Joint ESAs Consumer Protection Day

London, 4 June 2014

Opening remarks

Andrea Enria, Chairman of the Joint Committee

Ladies and Gentlemen, I am honoured to welcome you to the second Joint ESAs Consumer Protection Day of the three European Supervisory Authorities – European Banking Authority, European Securities and Markets Authority and European Insurance and Occupational Pensions Authority under the auspices of the Joint Committee of the ESAs. The Joint Committee is a forum that was established on 1 January 2011, with the goal of strengthening cooperation and ensuring cross-sectoral consistency between ESAs.

The first Joint ESAs Consumer Protection Day took place last year on 25 June 2013 in Paris and it was a very successful event. It attracted around 250 consumer representatives, academics, legal and financial consultants, national supervisors and experts from the EU institutions and financial services industry (banking, securities, insurance and pensions).

Today, it is my pleasure, as the current Joint Committee Chair, to welcome you to London and to continue with the good tradition of the Joint ESAs Consumer Protection Days. Last year we discussed topics like PRIPs, consumer trends, sales incentives and product intervention on a theoretical level. This year we are focusing more on the actual work done by the Joint Committee in the area of consumer protection and financial innovation as we have the first cross-sectoral deliverables. The structure of the day is also different compared to last year – to allow you to take part in each of the presentation and panel discussion. The discussions on product oversight and governance, behavioural finance, cross-selling and financial innovation will

follow one after the other and unlike last year there will be no break-out sessions in the afternoon.

Last, but not least, it is my pleasure to welcome more than 30 consumer representatives in the audience. As the title of the event suggests, this day is about consumers, consumer protection and what the ESAs are doing in this area and therefore, questions from the audience and especially from you, the consumer representatives, are very much welcomed. The format we chose this year does not include many panels with representatives of all the different interests – as a matter of fact, we have only one representative from a consumers' association and one representative from the financial industry. We will instead focus on the opening interventions in each panel on the presentation of research and policy work being conducted in academia, European and national institutions, as well as in organisations that we as regulators would not usually interact with during our daily work. This is intended to lay out the basis for a hopefully intense, interactive and inspiring discussion with all stakeholders, and first and foremost with consumers of financial services in the audience today. The success of the event will eventually rest with you.

1. The remit of the ESAs

The ESAs were established in 2011 and are currently under a review process, which will assess whether the mandate has been correctly fulfilled and whether changes are needed to ensure that their objectives are met. Several stakeholders, including associations of consumers and users of financial services have contributed to the process.

It is important to understand that our ability to achieve our objectives, including in the area of consumer protection, is strictly dependent on the clarity and strength of the legislation that defines our tasks and instruments, including the resources that are assigned to us by the Authorities. We are convinced that a lot of progress has been made under the current framework, but additional clarity of the legal basis and a better matching of

tasks and resources are warranted.

The scope of action of the three ESAs in the field of consumer protection is defined along sectoral lines. To start with the EBA- the Authority shall act within the scope of several directives that cover pure banking products, such as mortgages; personal loans; deposits; credit and debit cards; payment services, and electronic money.

Ensuring the interests of investors are properly safeguarded is an important objective for ESMA. ESMA achieves this through promoting transparency, simplicity and fairness in securities markets for consumers of financial products or services. EIOPA's core responsibilities are focused on the protection of policyholders, pension scheme members and beneficiaries.

Different scopes of action of the ESAs are indeed effectively complemented within the Joint Committee, which brings together the three ESAs with a view to ensure consistency and coordination of their actions. Let me then turn to a description of the first deliverables of the Joint Committee in relation to consumer protection and financial innovation. Let me emphasis that the Joint Committee also provides an umbrella to joint initiatives of two of the ESAs – for instance, the work EBA and ESMA accomplished on EURIBOR and the benchmark setting processes; in my remarks, I will however focus only on those work streams that cut across the three sectors.

2. Joint Committee -Deliverables so far

2.1 Joint Position of the ESAs on manufacturers' product oversight and governance processes

In 2013, the Joint Committee developed its first cross-sectoral deliverable in consumer protection and financial innovation – the Joint Position of the ESAs on manufacturers' product oversight and governance processes. The ESAs were established to foster consumer protection and, at the same time, to promote the stability, effectiveness and integrity of the financial system. Designing, operating and bringing products and services to

markets may pose a risk to these two objectives if the target market is not identified correctly; their objectives and characteristics are not duly taken into account; or if products are sold outside of the target market. In seeking to fulfil its task to develop a set of high-level, cross-sector principles, the Joint Committee conducted a survey among national competent authorities (NCAs), in order to:

- gauge problems or failures in the area of product development and governance processes within firms;
- map national initiatives in the above-mentioned area; and
- collect the opinions of the NCAs on the need for further development of cross-sectoral high-level principles for manufacturers' product oversight and governance at EU level and, if so, on the scope of the aforesaid principles.

The survey revealed numerous instances in which manufacturers had failed to have proper product oversight and governance arrangements in place, which then resulted in consumer detriment; a reduction in consumer confidence in financial markets; and, in cases where compensation had to be paid, an impact on the prudential situation of financial institutions. These issues have arisen across the three sectors of banking, insurance and investments, and across a few EU Member States.

Based on the results of the survey and the subsequent analysis done by the Joint Committee, and taking into account the principle of proportionality and existing and proposed EU legislation, the ESAs have developed the Joint Position on manufacturers' product oversight and governance processes. The high level principles developed in this Joint Position will provide a consistent basis for the development of more detailed guidance addressed to manufactures by each ESA in the respective sectors.

This topic will be discussed in more detail during the first presentation and panel discussion. While the presentation will reveal several findings of misconduct of financial institutions, the following panel discussion with the

three Chairs of the ESAs and moderated by the Director General of the Finnish FSA and the Chair of the Joint Committee Sub-committee on Consumer Protection and Financial Innovation, Ms Anneli Tuominen, will focus on the ESAs' work in relation to product oversight and governance.

2.2 Guidelines on complaints handling

A second deliverable that I would like to mention is the Guidelines on complaints handling.

In June 2012, EIOPA published its "Guidelines on Complaints Handling by Insurance Undertakings". Taking into account the different regulatory provisions for complaints handling between the securities and banking sectors, and the Alternative Dispute Resolution Directive, ESMA and EBA considered that the adoption of EIOPA's guidelines for the securities and banking sectors should help to ensure a consistent approach to complaints handling across the banking, investment and insurance sectors. This should result in benefit for firms, which may sell products from more than one sector; national authorities, which will have to oversee implementation of one set of guidelines in their respective jurisdictions; and consumers who will be able to rely on the same approach within the EU, irrespective of what type of product they have purchased and where they have purchased it – thereby improving consumer confidence in financial services. ESMA and EBA have also noted the G20's October 2011 "High-level principles on financial consumer protection" which mentions "adequate complaints handling and redress mechanisms" as a means to reinforce financial consumer protection.

The Joint Committee's Consultation Paper (CP) on 'draft guidelines for complaints-handling for the securities (ESMA) and banking (EBA) sectors' was published on 6 November 2013. The consultation period closed on 7 February 2014 and ESMA and the EBA received 31 responses, all of which have been published on the Authorities' websites.

It is my pleasure to announce that the guidelines have been endorsed by EBA's and ESMA's Board of Supervisors. It means that the guidelines will be

now translated into all official EU languages and published on the EBA's and ESMA's website, and firms and national competent authorities will be expected to comply with them.

3. Joint Committee - ongoing work

In addition to the mentioned work on product oversight and governance and complaints handling, the Joint Committee is working on several other topics aimed at fostering consumer protection. Let me update you on the latest developments.

3.1 Self placement

A work stream that is coming close to delivery is what we refer to as "self-placements", particularly in the banking but also in the insurance sector. Allow me to give you a bit of background.

a) Background

In response to the financial crisis, the regulatory reforms endorsed at the G20 level and implemented in the EU have requested a significant effort to strengthen the resilience of financial institutions. This has generated an enormous pressure to increase the loss-absorbing capacity of all regulated institutions, especially those that in light of their dimension, complexity and international reach could give rise to systemic crises. The ESAs have been at the forefront of these developments, by contributing to developing the new capital requirements for credit institutions and insurance companies in the EU and exercising, together with the European Systemic Risk Board (ESRB), extensive pressure on financial institutions, especially banks, to strengthen their capital position.

Let me focus for a moment on banks, which have been the key focus of the policy efforts to repair the functioning of the financial system. The new regulatory framework – in the EU the Capital Requirements Directive and Regulation (CRD4-CRR) – requires banks to enhance significantly their capital

position, by means of capital instruments that are permanent, loss-absorbing, and allow for a prompt suspension of payments to investors in case of a crisis. The higher quality requested for capital instruments means an increased likelihood of losses for investors in a crisis. Moreover, policy makers have been adamant that in the future they don't want to see anymore the extensive recourse to bail-out of private institutions with taxpayers' money. Hence, the Bank Recovery and Resolution Directive (BRRD) has introduced the principle of *bail*-in, as opposed to *bail-out*. This means that banks will be required to finance themselves for a significant part through instruments that can be written down or converted into equity in cases in which the supervisory authority considers that the bank is not viable anymore and needs to be pushed into resolution. Loss-absorbing instruments should account for at least 8% of a bank's total liabilities, and these instruments would have to absorb losses before a resolution fund or public resources could be used.

The EBA has already issued recommendations asking banks to significantly strengthen their capital position, via issuance of common equity and other particularly loss-absorbing capital instruments. The stress test we are currently conducting, coupled with the asset quality review being accomplished by the ECB and other competent authorities, is putting a further hurdle for banks, which are rushing to issue capital instruments – common equity, and sometimes more complex convertible instruments. The progress is significant and very satisfactory from a prudential perspective. But are the issuers placing these risky and sometimes complex instruments with investors that are capable of assessing the likelihood of losing their money, and adequately informed as to the type of instruments they are buying?

b) Placement practices observed

The three ESAs have conducted some analyses on the ways in which financial institutions across the EU have chosen to comply with the new rules and the requests of supervisory authorities. The findings suggest that financial institutions are often tempted to comply by placing with retail investors, and

depositors in particular, financial instruments that are eligible as high quality (Tier 1) capital and/or that rank high in the hierarchy of a possible bail-in under BRRD terms. These instruments have been, and are being, sold using designations such as subordinate debt securities, hybrid/convertible securities, participation capital securities, mandatory convertible bonds, or contingent convertibles (CoCos), to mention but a few. In the insurance sector, in turn, unit linked insurance policies have been placed in order to comply with pending Solvency 2 requirements.

The reasons for institutions to engage in such practices are manifold: they are a less costly and an easier alternative to comply with prudential requirements than the selling of non-core assets; some credit institutions may lack access to alternative sources of funding, due to the reluctance of wholesale investors; others may leverage off the trustful links they have forged with their regional depositor base or may consider existing retail banking customers to be more captive and therefore a more suitable sales target; or they may exploit the search for a higher yield investment in a generally low interest rate environment.

However, such practices put consumers, investors, depositors and policy holders at risk. The risk of detriment arises because many of these products do not offer standardised features, and inherent risks are often difficult to assess and compare.

c) Risks for investors and depositors

The assessment carried out by the ESAs, of the ways in which credit institutions have placed these instruments, has revealed a number of shortcomings. In particular, we have recorded cases in which:

- consumers receive no, insufficient or misleading information about product characteristics, prices, or risks;
- consumers receive unsuitable advice;
- existing depositors are approached through aggressive selling techniques;
- existing depositors are proactively approached by credit institutions and given the impression that the product is as safe as

a deposit or protected by a deposit guarantee scheme, neither of which is true;
- consumers are exposed to misleading marketing and advertising;
- consumers are sold inappropriate products during non-advised sales; and
- consumers receive no, insufficient or misleading information about the financial status of the issuer;

When consumer detriment of this kind materialises, issuers of such instruments suffer, too, from reputational risks and the reduced confidence of markets and investors in taking up issuances of this kind in the future.

The causal drivers for these issues include poor management of the conflicts of interest within the entity or group of entities that issues and then also distributes the instrument; inappropriate remuneration arrangements for the staff placing these instruments; and the lack of information provided to consumers and investors. These observations suggest that financial institutions are in need of being reminded of the existing regulatory obligations that apply to any instrument they may decide to place. The three ESAs will go public with their views later this month.

3.2 Cross-selling

The Joint Committee's work programme for 2014 includes addressing cross-selling practices, in the perspective of the ESAs' statutory objectives in the area of consumer protection in financial services. The joint work of the ESAs on cross-selling practices is justified for a number of reasons:

a) the widespread use of such practices by financial institutions in each of the insurance, banking and investment sectors;

b) the potential for consumer detriment of some of such practices;

c) the cross-sectoral nature of a number of cross-selling packages offered to consumers. Indeed cross-selling practices very often consist in grouping together two or more financial products or

services from more than one sector;

d) the recent evolution of the sectoral regulatory frameworks which address cross-selling practices. Indeed provisions aiming at specifically regulating cross-selling practices are included in:

- the Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property (so called Mortgage Credit Directive/MCD);

- the final text of the Directive on markets in financial instruments (recast) (MiFID2);

- the proposal for the review of the Insurance Mediation directive (IMD2) (text voted by the EP); and

- the final text of the Directive on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features (PAD).

The MiFID2 and the IMD2 texts also give mandates respectively to ESMA and EIOPA to develop, in cooperation with the other ESAs, guidelines for the assessment and the supervision of cross-selling practices in the respective areas, indicating, in particular, situations in which cross-selling practices are not compliant with the firms' obligations to always act honestly, fairly, trustworthily, honourably and professionally in accordance with the best interest of clients / customers.

The Joint Committee initiative aims at analysing and addressing cross-selling practices and the risks they raise, by developing guidelines which will help establish coherent and effective approaches in the supervision of firms and will contribute to the enhancement of consumer protection across Member States as well as across the three sectors. The identification of actual practices which are not in line with the overarching principles and general rules of conduct for the protection of customers is also envisaged.

Verena Ross, the Executive Director of ESMA will be presenting the work

done by the ESAs in relation to cross-selling in the afternoon after the Behavioral Finance panel.

3.3 Packaged Retail Investment and Insurance Products (PRIIPs)

During last year's Joint ESAs Consumer Protection Day, the topic of PRIIPs was discussed in detail and what was, at that time, only a theory, has become a reality. A political agreement on the PRIIPs text was reached in April, after the vote in the European Parliament on 15 April. The agreed text now provides a clear basis for the progress of the ESAs work and it foresees three regulatory technical standards – a main one on the content and presentation of the Key Information Documents (KID), and two subsidiary ones (on the revision and review of KID, and on the timing of delivery of KID).

According to the agreed text, the ESAs shall develop draft regulatory technical standards specifying:

> (a) the details of the presentation and content of each of the elements of information [content of KID];
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> (b) the methodology underpinning the presentation of risk and reward; and
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> (c) the methodology for calculation of costs, including the specification of summary indicators.

When developing the draft regulatory technical standards, the ESAs shall take into account the various types of PRIIPs, the differences between them, and the capabilities of retail investors. They will also take into consideration the features of PRIIPs that allow retail investors to select between different investments and between different product options. These include products that allow such a selection to happen at different points in time.

Two additional technical standards to be developed by the ESAs shall specify:

> (a) the conditions for reviewing the information contained in the Key

Information Document (KID);

(b) the conditions under which information contained in the KID must be revised;

(c) the specific conditions under which information contained in the KID must be reviewed or the KID revised where a PRIIP is made available to retail investors in a non-continuous manner;

(d) the circumstances in which retail investors are to be informed about a revised KID for a PRIIP purchased by them, as well as the means whereby the retail investors are to be informed; and

(e) the conditions for fulfilling the requirement to provide the KID in good time before is bound by any contract or offer relating to the PRIIP.

As a part of developing technical standards, the ESAs will perform consumer testing of the KID content and this will help find the most appropriate structure of this document.

The ESAs are currently identifying and developing key options in view of consumer needs, and clarifying underlying methodological pros and cons of different approaches. It is planning to publish a discussion paper later this year and a consultation paper in 2015. In the meantime, the ESAs are also planning the setting up of a "consultative expert group" and a call for interest for experts representing academic, consumer and industry interests will be shortly published on the ESAs' websites.

Conclusions

I would like to conclude my opening remarks by emphasising the importance of the involvement of you- consumer representatives, academics, providers of financial services, and supervisors and regulators -in our work, and especially for your contribution today. The discussions that will follow shall be interactive and I would like to encourage all of you to ask

questions and become involved in the Joint ESAs Consumer Protection Day 2014. We should not forget that at the end of the day, we are all consumers and therefore issues that will be discussed today influence the daily life of all us.

Thank you for your attention.