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EU Sub-Committee A
House of Lords
London SW1A 0PW

29 September 2014

Dear Sir, Madam,

House of Lords EU Economic and Financial Affairs Sub-Committee Inquiry into the EU Financial Regulatory Framework

1. This is the UK Financial Services Consumer Panel's (the Panel) response to the Sub-Committee's inquiry into the EU Financial Regulatory Framework.
2. The Financial Conduct Authority (FCA) is required to set up and maintain a panel to represent the consumer interest under financial services legislation (2000 Financial Services and Markets Act as amended by the 2012 Financial Services Act). The Panel represents the interests of all groups of financial services consumers and operates independently of the FCA. The emphasis of its work is on activities that are regulated by the FCA, although it may also look at the impact on consumers of activities that are not regulated but are related to the FCA's general duties.
3. The Panel is grateful for this opportunity to inform the Sub-Committee about our view of the consumer protection aspects of the EU's financial services reform. We have only answered those questions where we have particular insights or expertise.
4. Overall, we believe the EU's recent regulatory reforms have taken consumers' interests into account and that the EU is rightly focusing on regulating the conduct of financial services firms to ensure a good outcome for consumers.
5. We will continue to pursue our consumer protection objectives at the European level through cooperation with our partner organisations, including BEUC, an umbrella body for Europe's independent consumer organisations. The Panel also communicates with the EU institutions directly through responses to public consultations, the Financial Services User Group (of which the Chair of the Panel is a member) and bilateral meetings with MEPs and Commission officials.

Question 4: Which elements of the reforms have been most and least effective in addressing: consumer protection; market efficiency, transparency and integrity; and financial stability?

European Supervisory Authorities

6. The Panel supported the creation of the European Supervisory Authorities (ESAs), especially each Authority's so-called 'article 9' obligations to ensure consumer protection. However, the Panel believes the effectiveness of the ESAs has suffered from a lack of representation of the consumer interests in the regulatory process.

7. Notably, the ESA Boards of Supervisors (EIOPA, ESMA and EBA¹) are composed of the EU Member States' national authorities, but many of these authorities have no specific consumer protection mandate. Research by the European consumer organisation BEUC² found that the financial supervisory authorities of eight EU countries, including Germany, have no statutory consumer protection objective. It concluded:

"In some Member States no authority is really in charge of consumer protection in the financial services area. When such authority exists, many of them are under-staffed, have little on-site inspection capacity, have limited legal powers to make binding decisions and limited powers of sanction. Some of them do not have capacity to deal with consumer complaints."

8. As the ESA's Boards play a prominent role in deciding their respective Authority's work programme and new regulations, the panel believes consumers' interests should be represented consistently and adequately. Because of the differing statutes underpinning the work of national supervisors, many of the EU's national consumer protection authorities are absent from ESA Board meetings and cannot vote on policy changes or regulatory measures that are clearly relevant to their brief.

9. The Panel believes that national consumer protection authorities should be invited to participate in ESA Board meetings where their national financial supervisory body has no consumer protection mandate. More generally, the Supervisory Authorities should demonstrate clearly how they are meeting their Article 9 consumer protection objectives. The Panel will raise these issues with the new European Commission directorate-general for financial services as it carries forward the work of the initial ESA review published in August this year³.

Direct consumer representation

10. The Panel is also concerned at the lack of direct consumer representation during the preparation of new EU proposals and regulatory measures. The European Commission and ESA stakeholder groups are generally dominated by industry representatives.

¹ The European Insurance & Occupational Pensions Authority, the European Securities & Markets Authority and the European Banking Authority.

² BEUC, 'Financial Supervision in the EU, A consumer perspective', February 2011.

³ http://ec.europa.eu/internal_market/finances/docs/committees/140808-esfs-review_en.pdf

11. Research undertaken on behalf of the Panel⁴ found that financial services consumer groups often lacked the resources for effective representation:

- **Lack of financial backing to attend meetings overseas.** This may prevent consumer groups from participating fully in the EU's stakeholder groups.
- **Limited access to the technical and research resources** needed to participate fully in discussions and to challenge the views put forward by the financial services industry.
- **Lack of knowledge of EU processes and procedures.** Consumer organisations may not be aware of the existence of specific stakeholder groups or the role they play in the formulation of EU financial services policy.

12. The Panel believes that several solutions should be implemented to redress this imbalance and to improve the representation of consumers at EU-level:

1. A statutory requirement for the ESAs to provide feedback to their stakeholder groups;
2. A review of remuneration and expenses to encourage the right balance of expertise on the ESA stakeholder groups;
3. Increased support and resources for the stakeholder groups to carry out their own research and build up data.

Impact Assessments and Consultation

13. The Panel believes the European Parliament and Council should draw up impact assessments to ensure that new legislation does not undermine consumer protection. This is of particular importance where the EU institutions adopt significant amendments to proposals, as these may undermine the validity of the Commission's original impact assessments. In consequence, there is a risk that EU legislation will be adopted without its impact on consumers being adequately quantified.

14. We believe that such impact assessments should be the responsibility of the European Parliament's dedicated Impact Assessment Directorate, assisted by the General Secretariat of the Council and where necessary drawing on external expertise through public consultations or studies.

15. Consultations also pose problems after European legislation is adopted. Most EU financial services laws delegate responsibility to the European Commission, assisted by the ESAs, to ensure uniform implementation across the EU.

16. Following the financial crisis, the sheer volume and scope of European financial services legislation has made it difficult for consumer groups to respond

⁴ http://www.fs-cp.org.uk/publications/pdf/consumer_representation_at_eu_level_panel_final_report_dec_2013.pdf

effectively to Level 2 consultations (see table on page 4). Not all consultations have a consumer protection element, but even responding to all relevant calls for submissions is likely to be beyond the resources of most consumer groups.

17. For example, the ESMA consultation paper⁶ on the new MiFID Directive ran to 311 pages and contained 245 questions, often of a very detailed and technical nature.

| ESA | Consultations (2014) ⁵ |
|--------------|-----------------------------------|
| EBA | 35 |
| EIOPA | 9 |
| ESMA | 13 |
| Total | 57 |

Markets in financial instruments

18. The Panel believes that the new Markets in Financial Instruments Directive (MiFID)⁷ is a good example of EU legislation effectively addressing consumer protection issues. The Panel welcomes in particular the final text of article 24 of the new Directive, which enshrines a legal duty of care on investment firms:

“Member States shall require that, when providing investment services or, where appropriate, ancillary services to clients, an investment firm act honestly, fairly and professionally in accordance with the best interests of its clients”.

19. We believe that this provision sends a strong signal about the basis of any firm’s relationship with its clients and reiterates the overriding need for honesty and fairness.

Question 7: Do you identify any overlaps, contradictions or inconsistencies when assessing and comparing individual pieces of the regulatory agenda? Which combination of reforms has generated the most significant costs and inefficiencies for financial actors?

20. The new financial supervisory architecture has been adopted piecemeal by the EU institutions, and as a result the approach taken to key aspects of consumer protection has been inconsistent.

Alternative Dispute Resolution

21. Access to alternative dispute resolution (ADR) for financial services consumers is notably fragmented. For example, it has been incorporated into the Mortgage Credit Directive but it may be missing or watered down in the new Insurance Mediation Directive.

22. In particular, the Panel believes there should be consistency in the approach to:

⁵ Figures collated from the websites of the EBA, EIOPA and ESMA.

⁶ <http://www.esma.europa.eu/consultation/Consultation-Paper-MiFID-IIiMiFIR>

⁷ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments

- Whether ADR should be independent or may be set up by the financial services industry;
- At what stage customers are informed about the system, and by whom;
- Whether decisions by the ADR body are binding on the industry.

Obligation on firms to act honestly, fairly and professionally

23. As noted above, the Panel supports the inclusion in MiFID of an obligation on firms to act “honestly, fairly and professionally in accordance with the best interests of its clients”. We are also pleased that both the Parliament and Council have so far supported an equivalent provision in the new Insurance Mediation Directive (IMD), although the Parliament has opted for slightly different wording compared to MiFID⁸. For reasons of consistency and clarity, the Panel will call on MEPs to support the same wording as used in MiFID during the trilogue negotiations on the final text of the legislation later this year.

24. However, despite these recent advances, a legal duty of care has not been incorporated consistently into all relevant measures. The Panel believes this core principle should have been embedded across all measures which apply to intermediaries to ensure a similar level of consumer protection across the board. In particular, we regret that the new Regulation on key information documents for Packaged Retail Investment Products (“PRIIPs”) has no equivalent provision.

25. We also believe there should be a clause equivalent to MiFID article 24 applying to prospectus disclosures under the Prospectus Directive. The review of the Directive in 2016 provides a timely opportunity to amend the wording of the legislation, as it currently does not apply to the prospectus or the prospectus summary.

26. In general, the Panel believes the EU should aim for a consistent reference to this duty of care principle in all legislation still under consideration or proposed in the future. We will continue to push for the inclusion of a legal duty of care in both pending and future legislative proposals.

Question 10: Have the needs of consumers of financial services and products been appropriately addressed by the reform process? Do particular risks in relation to consumer protection arise from the reforms?

27. As noted above, the architecture of the new supervisory system has not ensured proper representation of consumer interests. As a result, consumers’ interests are not always sufficiently taken into account when regulatory measures are formulated or when long-term work programmes are developed (the fragmented approach to ADR being an example).

28. The tension between prudential and conduct regulation could also pose a risk to an effective EU agenda for consumer protection. The current supervisory

⁸ The European Parliament introduced in IMD an obligation for firms to act “honestly, fairly, trustworthily, honourably and professionally”.

structure separates regulation by sector and obliges each regulator to monitor both the prudential and conduct aspects of the sectors it regulates. In practice, we are concerned that this may lead to neglect of conduct supervision because prudential considerations either take precedence or are seen as sufficient to protect consumers through overall market stability.

29. For example, despite the fact that EIOPA, ESMA and EBA have a specific product intervention power⁹, this has never been used. Similarly, internal resources at the ESA appear to be overwhelmingly devoted to prudential supervision, with EBA's consumer protection unit consisting of only 2-3 staff members¹⁰. In addition, as noted above, the composition of the ESA's Supervisory Boards is skewed towards prudential considerations because a significant number of the EU's national financial authorities have no explicit consumer protection mandate.

30. The European Commission has recently announced that it will review the possibility of adopting the UK's 'twin peak' approach by splitting the ESAs into separate authorities responsible for conduct and prudential regulation, although it seems distinctly lukewarm about this prospect. A dedicated conduct regulator appears to be making a difference to consumer protection in the UK, although the tensions with prudential regulation remain.

31. As a general remark, the Panel would also like to underline the continued risk that EU legislation could erode existing rights for UK consumers if uniform standards are adopted that are less stringent than those currently in place. This should be borne in mind in particular during the negotiations for the Insurance Mediation Directive, which could undermine the binding nature of Financial Services Ombudsman judgments in favour of consumers.

⁹ Article 9(5) of the ESA Founding Regulations

¹⁰ BEUC, 'Review of the European System of Financial Supervision', August 2013.