



The Consumer Voice in Europe



Proposal for the EU financial supervisory reform

Open letter

BEUC-X-2017-139/FAL/cma

Brussels, 27 November 2017

Dear Mr. Tajani,
Dear Mr. Juncker,
Dear Mr. Gualtieri,
Dear Mrs. Van Bossuyt,
Dear Mr. Töniste,
Dear Mr. Goranov,

Last September the European Commission published its proposal for the review of the European Supervisory Authorities (EBA, ESMA and EIOPA – ESAs). The aim is to reform the ESAs' mandate, governance and funding to underpin the Capital Markets Union, the EU's flagship project in the area of investments.

As the major EU public interest organisations working on financial services, we want to stress we are **extremely disappointed** with this proposal.

The Commission missed a **historic opportunity** to propose an ambitious reform of the ESAs to deliver the protection EU financial consumers need.¹ Currently, financial consumers continue to suffer from mis-selling and other abuses in the EU. This is a very serious issue and explains the very poor ranking of financial services among consumer markets as reported repeatedly by the EC Consumer Scoreboards. It also highlights the insufficient focus of the ESAs on consumer protection and the inconsistent and ineffective enforcement of EU law in Member States.

The Capital Markets Union seeks to create a single market for capital and, in this context, encourage consumers to take more risk. But it fails when it comes to the enforcement of EU financial legislation, by leaving it to the full discretion of Member States.

For the Capital Markets Union to succeed, consumers must be able to rely on a harmonised and effective supervisory system, coordinated at EU level.

¹ By "financial consumers" we mean all retail users of financial services, including savers and individual investors.

Therefore, we call for an ESAs reform that would **separate conduct of business supervision from prudential supervision**. This implies providing separated governance, adequate resources and a far-reaching mandate to a new consumer protection structure. Such a reform would accelerate the creation of a common supervisory culture across Europe to the benefit of consumers and EU market integration alike.

Please find in annex our detailed analysis and recommendations for a reform of the ESAs that would truly deliver for consumers. We trust they will fuel the co-legislators' reflections.

Yours sincerely,

Monique Goyens
Director General
BEUC

Guillaume Prache
Managing Director
Better Finance

Benoît Lallemand
Secretary General
Finance Watch

Anne-Sophie Parent
Secretary General
AGE Platform Europe

Olivier Jérusalmy
Managing Director
EFIN

Liz Gosme
Director
COFACE Families Europe

Annex

Assessment and recommendations for the EU financial supervisory reform

Fundamental shortcomings of the current supervisory model

The current supervisory architecture suffers from three fundamental shortcomings:

Ignorance of current reality in retail financial markets

The ESAs follow a sectoral approach to supervision: EBA is responsible for banking, ESMA financial markets, and EIOPA the insurance and pensions sectors. This sectoral split reflects a traditional development of the financial sector with clear-cut boundaries between its sub-sectors. However, it ignores the current reality of retail financial markets in Europe where the boundaries are ever more blurred and many banks and other financial institutions offer retail banking, insurance and investment products. Many investment products are substitutable at the point of sale and the same retail distributor may alternatively propose securities, funds, life insurance, banking or pension products, sometimes insurance-based, sometimes not. As a response to these market developments and in order to break these silos, several national supervisors have already successfully moved to an integrated model of supervision.

Conduct of business supervision as a second rank priority, to the detriment of consumer protection

The ESAs are in charge of both prudential and conduct of business supervision. Despite being closely interlinked, these mandates pursue differing and often conflicting goals. Macro- and micro-prudential supervision aim to ensure the stability and health of the financial system and individual financial institutions respectively, while the aim of the conduct of business supervision is to make sure that consumers are treated fairly by financial institutions. It is widely acknowledged that entrusting these tasks to the same supervisory authority very often leads to conflicting objectives and is to the detriment of consumer protection. For example, the authority may be reluctant to impose a significant fine on a firm and force it to compensate consumers in cases of mis-selling due to fears of undermining financial stability. Or else, the authority might not disclose the names of misbehaving firms due to macro-prudential concerns. See an example below.

Example: the case of falsely active funds (“closet indexers”)

Following a request by Better Finance, ESMA investigated the case of investment funds that claim to be actively managed, but turn out to more or less track the performance of their benchmark (typically an equity index) while still charging high “active” management fees to fund investors.

ESMA discovered that up to 15% of the main UCITS equity funds could “potentially” be closet indexers. But it refused to give investors the names of the suspicious funds, leaving them totally in the dark. Better Finance therefore decided to replicate the ESMA study and to publish all the names of the suspicious funds last February (www.CheckYourFund.eu). In addition, the NGO discovered and disclosed that a large number of those suspicious funds also violated disclosure rules by not disclosing their benchmark performance alongside the performance of the fund. To date (November 2017), neither ESMA nor the national supervisors have sanctioned any of these violations to our knowledge, but the mere publicity created by the NGO has led several of these funds to make their disclosures compliant with the law.

The ESAs have the objective of protecting the public interest, inter alia by enhancing customer protection, yet this task comes last in the list of the ESAs' objectives.² As a consequence of attaching a low priority to consumer issues compared to other objectives, the ESAs' effective impact on consumer protection since their establishment in 2010 has been quite marginal due to their current governance and lack of a clear mandate. For example, the ESAs have never used their power to prohibit dangerous financial products or activities. Nor have the ESAs ever used their powers regarding the breaches or non-implementation cases of EU law³ except in one very specific case (EBA/Bulgaria)⁴.

The ESAs current governance models are also partly responsible for de-prioritising their consumer protection mandate. Several national supervisory authorities are not in charge of financial consumer protection but are members of the Boards of Supervisors. At the same time, not all national authorities in charge of financial consumer protection are represented on the ESAs Boards of Supervisors. This makes it difficult for consumer protection issues to get as much attention as other issues that directly come under the responsibility of all members of the Boards of Supervisors. Now the Commission proposes to allow all national consumer protection authorities to join the Boards of Supervisors, but with no-voting rights⁵. We consider this to be a superficial semblance of reform rather than a real reform.

The quality of conduct of business supervision is fragmented across Member States

Despite the fact that the bulk of retail finance legislation across Europe originates at EU level, Member States have full discretion over how to enforce it at national level. Sectoral EU regulations and directives only require Member States to designate a competent authority responsible for implementation and oversight, and for it to apply dissuasive sanctions in case of law infringement.

However, today's reality is that in some Member States, no authority is really in charge of financial consumer protection. Many national supervisors lack a clear statutory objective to provide consumer protection. Many of them are under-staffed, or have little on-site inspection capacity. or have limited legal powers to make binding decisions and limited powers of sanction. Some of them do not have the capacity to deal with consumer complaints.

What are the remedies?

In order to address these supervisory shortcomings, a growing number of countries within and outside Europe are moving to a 'twin peaks' supervisory model, i.e. mandating separate authorities to deal with prudential and conduct of business oversight. In the Netherlands, this reform was implemented in 2002: the central bank and the insurance and pensions regulator are in charge of prudential supervision, while the Authority for Financial Markets (AFM) is tasked with protecting consumer interests.⁶ The twin peaks model has gained further traction in the aftermath of the recent financial crisis. The Belgian Financial Services and Markets Authority (FSMA) and UK's Financial Conduct Authority (FCA) are good examples. The recent scandal related to tracker mortgages in Ireland spurred debate on whether the central bank is well placed to protect consumers, and whether it would not be more appropriate to set up a separate authority for that purpose.

² Article 1 of the ESAs Regulations: The ESAs contribute to: improving the functioning of the single market for financial services, underpinned by sound, effective and consistent regulation and supervision; ensuring the integrity, transparency, efficiency and orderly functioning of financial markets; strengthening supervisory coordination; preventing regulatory arbitrage and promoting equal conditions of competition; ensuring that risks in their respective sectors are appropriately regulated and supervised; and enhancing customer and investor protection.

³ Article 17 of the ESAs Regulations.

⁴ <https://www.eba.europa.eu/-/eba-notifies-breach-of-eu-law-to-bulgarian-authorities>

⁵ Art 39 of the EC proposal on the ESAs review.

[file:///C:/Users/fal/Downloads/PART-2017-416567V1%20\(1\).pdf](file:///C:/Users/fal/Downloads/PART-2017-416567V1%20(1).pdf)

⁶ <http://personal.vu.nl/d.schoenmaker/dutch%20model%20fr6.3.pdf>

There is also merit in reviewing the US supervisory experience, where the twin peaks model was put in place by the Dodd-Frank Act in 2010. The Federal Reserve is in charge of prudential supervision, while the consumer protection mandate was given to the Consumer Financial Protection Bureau (CFPB). It is worth recalling that the US supervisory reforms were also implemented following the financial crisis originating from market misbehaviour by firms who distributed subprime mortgages designed to fail.

There are several elements that demonstrate the need to shift the EU level supervisory architecture to a twin peaks model. Recent national developments described above suggest that this is the right direction to take. It is worth recalling that the de Larosière Report (2009) which set out the basis for the establishment of the ESAs, suggested that it would make sense in the longer run to move to a twin peak supervisory model at EU level.⁷

Regrettably, the Commission has not assessed the potential added value of an EU twin peaks model. This option is only briefly mentioned in the impact assessment accompanying the Commission's proposal for the ESAs reform. It merely stated that each supervisory model has its advantages and inconveniences, and that there is no evidence that the twin peaks approach is better than sectoral and integrated supervision.⁸

Harmonisation of supervisory practices across Member States can only be coordinated at EU level (the subsidiarity principle would be complied with) and requires a genuine reform of the ESAs i.e. shift to the twin peaks. We believe that this important reform would accelerate the creation of a common supervisory culture across Europe to the benefit of consumers and EU market integration alike.

Therefore, our main idea is to implement the proposal made by Jacques de Larosière 8 years ago, which is nowadays referred to as the twin peaks model.

We are conscious that the EU twin peaks reform is a heavy transformation that needs to be thoroughly thought through and properly designed. The reform could be implemented in two phases (see our recommendations below).

Our proposal for the EU financial supervisory reform

1. Supervisory architecture:

- Phase 1 (short term): Clearly separate the consumer protection mandate from other mandates within the existing ESAs. The reformed Consumer Protection Divisions of the three ESAs should closely cooperate to fulfil their tasks described below;
- Phase 2 (medium term): Establish a twin peaks supervisory model at the EU level. This implies creating an EU Financial Consumer Protection Agency;

2. Governance and funding:

- Both phases will require adaptations of the ESAs governance and funding as the aim is to eliminate the conflicting supervisory objectives and put both objectives on an equal footing. The Consumer Protection Divisions of the ESAs (and later the EU Consumer Agency) will need:

⁷ There may be merit, over time, in evolving towards a system which would rely on only two Authorities: The first would be responsible for banking and insurance issues, as well as any other issue which is relevant for financial stability (e.g. systemically important hedge funds, systemically important financial infrastructures). The second Authority would be responsible for conduct of business and market issues, across the three main financial sectors. Combining banking and insurance supervisory issues in the same Authority could result in more effective supervision of financial conglomerates and contribute to a simplification of the current extremely complex institutional landscape.

See p.58: http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf

⁸ https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/european-system-financial-supervision_en

- i. Separate governance structure: Boards of Supervisors composed exclusively of authorities in charge of financial consumer protection (both regulatory and supervisory authorities);
- ii. Separate and independent budget;
- iii. A consumer panel composed of financial consumer representatives;
- iv. Adequate human resources necessary to fulfill their tasks.

3. Mandate:

- Regulatory and supervisory functions:
 - i. Develop binding standards on conduct of business supervision addressed to national competent authorities. The standards must detail the minimum mandate, powers, tasks and resources that each relevant national competent authority must be equipped with;
 - ii. Coordinate enforcement activities with national authorities based on those standards;⁹
 - iii. Make public the outcomes of coordinated activities, including the application of the above standards;
 - iv. While responsibility for day-to-day supervision of financial institutions should essentially remain with national competent authorities (provided that their supervisory practices are harmonized), the Consumer Protection Divisions of the ESAs (and later the EU Consumer Agency) should be granted direct supervisory and effective product intervention powers with regard to cross-border issues, as well as EU-wide negative trends and risky products/practices that are widespread across several Member States in order to adopt a pro-active approach to prevent mass consumer detriment caused by toxic financial products and practices;
 - v. Continue working on implementing measures (level 2 legislation);
 - vi. Continue working on guidelines and recommendations.
- Market monitoring and data collection:
 - i. Monitor and assess the way national markets function, any cross-market and cross-country trends. This would help build more knowledge and understanding of problematic issues for consumers, to prevent risky developments and consumer detriment;
 - ii. Have a mandate to collect data directly from financial firms.

About us

- BEUC, The European Consumer Organisation, represents 43 well respected, independent national consumer organisations from 31 European countries and defends the interests of all Europe's consumers.
- Better Finance, The European Federation of investors and Financial Services Users, acts as an independent expertise centre and federates about 30 independent investor and financial services user organisations throughout Europe, which in turn gather more than 4 million European financial users as members.
- Finance Watch is the independent non-profit Members' association that defends the public interest in financial reform, with more than 70 Members including experts and civil society organisations that together represent millions of European citizens.
- COFACE Families Europe is a pluralistic network of 57 civil society organisations in 23 Member States representing the interests of all families.
- EFIN, The European Financial Inclusion Network, a network of 30 organisations, including 6 EU Networks and 13 researchers dealing with financial inclusion issues.
- AGE Platform Europe, European network of 120 non-profit organisations of and for people aged 50+ representing some 40 million citizens aged 50+ in the EU.

⁹ In this context, it would be useful, *inter alia*, to assess the US supervisory experience, in particular, how the CFPB cooperates with the state-level consumer protection bodies, insofar as a parallel can be drawn between the EU (national and EU levels) and the US (states and federal levels).