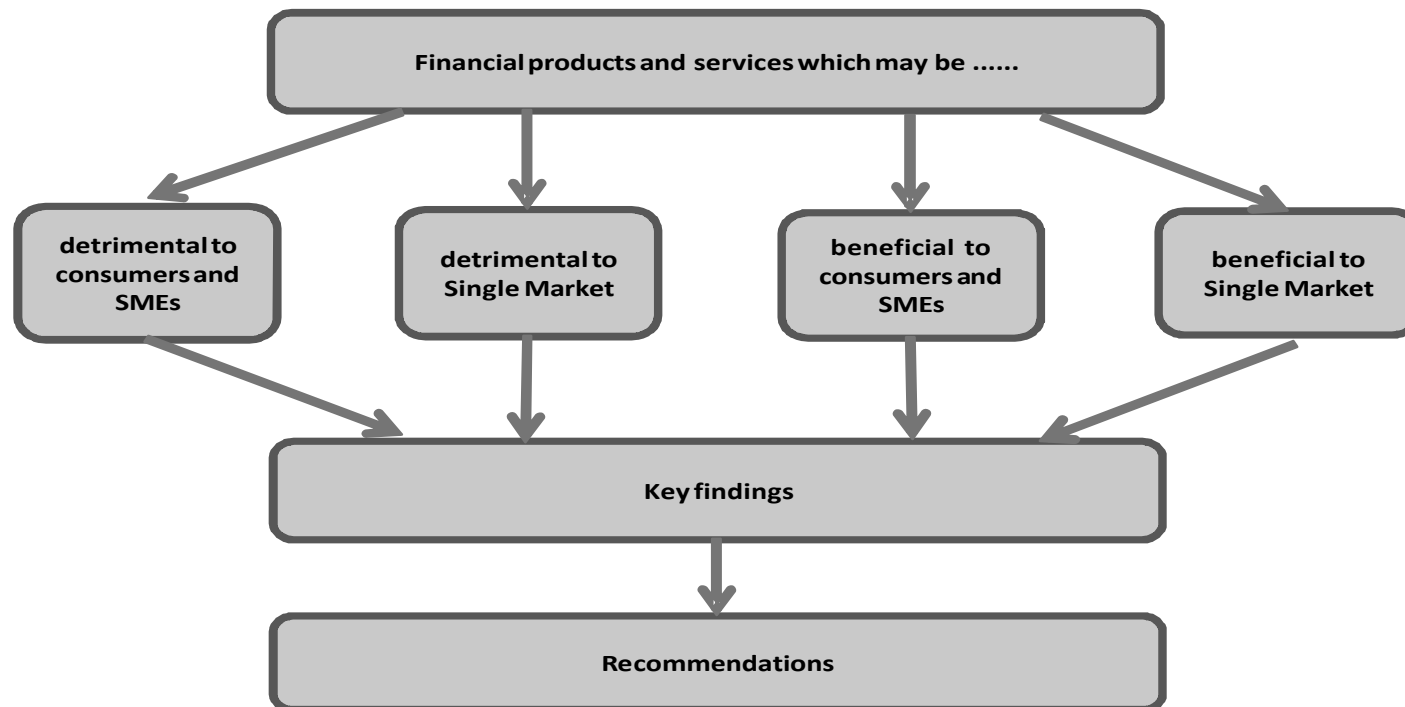
- Infrequent acquisition of products
- Complexity of products
- Asymmetric power relationship – consumers have little bargaining power
- Long duration
- Redress often difficult to access, sometimes nil
- Limited financial literacy skills & behavioural biases

➡ market / regulatory failures

➡ potential for **mis-selling** /

inappropriate selling / **fraud** with major consequences for consumers and economy (for example, subprime crisis in USA)





Key information sources:

- Stakeholder consultations (late spring to early autumn 2013): financial regulators, financial ombudsmen, consumer associations, banks and banking associations
- Literature review

1. Financial services and products which may be detrimental to consumers and SMEs

Potential impact of such services and products

- **Financial health** of consumers (SMEs) is **seriously impaired** and consumers (SMEs) may be pushed into a state of **financial vulnerability** if/when the following occur:
 - mis-selling, inappropriate selling
 - crystallisation of the risk(s)
 - non-respect of the contractual obligations by the consumer

Key characteristics of such services and products

- Products and services:
 - involve **imperfectly understood risks**
 - carry **high interest rates**
 - subject to **high fees and charges**
 - subject to **high costs** in case of **non-respect of obligations**
 - can **trap** some consumers, especially vulnerable consumers



1. Financial services and products which may be detrimental to consumers and SMEs

- **Specific financial products identified as being potentially highly disruptive**
 - ***range of mortgage products***
 - foreign currency mortgages, variable rate mortgages, high loan-to-value and debt-to-income mortgages, and mortgages sold with interest rate hedges and swaps
 - ***loan products which carry a high risk of substantial residual liability*** because of lack of proper debt discharge or reduction mechanism
 - ***credit products with high interest rates***
 - in particular high cost/payday/instant loans and credit cards with high rates combined with high limits – risk of debt trap from which it is very difficult to escape without a formal debt reduction or discharge process
 - ***savings, investment and pension products with high charges*** which reduce net returns
 - ***complex hedging products***



2. Financial services and products which may be detrimental to Single Market

Potential impact of such services and products

- At present, **very little cross-border financial shopping**
- But **particular financial products or services may be detrimental** to the Single Market if:
 - the disruptive impact is so large **that it imperils financial stability**
 - **particular groups of consumers are affected** and it impacts their cross-border activities
 - **many consumers are impacted** even though the scale of each impact is small

Key characteristics of such services and products

- Products and services that:
 - involve mis-selling / inappropriate selling
 - are opaque (rate, costs and risk)

2 . Financial services and products which may be detrimental to Single Market

- **Main** products identified as having potentially large detrimental Single Market **impacts** if not well regulated:
 - ***mortgage products*** – potential impact on financial stability due to large volume/value
 - ***payment protection insurance*** – smaller detriment for each potentially affected consumer but very large number of consumers
- **Access barriers** to “better” or “safer” products offered in other MS
- Stakeholders (regulators, consumer organisations) also identified a **range discrimination cases** - age, gender, health status, disability, internet access, employment status, and residency



3. Financial services and products which may be beneficial to consumers and SMEs



Key Features

- Better tailoring of some products to consumers' individual needs / simplicity
- Greater flexibility in meeting the terms of the agreement
- Facilitate cross-border transactions
- Reduce cost/price

Examples of types of products and services

- tailored consumer credit and auto-enrolment pensions / basic bank accounts
- P-accounts in Germany or credit agreements with possibility to skip one or few payments with no penalty
- internet and electronic banking, mobile banking mobile devices, debit and credit cards
- consolidation loans, longer term vehicles, range of state-subsidised savings and loan regimes



Financial products and services with substantive beneficial effects to the Single Market



Key Features

- Facilitate non-financial cross-border transactions
- Facilitate cross-border labour mobility
- Facilitate cross-border transactions in the financial sector

Examples of types of products and services

- payment services, credit / debit cards, internet banking
- basic bank accounts, access to payment service networks including ATM networks, e-money
- standardised information through the Standard European Consumer Credit Information (SECI) and the European Standardised Information Sheet (ESIS)



5. Key conclusions

1. **Inappropriate sales or mis-selling of certain mortgage products** in the USA and some EU Member States were a major contributing factor in the 2007/2008 financial crisis. This was also the case in the Nordic banking crisis of the early nineties
2. The **other financial products discussed in the study** can at times be **seriously harmful** to some consumers but **do not appear to contribute significantly to financial instability**
3. **Some of the products** identified by stakeholders as being **potentially harmful** to consumers were also noted by other stakeholders as being **potentially positive** for consumers provided they are well regulated and not mis-sold
4. **Financial literacy and capability is relatively weak among consumers**, even in industrialised countries with biases and cognitive limitations being important in financial markets



5. Key conclusions

5. Overall, the **consumer experience from 2000 to 2007** can be characterised as a period of **financial innovation and liberalisation** during which consumers were offered a **growing range of financial products** (of increasing complexity in some cases)

Yet paradoxically, many consumers were not well-equipped to make proper choices and fell prey to mis-selling or inappropriate selling

6. While **improved financial literacy** will **benefit** consumers, the study also highlights that, **on their own, policies aimed at raising financial literacy are not enough**

7. **Purchase of many types of financial products or services will continue to be challenging for consumers**

- **Infrequent purchases**
- **complexity, opacity and difficult-to-assess risks**
- **consumers have no or little bargaining power in retail financial markets**



6. Recommendations

Objective

- **Reduction in information asymmetry between consumers and financial service providers**

Detailed recommendations

1. Requirement for seller to provide **accurate, simple, comparable information** of a financial product or service before and after buying it
2. The information provided to consumers can be improved by **presenting the average consumer experience**, using a “descriptive norms” approach and providing illustrative worst and best case scenarios
3. Consideration should be given to implementing systems whereby **consumers** would be encouraged by lenders to **seek independent financial advice** from a third party provider for more complex products which have the potential to result in significant harm to consumers - the list of such products could be established by the regulator



6. Recommendations

Objective

- **Better equip consumers to deal with financial matters**
- **Strengthen consumer protection in financial sector (ex-ante)**

Detailed recommendations

4. More efforts and resources should be devoted by governments, the financial sector and civil society to **strengthening financial literacy and capability, and allow for better learning** from the various **programs** already implemented

5. **Financial sector regulators and institutions responsible for consumer protection** should adopt a **much more pro-active approach** to ensure that financial markets work well rather than respond to consumer complaints and pursue misbehaviour re-actively

This could involve **the prohibition of the sale of certain products** or explicit **action to address high transactions costs** for certain products



6. Recommendations

Objective

- **Strengthen consumer protection in financial sector (ex-ante and ex-post)**

Detailed recommendations

6. Financial sector regulators should also ensure that **consumers do not face excessively high charges and fees which do not reflect actual costs when buying, holding or liquidating a product**

7a. **Sanctions** (financial penalties, prohibition to undertake certain activities for a certain period, etc.) of mis-behaviour by sellers (financial institutions as well as officials of financial institutions) **to be made more severe** (deterrence and incentivise effects)

7b. **Financial institutions** to be made **systematically liable** for **adequately compensating consumers** who suffered **detriment** as a result of mis-selling or inappropriately selling of financial products or services



6. Recommendations

Objective

- **Provision of redress**
- **Clean exit from over-indebtedness**

Detailed recommendations

8. Consumers should always have **access to an independent, fast, efficient and inexpensive dispute resolution mechanism**
9. **Development of better mechanisms and processes for dealing with excessive personal debt burdens**

