

Report on Consumer Trends

Supervisory Concerns Regarding Consumer Protection Issues in 2012/13



Table of contents

Table of contents	2
Abbreviations	3
Executive summary	4
1. Supervisory concerns identified in 2011 and actions taken in 2012	5
1.1 Indebtedness and responsible credit	5
1.2 Financial literacy and education	7
1.3 Complex savings products	8
1.4 Bank account fees and charges	8
1.5 Unnecessary and unsuitable sales	9
1.6 Impact of technology	10
2. Supervisory concerns in 2012 and the areas of work identified for 2013	11
2.1 Indebtedness and responsible credit	12
2.2 Continuing concerns about the transparency and levels of charges and fees	12
2.3 The scope of mis-selling of financial products	12
2.4 Specific issues concerning certain products – notably foreign currency loans, payment protection insurance and complex products	13
2.5 Continuing concerns about the security of new technologies used for banking services	13
2.6 Emerging new forms of liquidity raising	13
2.7 Issues identified by the Banking Stakeholder Group	14
Annex - Methodology for compiling this report	15

Abbreviations

SCConFin	Standing Committee on Consumer Protection and Financial Innovation
SGCP	Sub-group on Consumer Protection
Regulation establishing the EBA	Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority)
EBA	European Banking Authority
NCA	National Competent Authorities
CCD	Consumer Credit Directive
MCD	Mortgage Credit Directive

Executive summary

One of the tasks of the European Banking Authority (EBA) as laid down in Article 9(1)(a) of its founding Regulation is to collect, analyse and report on consumer trends. In compliance with this provision, in February 2012, the EBA published its first report setting out an overview of the EBA's objectives and work in the area of consumer protection and financial innovation. This report included a summary of the outcomes of a first survey of national competent authorities (NCAs) and aimed at identifying key issues and trends with regard to consumer protection in the EU banking sector. The survey and report also identified a number of issues and products on which the EBA proposed to undertake further work.¹

Following on from a new survey conducted in the second quarter of 2012, the current report provides an update on this exercise, revisiting the issues, trends and products covered in the Overview of EBA work.² It also provides a revised set of consumer issues, trends and products identified as at the end of 2012.³

The main findings of the survey indicate that indebtedness and responsible lending remain the key concern for the majority of member states. During 2012, a number of member states introduced further requirements/standards to attempt to address these issues. As a result, the EBA is also currently working to produce good practices on responsible lending and on the treatment of borrowers in payment difficulties.

Another related area of concern is the level of fees and charges applied to loan repayments or the introduction of new fees and charges, particularly for late repayments. This adds to the burden of the already indebted consumer. Some member states are currently examining whether regulations are required in this area.

In 2011, the impact of technology was highlighted as a concern, an observation which was echoed also in 2012. The main issues relate to security and fraud risks in connection with new banking and payment technologies. It is hoped that initiatives such as the ECB's SecuPay work in addition to the Payment Services Directive will address these concerns.

Other issues highlighted in this report include the mis-selling of financial products, foreign currency loans and emerging forms of raising liquidity.

¹<http://www.eba.europa.eu/cebs/media/Publications/Consumer%20Protection/EBA-BS-2012-003-Financial-Innovation-and-Consumer-Protection--Overview-of-EBA-work-in-2011-2012.pdf>

² It should be noted that the information collected from NCAs is not exhaustive and in some cases is not based on statistics data.

³ The methodology for producing the report is described in the Annex.

Part I

1. Supervisory concerns identified in 2011 and actions taken in 2012

In summary, the Overview of EBA work identified the following topics of particular regulatory concern and attention with regard to consumer protection and innovation in the EU banking sector:

- Indebtedness and responsible credit
- Financial literacy and education
- Complex savings products
- Bank account fees and charges
- Unnecessary and unsuitable sales, and disclosure of information; and
- Impact of technology.

Further brief comment is provided on each of these topics below, together with an indication of particular action that has been taken to address each topic over the past year, by the EBA, NCAs, or other relevant EU institutions.

1.1 Indebtedness and responsible credit

The global financial crisis and the ongoing challenging economic environment had led to concerns in many member states about consumer over-indebtedness, arrears and foreclosures and about how such risks might be mitigated (including through responsible lending and credit practices). Highlighted concerns covered both mortgage lending and other lending to consumers (e.g. overdrafts, term loans, hire purchase, credit cards and other personal loans). In addition to the actual levels of indebtedness and/or arrears, concerns related to:

- the role of intermediaries in the provision/granting of credit;
- a lack of clarity in how some requirements set out in the Consumer Credit Directive (CCD) were understood and applied (including e.g. when and how pre-contractual information and adequate explanations should be provided, or what conditions to take into account when conducting creditworthiness assessments);
- issues relating to specific types of credit and mortgage products (e.g. interest-only mortgages), and product innovations such as negative equity mortgages (which allow a homeowner in negative equity to carry their existing mortgage to a new property);
- complaints from consumers about the terms and conditions for some loan restructuring;
- poor underwriting practices coupled with poor assessments of the borrower's credit rating and/or ability to repay; and

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- specific risks associated with foreign currency loans.

During 2012 the EBA has been following the progress on two key EU initiatives relevant to these issues: the negotiation of the Mortgage Credit Directive (Directive on Credit Agreements Relating to Residential Property, CARRPD), and the review (in which the European Parliament has so far played a leading role) of how member states have implemented the CCD which is due for formal review in 2013. NCAs have also been engaged with both initiatives, inputting their views and relevant experience of regulating these markets. Some of them have also fed into the related, ongoing studies being conducted for the European Commission and for its Financial Services Users Group.

Once it is agreed, the CARRPD should provide EU solutions to some other of the issues identified above in relation to indebtedness and responsible lending in the mortgages sector. In particular, it will require lenders to assess creditworthiness before making any loan, ensure that consumers receive an adequate explanation of the mortgage features and risks, and introduce approval requirements for all mortgage credit intermediaries.

During 2012, a number of NCAs have introduced further requirements, standards and guidelines for their national mortgage markets aimed at addressing a number of the issues identified above. For example, one NCA completed work launched in 2009 on its mortgage market review and finalised a set of additional requirements to be implemented by April 2014. Some NCAs have strengthened their regulatory oversight under national laws in order to address problems arising from deteriorating economic conditions (e.g. new requirements for policies on responsible lending and assessments of creditworthiness, new provisions on the treatment of borrowers in arrears, foreclosures). Three NCAs have also reported specific action they have taken during 2012 to address foreign exchange/foreign currency concerns.

Furthermore, all member states have participated in a follow-up exercise to the European Commission's consumer credit 'internet sweep'. This found that in 2011 70% (393) of sites were for further investigation in relation to the following main problems: advertising did not include the required standard information; offers omitted key information essential for making a decision; and costs were presented in a misleading way. According to the follow-up exercise, over 75% of websites checked in 2012 now provide satisfactory information to clients.

Other relevant EU and international work on issues identified by the EBA above includes:

- finalisation of the Financial Stability Board's Principles for Sound Residential Mortgage Underwriting Principles (published in April 2012);⁴
- implementation by all EU member states of the European Systemic Risk Board (ESRB) October 2011 Recommendations on lending in foreign currencies (and also covering relevant responsible lending practices).⁵ Member States and NCAs were required to report to the ESRB on their implementation of the Recommendations relevant to risk disclosure and the credit assessment of borrowers by December 2012;

⁴http://www.financialstabilityboard.org/press/pr_120418.pdf

⁵http://www.esrb.europa.eu/pub/pdf/recommendations/2011/ESRB_2011_1.en.pdf?37353998c5a15cfa683de6ca18aab108

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- work being undertaken by the OECD for the G20 on Financial Consumer Protection, which includes an exercise to test how national authorities have responded to its 2011 Principles on Financial Consumer Protection.⁶
 - a research study contracted by the European Commission (DG SANCO) which aims to map the over-indebtedness of European households and to obtain updated information on the nature, causes and effects of over-indebtedness as well as on the initiatives to alleviate its impact. The study, which covers all 27 Member States is planned to be completed in March 2013

The EBA and/or NCAs are involved in all of these initiatives, and the EBA will be monitoring the effectiveness of this action through its relevant committees and working groups. Further EBA work in the areas of responsible lending and dealing with borrowers in difficulty is also discussed below in section 2.1.

1.2 Financial literacy and education

Particular concerns from a number of member states included:

- consumers being provided with information and disclosure that they cannot understand or interpret, compounded by the fact that, due to the ever increasing complexity of products or the way in which the information is presented, information can be too complex or too detailed, and is therefore often ignored by consumers; and
- consumers may not understand the consequences of their decisions/purchases – including their obligations, their rights, and the protections offered by conduct of business rules. This may also mean that some consumers do not complain if they are dissatisfied with any unfair treatment, when they actually have a right to do so.

Some NCAs have reported action they have taken in 2012 to encourage the banking sector to improve and simplify information provided to consumers and to work with educational and consumer groups to promote greater financial literacy and understanding.

As the EBA has previously recognised, although financial education is an area specifically mentioned in Article 9 of the EBA Regulation, some NCAs do not have legal competence in this area. This fact has a bearing on the nature of the specific work that the EBA has undertaken so far on this.

However, the EBA continues to follow the work of the European Commission (and its ongoing specific initiatives) and the OECD in relation to financial literacy and education. This has also been considered by the Joint Committee of the three ESAs, which is going to leverage on both the national initiatives for literacy/education already in place, as well as on the high quality OECD work already undertaken. In addition, the Joint Committee will recommend that each ESA adds links on their respective websites to relevant national initiatives, along with a link to the OECD global database on financial education [<http://www.financial-education.org/gdofe.html>].⁷ The Joint Committee noted that this approach would

⁶<http://www.oecd.org/daf/financialmarketsinsuranceandpensions/financialmarkets/48892010.pdf>

⁷(EIOPA is already putting this action in place).

also help to deliver on the G20 suggestion in its October 2011 principles to “encourage stakeholders to implement the OECD/INFE principles and guidelines”.

1.3 Complex savings products

Specific issues relating to sales of complex products included concerns relating to the suitability of certain types of products for those consumers to whom they were offered or sold, and resulting alleged mis-selling; but also regulatory difficulties in establishing the evidence (including records of advice and information provided) for such possible mis-selling.

During 2012, SCConFin’s Sub-group on Innovative Products (SGIP) has launched several pieces of work focusing on particular complex products which might be manufactured and offered by institutions within the EBA’s scope. This work has covered Exchange Traded Funds (also covered by the Overview of EBA work), Contracts for Differences, structured products, and the ‘retailisation’ of other types of complex products. Given the responsibility of the European Securities and Markets Authority (ESMA) in these products, EBA has worked on these with ESMA. Both the EBA and ESMA are keen to issue information and advice to European consumers about the risks associated with these products, and that consumers must be particularly aware of these risks if they are considering buying any of these types of products.

A number of NCAs have taken action in their jurisdictions to address risks around sales of complex products to consumers. This has included the publication of information, guidance and warnings to consumers, new risk labelling of products, regulatory reviews of marketing material, and a voluntary industry undertaking not to distribute certain complex products to retail investors.

In addition, many of the issues relating to the sale of complex savings products will be covered by the ongoing review of the EU Markets in Financial Instruments Directive (MiFID), with revised legislation expected to be finalised shortly, and by the work on the draft EU Regulation on disclosure requirement for Packaged Retail Investment Products (PRIPs). Amongst other things, both the revised MiFID and the PRIPs regulations will cover structured deposits as well as the other products mentioned in this section. The EBA, along with the other ESAs, is actively engaged in these initiatives and the Joint Committee’s subcommittee on consumer protection and financial innovation has set-up a subgroup to develop technical standards required under the PRIPs Regulation.

These issues will also be covered by other work initiated by the Joint Committee’s subcommittee on consumer protection and financial innovation, on the oversight and governance of product development processes within financial institutions. A survey of national competences and approaches to product oversight and governance has been undertaken by the Product Oversight and Governance sub-group, and analysis is now underway to identify common practices and issues, in order to inform the work of the Joint Committee and the individual ESAs.

1.4 Bank account fees and charges

Concerns identified by national authorities in the Overview of EBA work related to consumer complaints about excessive charges, lack of transparency in charges and fees, the clarity and/or

accuracy of pricing and the number of cases of overcharging which ultimately lead to refunds being made to customers. Issues raised related both to services already covered by the EU Payment Services Directive and other services which are not covered by EU regulatory framework.

Some NCAs have reported action taken in 2012 to increase consumer awareness about their rights when using financial products and services, partly as a result of concerns about increased interest rates being charged by lenders and increased bank fees. This action has included the publication of guidance and other information, increased oversight of marketing/advertising activities, and a survey of costs incurred by banks when providing payment services and the income generated by these activities. These authorities report some signs of increased transparency, improved understanding and reduced perceived unfair practices.

The European Commission is proposing to bring forward legislation on basic bank accounts, account transparency and bank account switching. The EBA will closely follow the development of this legislation and will provide technical input as necessary.

1.5 Unnecessary and unsuitable sales

A number of countries identified unsuitable sales as areas of concern or risk for consumers in their member state. Specific issues included:

- low levels of financial literacy, a complex market, and complex products, can result in significant risks for a consumer who may choose a financial product which is unsuitable for their needs;
- consumers are often not properly informed by service providers about their products, consumer rights and obligations;
- where financial advice is provided, it is not always suitable; sometimes because remuneration incentives mean that advice is not always motivated by the best interests of the customer;
- the sale of payment protection insurance in conjunction with loans was specifically identified by some authorities.

At EU level, these issues are likely to be largely addressed by the work already described in this report on: financial literacy and education, CARRPD implementation, the review of the CCD, work on the revised MiFID, and the PRIPs initiative. Work on remuneration practices within banks and MiFID investment firms has also been published by the EBA and by ESMA respectively.

One NCA reports that during 2012 its government has introduced new requirements for disclosure of information to customers to help them assess whether a proposed product is suitable for them. This includes prescribed information disclosure on mortgage loans (including products intended to hedge against changes in floating rate mortgage loans). Another NCA is introducing new rules for sales of insurance products as elements of 'packaged bank accounts', and also issued guidance to all firms about risks to customers from financial incentives – providing examples of how financial incentive schemes can be a key driver of mis-selling and how firms are not adequately managing these risks.

1.6 Impact of technology

The rapid speed of technological developments associated particularly with the retail payments market raised a number of supervisory concerns. In particular these related to the need to ensure the security of operations conducted through innovative channels, such as internet and services via mobile phones.

These technological developments have been accompanied by increasingly sophisticated fraud attempts, despite the efforts of institutions to put in place appropriate security mechanisms. In some member states, concerns about security and/or confidentiality were seen as significant restraints to the development of internet banking and online card payments (which, in turn, limits the development of some economic segments such as e-commerce). Two NCAs reported supervisory work in 2012 on e-banking practices (including mobile phone banking and payments) and plan to issue new guidance and recommendations in the light of their findings. Elsewhere, awareness campaigns have been undertaken to remind consumers of the risks.

Internet and mobile banking were also seen as presenting a number of regulatory concerns relating to the practical monitoring and enforcement of existing market conduct rules (e.g. information disclosure requirements) when banking products are contracted through these channels. The European Commission's 2012 Green Paper on card, mobile and internet payments launched a consultation on related issues, on which we expect follow up in Q2 2013.

A number of these issues will need to be addressed through the coming reviews of the Payment Service Directive in 2013 and E-money Directive in 2014. They have also been at the forefront of the ECB's work during 2012 on the security of retail payments ('SecuRe Pay'), in which several SCConFin members have been actively involved. The EBA is considering what role it should play in helping to give effect to the forthcoming recommendations of the SecuRePay Forum.

Part II

2. Supervisory concerns in 2012 and the areas of work identified for 2013

Following the survey of SConFin members undertaken in Q4 2012 (see Annex to this report), the EBA presents the following trends and issues for 2013, as identified by the members of the SConFin⁸

The issues identified from the survey can be summarised as follows:

- Indebtedness and responsible credit;
- Transparency and levels of charges;
- The scope of mis-selling of financial products resulting from a combination of pressures on institutions and the continuing challenges for consumers in understanding the suitability of products for them;
- Specific issues concerning certain products – notably foreign currency loans, payment protection insurance and complex products;
- Security of new technologies used for banking services; and
- Emerging new forms of liquidity raising.

As noted at the outset of this report, many of the trends and issues highlighted this year are the same as, or variations of, those identified in the Overview of EBA work. However, the financial literacy and education and comparison websites were not identified as highest priority issues again in 2012, mainly due to some activities in these areas. On the other hand, the concern from 2011 regarding the bank account fees and charges was widened in 2012 to transparency and levels of charges in general, similar to the complex saving products which were in 2012 in a broader category of problematic products. A completely new issue in 2012 was related to the new forms of liquidity raising which is probably linked to the impact of the financial crisis and a need to raise the capital of banks. These findings are not unexpected, given the fact that many of the points reflect the effects of macro-economic conditions which have continued over the period. These effects are evidenced both in the financial situations and behaviours of consumers and in the behaviours of some financial institutions in the EU banking sector.

⁸ It should be noted that the information collected from NCAs is not exhaustive and in some cases is not based on statistical data.

2.1 Indebtedness and responsible credit

Given the continuing challenging economic environment in many EU member states, over-indebtedness and the issues that result continue to remain a key consumer protection concern for many regulators and their governments. New measures continue to be explored at national level to assist borrowers and lenders to cope with consumer debts, to promote responsible lending, and to investigate ways of alleviating the pressures through loan restructuring or renewed standards for the fair treatment of those in arrears and payment difficulties. Mortgage debts continue to be the chief concern for many regulators, though wider levels of non-mortgage debt remain. In some member states, certain debt-collection practices and intermediaries are also causing concern. NCAs in a number of member states are involved in initiatives to target more vulnerable groups of consumers (such as the young or elderly) with advice and information. In some countries, access to credit and other banking services is becoming an issue for such vulnerable groups.

One NCA also highlighted a particular increase in its market in offers of ‘quick loans’ to consumers, which may involve inadequate credit checks and disproportionate penalties for delayed payments. Such lending has also historically existed in many other markets (including in the practices of unregulated so-called ‘loan sharks’).

In addition to national initiatives already in hand, the EBA believes that SCConFin’s current work on good practices (and possible future guidelines) on responsible lending and on the treatment of borrowers in payment difficulties can make a valuable contribution in this area.

2.2 Continuing concerns about the transparency and levels of charges and fees

An issue related to indebtedness is the trend for some financial institutions to increase fees and charges, or introduce new ‘administrative’ fees and charges, for certain loan repayments (particularly when repayments are late) which further burden indebted consumers. Some NCAs have also identified a lack of transparency in charges being levied for overdrafts, and some disregard for the disclosure requirements of the CCD.

A number of regulators are considering whether such behaviours are consistent with their national laws and regulations, and whether clarification or regulatory intervention is required.

2.3 The scope of mis-selling of financial products

As reported in the Overview of EBA work, the continuing scope for mis-selling of products remains a concern for most regulators. The lack of consumer understanding and financial literacy is compounded by the increased incentives for some financial institutions to rebuild their balance sheets and explore revenue opportunities and profit in difficult economic conditions. This includes the scope for inadvertent mis-selling by intermediaries who do not understand the products they are distributing (being addressed by a number of NCAs).

One NCA has also specifically commented on an increase in customer complaints about the behaviour of its banks and other financial institutions over the past year, and this regulator’s increased focus on how institutions are handling customer complaints (also mentioned by other NCAs). This is

an area that SCConFin is likely to consider further – including in developing its future methodology and data for monitoring consumer trends.

2.4 Specific issues concerning certain products – notably foreign currency loans, payment protection insurance and complex products

Related to the previous issue, NCAs have again highlighted concerns about unnecessarily complex products being offered to consumers who do not understand the products or the risks they involve. Concerns continue about the quality of information provided about such products and whether it can readily be understood by those to whom the products are offered. NCAs continue to monitor the effects of actions they have already taken on these issues.

Several NCAs have again identified particular challenges for consumers to understand the risks associated with loans taken out in foreign currencies (including foreign currency mortgage loans), which have been attractive in recent years in some member states. Again, NCAs are monitoring the effects of actions they have taken on these issues (including warnings and guidelines).

Several NCAs have (as in 2011) reported their concerns about the potential mis-selling of payment protection insurance/credit protection insurance in connection with loans. These NCAs are monitoring selling practices and considering the incentives and possible conflicts of interest that may arise in some circumstances. In other member states payment protection insurance has already emerged as a regulatory issue on which national action has been taken and is still continuing (including customer redress for past mis-selling).

2.5 Continuing concerns about the security of new technologies used for banking services

The same concerns as were raised in the Overview of EBA work remain current in many member states in relation to security and fraud risks still arising in connection with new banking and payments technologies; and the need to ensure that all providers have appropriate systems and controls in place to manage the risks and to deliver their consumer protection obligations (including where services are provided across national borders).

In addition to the EU framework provided by the Payments Services Directive and national regulatory responses, it is hoped that initiatives such as the ECB's SecuRePay work will help address such concerns.

2.6 Emerging new forms of liquidity raising

Certain emerging new models of liquidity raising and funding have been highlighted this year by SCConFin members. One of these is so-called “crowdfunding” or “peer-to-peer” lending, whereby groups of consumers are invited to participate in direct lending to other borrowers or enterprises, as an alternative to funding from financial institutions. While such models may have their place, some regulators have issued reminders to consumers to be aware of the risks that may be involved and the lack of protections to underpin some of these schemes (e.g. lack of regulation and compensation cover).

Another type of liquidity raising product reported to be used increasingly, is 'time deposits' (or 'term deposits' or types of bond) marketed by some banks to raise longer term capital. The regulator that has identified this trend was concerned that retail consumers need to be properly informed about the features of the product and the conditions attaching to it (including potential penalties for early withdrawal of deposited cash) – and the regulator has issued a recommendation about the marketing and information disclosure it expects.

2.7 Issues identified by the Banking Stakeholder Group

In December 2012, the EBA Banking Stakeholder Group (BSG) conducted a short informal poll of all BSG members to identify the current key issues in consumer protection, within the EBA's remit. A total of 21 responses were received and the results are broadly in line with SCConFin's analysis on Consumer Trends. The following were identified as being the top 5 areas of concern amongst BSG members:

- *Responsible Lending:* The key issues identified included over lending by banks to vulnerable consumers and over-generous lending ratios.
- *Incentive Structures:* The main concerns related to sales incentive structures for bank employees and that these incentives may entice the employee to recommend unsuitable products.
- *Transparency, Disclosure and Comparability:* Several issues were identified including transparency of terms and pricing, price disclosure which leads to a difficulty in comparing products and high levels of switching costs.
- *Investment Products:* The main concerns regarding investment products sold by banks are the lack of disclosure of relevant information and risk characteristics being identified. It is noted that issues in this area are likely to fall into the responsibility of ESMA.
- *Financial Literacy and Education:* The key concern is the ability of consumers to understand financial products and contracts before determining that the product is suitable for their needs and circumstances.

Annex - Methodology for compiling this report

In October 2012, SCConFin conducted a survey amongst its members. The intention was to review the previous year's report and priorities and to update it where necessary to reflect current priorities and wider retail banking and payments issues.

SCConFin members were asked to review the key consumer protection issues they identified in October 2011 and to identify what action had been taken (by them or at EU level) to mitigate those risks. They were then asked to identify their top consumer protection issues in 2012, along with a description of possible measures and recommendations planned to be taken.

In identifying issues and trends, SCConFin members were asked to consider:

- issues arising at the 'borderline' of regulated and non-regulated issues, providers, or new entrants or new technological means for carrying out banking business (e.g. e-banking, payments providers);
- trends that do not present any particularly innovative characteristics;
- issues that arose/were illustrated by the recent crisis;
- the potential cross-border effects of such issues;
- the size of the issue/problem, e.g., the number of consumers who own the product or are impacted by the issue or the number of firms selling it;
- data/evidence covering (a) product sales, (b) complaints, and (c) thematic issues identified by national competent authorities.

Responses were collated by SCConFin and the resulting report was reviewed by the EBA Board of Supervisors and approved for publication.