



**BANKING STAKEHOLDER
GROUP**

CONSULTATION ON EBA/CP/2014/37 ON
“DRAFT GUIDELINES ON PRODUCT OVERSIGHT AND
GOVERNANCE ARRANGEMENTS FOR RETAIL BANKING
PRODUCTS”

General Comments and Replies to Questions

BY THE EBA BANKING STAKEHOLDER GROUP

London, February 10, 2015

Foreword

The EBA Banking Stakeholder Group (“BSG”) welcomes the opportunity to comment on the Consultation Paper EBA/CP/2014/37 on Draft Guidelines on product oversight and governance arrangements for retail banking products.

This response has been prepared on the basis of comments circulated and shared among the BSG members and the BSG’s Technical Working Group on Consumer Issues and Financial Innovation.

Developments in the markets for financial services in recent years have shown that failures in the conduct of financial institutions towards their customers can cause not only significant consumer detriment but also undermine consumer and market trust and confidence, financial stability and the integrity of the financial system. In addition, conduct failure can result in direct costs for financial institutions as a result of redress and compensation pay-outs, penalties, fines, and loss of income.

Several general consumer-related concerns and common points of failure have been highlighted by some members of BSG and which inform this response to the Consultation Paper:

- ▶ Not identifying the target market: firms frequently market products without a clear understanding of who should be purchasing the product and why it is suitable for that group.
- ▶ Failure in risk profiling: firms fail to risk-rate products appropriately, which can lead to products being sold to the wrong customers, who may be unaware of the potential volatility of the product or the potential risk of loss of investment. An example would be structured complex products marketed as “medium” risk that are targeted to customers whose level of sophistication is out of line with the risk profile of the product, i.e., customers with a low risk appetite.
- ▶ Failure to recognize responsibility for a product by those in the distribution chain: even when a value chain is heavily intermediated, the BSG does not expect those further down the chain to say that they have no responsibility for the interests of the end client. Firms should be expected to show that they have considered their target market and take steps to ensure that the product is not sold outside that market. The distribution strategy needs to be appropriate; they need to be honest with distributors about the nature of the product and have some responsibility for ensuring that the intermediaries understand and are competent to offer such products. In addition, all those within the chain should be aware of, and understand, any changes in the nature of the product.
- ▶ Failure to understand the distribution chain: confusion between manufacturers and distributors of products may lead to required

disclosure of product features and risks not being effectively relayed from manufacturers to distributors as well as miscommunication regarding correct target audiences for products. In addition, a lack of clarity as to who is accountable for each stage of the distribution chain may arise.

- ▶ Fee charging structure: firms need to clearly disclose the end-to-end fee charging structure of products (where applicable) to customers to ensure that prices are clear and transparent from the beginning of the transaction. The level of disclosure should have due regard to the likely degree of sophistication of the target customer.

- ▶ Failure to disclose: firms must ensure that all disclosures regarding performance of the product due to prevailing market conditions have been communicated clearly and in good time to customers. This includes clear statements about how the product is likely to perform in different market conditions and drawing particular attention to the fact that reliance on past performance of the product is not always an indicator of future performance.

- ▶ Pricing structure: firms should review the pricing structures of previous, existing and new products to ensure that hidden mark-ups are not embedded within the pricing where there is little or no real value to the end customer of that particular component.

- ▶ Excessive reliance on add-on products: “Add-ons” refer to any product sold alongside another product - also commonly known as packaged products — for example, current accounts with added mobile phone insurance or travel insurance. The terms for the tied product can be, or become, uncompetitive and may not be required by the customer. Institutions rely on these ancillary revenues to increase the profitability of the main product (due to the low-cost production and easy maintenance of the tied product) but often without ensuring that appropriate controls and assessment are in place for their sale.

- ▶ Failure to monitor who is purchasing the product: where the target market has been identified firms may fail to ensure it is being sold to that market.

- ▶ Failing to act where it is identified that a product is being miss-sold: the BSG has already identified that firms are sometimes slow to remove or amend products where failings are identified and conduct adequate remediation for the consumers impacted.

- ▶ Underestimating product sales following launch: where take-up is underestimated customer service offerings may suffer.

- ▶ Not investigating reasons for higher-than-expected sales: higher-than-expected sales may be an indication that the product is being purchased by groups of customers outside the intended target market.

Product intervention is based on the premise that disclosure, while necessary, is not sufficient given consumer behaviors. It is about moving toward being proactive rather than reactive. The ultimate intention is to complement the traditional focus on sales and marketing and the disclosure of information throughout the product life cycle. The product intervention regime recognizes that decisions taken by firms when designing new products, and managing existing products, have an impact on subsequent distribution and consumer outcomes. The interventionist regime will apply to all product types and sectors.

To address some of the causal drivers of conduct failure, and following the initial work carried out by the Joint Committee of the three European Supervisory Authorities in 2013, the EBA has developed detailed Guidelines for the product oversight and governance of retail banking products: mortgages, loans, deposits, credit cards, payment services, payment accounts and electronic money. The Guidelines, which apply to both manufacturers and distributors of retail banking products, aim at ensuring that the interests, objectives and characteristics of consumers are taken into account when such products are designed and brought to market.

This response to the Consultation Paper outlines some general comments by the BSG, as well as detailed answers to some questions indicated in the Consultation Paper. The BSG generally supports the EBA version of the Guidelines, but has some proposals which will help Competent Authorities to make better choices at national level.

General comments

The BSG welcomes the mandate for the EBA to issue Guidelines to address, not only past failings but rather provide a framework for robust and responsible product design and distribution to avoid future cases of detriment.

In the Consultation Paper the EBA emphasizes an important general point that:

"The banking sector should consider the needs of their customers when designing their products. This is crucial to help re-establish and maintain confidence in retail banks".

What may seem obvious at first sight is often not so in practice, in light of the abuses to the detriment of customers in the worst moments of the crisis. Through surveys in EU countries, misidentifications of market segment were discovered such as, for example, mortgages contracted by customers unable to assume its payment obligations. The sale of mortgages linked to other

products that customers do not need, or complex loans whose risks are not known by customers, are other cases of detected inadequate sales. In many cases the client tends to rely more on the explanations given by branch employees rather than information in the documentation provided.

Branch employees, who must have the appropriate knowledge and experience, should inform customers of the risks and the total price of the product to be signed, including all fees and expenses. This responsibility lies with the banking directors and shall be reviewed and documented periodically. First, they must identify the niche market to which the product is directed by its characteristics and, likewise, specify to which type of customer it should not be offered. Secondly, if a product is offered to a customer who is not part of the target audience this should be justified with appropriate documentation.

There needs to be a requirement for manufacturers to ensure that their internal control functions, identification of the target market, product testing, product monitoring, remedial actions, the selection of distribution channels, and information to distributors are effective. The obligations on distributors cover the distributor's internal arrangements, identification and knowledge of the target market, and information requirements.

The importance of product development and product manufacture within the governance arrangements of the firm need to be considered. Firms must ensure that governance arrangements take full account of product issues and that oversight and reporting arrangements are fit for purpose. Lack of governance in particular with regards to product development and marketing processes increases the risk of firms developing poorly designed products. This, in turn, would inevitably lead to mis-selling which highlights the need for firms to place product governance at the core of their business models and thus ensure that strategies aligned with governance are integrated and embedded.

The BSG supports the Cost/Benefit Analysis and the Impact Assessment of the Guidelines and the options preferred by the EBA. The BSG also generally supports the draft version of the Guidelines, but considers it useful to make some comments and proposals as detailed below.

Replies to Questions

General questions

1. Do you agree with the proposed approach of capturing the entire products life cycle by covering distributors as well as manufacturers?

We agree with the proposed approach.

2. Do you agree with the delineation of the two sets of requirements for manufacturers and distributors?

Yes. It makes sense to apply two sets of requirements that are tailored to their specific characteristics. However, it is important that the final Guidelines do not create any confusion over where responsibility lies, or create any gaps. The Guidelines should make clear that the manufacturer retains ultimate responsibility for product governance and oversight.

3. Are there any additional requirements that you would suggest adding to either of the two sets of requirements? If so, why?

No comment.

Specific questions regarding Guidelines for manufacturers (Title II)

4. Do you agree with Guideline 1 in establishment, proportionality review and documentation?

The BSG would like consideration to be given to whether companies should be urged by means of these Guidelines to make their POG arrangements public so as to allow for greater scrutiny. Greater transparency is more likely to elevate any policies put in place beyond a simple box-ticking exercise. We question whether the periodic review as currently foreseen should be conducted entirely internally within each firm. Were POG arrangements to be reviewed independently, it is more likely that the review would be sufficiently critical and shortcomings would be identified. Where repeated breaches of product oversight and governance procedures occur in firms, independent review should be encouraged.

5. Do you agree with Guideline 2 on manufacturers' internal control functions?

Reference is made to our answer to Question 4.

6. Do you agree with Guideline 3 on target market?

The guidelines do not refer to simple products, although adequate product oversight and governance arrangements are a key component in ensuring that products and their risks can be easily understood by consumers. The 2013 Sergeant Review in the UK¹, found that many consumers need simple financial products because of “the challenge of making good choices in what seems to many to be an overwhelmingly complicated marketplace with a very wide range of products which are complex and difficult to understand”.

The review established a set of principles which form the basis of an objective test to establish whether a product is simple or not. These include, for

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

example, the use of standardised language, a transparent fee structure and a straightforward and clear purchasing process. We would encourage the EBA, in cooperation with the other ESAs, to conduct a similar exercise at EU-level to establish such operating principles for manufacturers. To ensure adequate consumer understanding of the types of products they are offered, it is also critical that a designation of a product as 'simple' is subject to oversight by a regulator or some other independent body.

7. Do you agree with Guideline 4 on product testing?

No comment.

8. Do you agree with Guideline 5 on product monitoring?

No comment.

9. Do you agree with Guideline 6 on remedial action?

The EBA should include a clear reference in Guideline 6 to the possibility of suspending from sale a product where monitoring has found problems with the design or sale of the product. Any remedial action should be promptly reported to the competent authorities of the home Member State, so that the authorities can spot emerging problems and risks more rapidly.

10. Do you agree with Guideline 7 on the selection on distribution channels?

No comment.

11. Do you agree with Guideline 8 on information for distributors?

No comment.

Specific questions regarding Guidelines for distributors (Title III)

12. Do you agree with Guideline 1 on establishments, proportionality, review and documentation?

Reference is made to our answer to Question 4.

13. Do you agree with Guideline 2 on distributor's internal control functions?

Reference is made to our answer to Question 4.

14. Do you agree with Guideline 3 on the knowledge of the target market?

The Guidelines should make an explicit reference to staff involved in the sale of the product, as this is arguably where the greatest risk of mis-selling occurs. Such staff should receive adequate training to identify the target market for a specific product. The EBA could envisage a provision that staff should be properly trained and not be incentivised to act against the customer's best interest, for example through inappropriate remuneration structures.

15. Do you agree with Guideline 4 on information?

No comment.

Submitted on behalf of the EBA Banking Stakeholder Group

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