The Consumer Voice in Europe

Green Paper
Building a Capital Markets Union

BEUC RESPONSE

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Background

The launch by the European Commission of a **Capital Markets Union (CMU)** is aimed at supporting jobs and growth within Europe, by establishing stronger capital markets which should complement banks as a source of financing. The headline targets consist of:

- Unlocking more investment for all companies, especially SMEs and for infrastructure projects;
- Attracting more investment into the EU;
- Diversifying Europe's funding sources.

The main rationale of the Commission is that Europe is too much dependent on bank lending and that e.g. equity and bond markets play a smaller role in financing growth compared with other e.g. the US.

http://ec.europa.eu/finance/consultations/2015/capital-markets-union/index_en.htm

General Comments

BEUC, The European Consumer Organisation, welcomes this opportunity to comment in detail on the Commission's Green Paper outlining a Capital Markets Union (CMU).

As a consumer organisation, we will focus on the CMU building blocks which affect retail investors or have an impact on the consumer protection framework. However, some general remarks on this proposed roadmap are necessary.

While it is not our task to question the main rationale of developing a more diversified financial system, we are a concerned that the ambition of tapping more retail savings into capital markets is not matched by an equivalent focus on raising the bar for investor protection and, ultimately, investor trust. We would also like to highlight that retail investment cannot by any means be regarded as a superior substitute for household savings held in bank accounts, as suggested in the Green Paper. Both often cater for completely different needs of consumers.

Moreover, we firmly believe that boosting retail investment requires retail investors becoming prime beneficiaries of more integrated capital markets, something which is not articulated fully in the Green Paper. While stating that restoring investor trust is a key element in this process, the explicit ambitions expressed in the Green Paper to this end look quite meagre and are generally absent from the short-term priorities.

Therefore BEUC would like to stress that restoring investor trust depends – among other factors – on three core issues:

- Having simple, transparent and comparable products to choose from;
- The provision of unbiased advice;
- Strong supervisors who remove the rotten apples form the market.

This could spark real competition in a proper single market, bringing prices and charges down for individual investors and facilitate access to the best products and services.

Lastly we would like to reiterate our demand for a ban on commission. As long as this distorting mechanism biasing the advice of millions of consumers across Europe exists, "acting in the best interest of clients" will never become more than just another phrase in a distant legislative text.

Overall, BEUC would like to see more emphasis on improving retail investment within the CMU project and we urge the Commission to adapt its short term priorities accordingly.

Replies to questions

Q1) Beyond the five priorities areas identified for short term action, what other areas should be prioritised?

While the Green Paper recognises that restoring retail investor trust should be an integral part of the CMU, the short term priorities seem to cater mainly for the needs of financial institutions. Therefore we urge the Commission to consider the following issues in the shortest term possible:

- Improve and harmonise disclosure practices of all long term saving and investment products, including pension products and individual shares/bonds.
- Strengthen the European Supervisory Authorities' (ESA's) framework in order to better ensure investor protection. Promote effective supervision and enforcement in retail markets and services.
- Fixing the retail investment market will require additional direct regulatory action, including opening the toolbox of product intervention. This includes using banning powers of competent authorities to remove unsuitable products from the market, product governance and the development of more simple and comparable investment products.
- Establish a clear legal framework for crowdfunding guaranteeing consumer rights, in order to empower this maturing industry.

Q3) What support can be given to ELTIFs to encourage their take-up?

As European long term investment funds (ELTIFs) are by their very nature very illiquid products, their sales to retail investors is rightly strictly regulated. In general access to and advice on these products should be restricted to very well informed and qualified investors. Encouraging their take-up by tax incentives should take this into account. Fiscal incentives often have a huge impact on consumer behaviour and should not push retail investors into products which are not suitable for their needs.

Q6) Should measures be taken to promote greater liquidity in corporate bond markets, such as standardisation?

Corporate bond markets often lack efficient secondary markets. Adding to their illiquidity, they are mostly traded over-the-counter with high margins, leading to exaggerated costs for retail investors. As a result they are mostly bought at emission and kept until the end. In some countries like Portugal, corporate bond emission is also very sparse.

Overall, an efficient market for corporate bonds, accessible for retail investors which would making investment in bonds possible at any moment instead of waiting for a suitable emission and allowing to sell bonds before maturity without severe loss would be welcome. But any measures to promote liquidity should not undermine investor protection.

Q7) Is any action by the EU needed to facilitate the development of standardised, transparent and accountable ESG (Environmental, Social and Governance) investment, including green bonds, others than supporting the development of guidelines by the market?

There is growing tendency among retail investors to take issues of sustainability or ESG into account. To this end the market has developed many self-regulatory labels or codes of much varying quality. In order to develop this market and ensure investor trust in ESG products, EU action should be explored thoroughly. Any initiative should foster standardised, meaningful and reliable disclosure of ESG aspects of investment products and aim to ensure minimal standards for ESG investment products.

Q9) Are there barriers to the development of appropriately regulated crowdfunding or peer to peer platforms including on a cross border basis? If so, how should they be addressed?

In general, BEUC supports the development of investment-based crowdfunding and peer to peer platforms as it can give consumers direct access to a wider range of investment options. However, we believe that a clear legal framework guaranteeing consumer rights will be necessary to empower this still maturing industry.

It is clear that the current regulatory framework is not designed with this industry in mind, as was also pointed out in the ESMA opinion on investment-based crowdfunding[1], which is threatening investor protection in this market. As crowd investors are prone to a high risk of capital loss[2] and have very few options on

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[1] "*Investment-based crowdfunding: opinion*" , ESMA, 2014 http://www.esma.europa.eu/system/files/2014-1378_opinion_on_investment-based_crowdfunding.pdf

[2] Equity crowdfunding involves mainly start-ups, lacking any track record and with a very high failure rate.

secondary markets, there should be an effective risk warning pointing to the specific risk profile of these investments. Moreover, platforms can be exposed to conflicts of interest as they are generally remunerated on the basis of the amount of transactions on its platform. A recent study[3] by our member AK Wien exposed the weak disclosure practices in this area.

Peer to peer lending faces similar regulatory challenges and unaddressed lending-related risks as was coined by EBA[4]. As this business has the capacity of expanding rapidly, as is noticed in the UK[5], it could require swift regulatory attention.

Moreover, due to the inherent digital nature of this service, and the associated cross border potential, we believe that an EU framework guaranteeing minimal consumer protection standards will become necessary in the near future. This could equally serve the scalability of user-friendly platforms. Regulatory efforts should focus primarily on the following aspects: clearly visible risk notices, disclosure and organisational requirements, right of cancellation and investment amount caps. Specifically for peer to peer lending, creditworthiness check on the borrower should be performed[6].

In this context, BEUC wants to make clear that a self-regulatory approach, including the promotion of a voluntary transparency label without public enforcement, is not the best way to give investors the much needed trust in these new type of intermediaries and risks giving a false sense of security.

Any regulation needs to be calibrated in order to strengthen this industry, not stifling its growth. We would also recommend the European Commission to consult on this topic more in detail before taking further action. Merely loosening prospectus' requirements for the sake of crowdfunding, without a broader regulatory approach is not the best way forward.

Q13) Would the introduction of a standardised product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?

European consumers increasingly struggle to meet their retirement's needs. In the context of a weakening economy and state budget restraints, consumers need to rely more and more on personal pension's products (PPP). However, this growing reliance on individual pension products is not matched by an adequate supply of value for money pension savings vehicles.

3 "*Crowdfunding: An analysis of 18 platforms in Germany, Switzerland, United Kingdom and Austria seen from the perspective of consumer*", AK Wien, 2014 http://akeuropa.eu/_includes/mods/akeu/docs/main_report_en_337.pdf

4 "*Opinion of the European Banking Authority on lending-based crowdfunding*", EBA, 2015https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-03+%28EBA+Opinion+on+lending+based+Crowdfunding%29.pdf

5 *"Moving mainstream, The European Alternative Finance Benchmarking Report",* University of Cambridge/Ernst & Young , 2015 http://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2015-uk-alternative-finance-benchmarking-report.pdf

6 In the UK, peer 2 peer borrowers have similar protection as those coined by Consumer Credit Directive.

Multiple fees and *charges have a dramatic impact on capital accumulation over the life of a pension*[7]*.* Obviously this has a very detrimental impact on the (real) return of pension products, as confirmed by recent research[8]. Moreover, weak disclosure practices add to the opacity of often very complex personal pension products. Also, the lack of proper financial advice and the absence of an aggregated overview of different pension pillars are making it difficult for European consumers to make good and informed choices.

In short, current market outcomes are not at all satisfactory and regulatory attention to personal pensions is very much welcome. In general, we believe there is a need across Europe for consumers to have an easy access to a low-cost, transparent and standardised personal pension product. To this end we invite the Commission to develop more detailed policy options. Possible ways forward range from improving disclosure standards and capping charges to developing an easy to access, publicly supervised and standardised savings vehicle.

In the short term, improving disclosure practices of personal pension products is essential for a better functioning market, as this should make comparison easier and drive effective competition. To this end we demand that the PRIIPS for KID principles are extended to all PPPs. Moreover, we believe that consumers should be able to assess their overall pension situation in order to make an informed choice when buying a PPP. In this context, we welcome the ongoing initiative from the Commission on improving disclosure of occupational pension plans within the Revision of the Institutions for Occupational Retirement Provision (IORP) Directive.

While we regard disclosure as a first essential step, more supply-side regulation, along with improved governance and aligned incentives for providers will be crucial in fundamentally improving consumer outcomes. One way forward in this perspective is the promotion of default products and auto-enrolment options in pension provision, which has a big potential towards achieving a better market outcome for those disengaged consumers unable to make active choices[9].

Q17) How can cross border retail participation in UCITS be increased?

First of all, increasing cross border participation requires investor trust in cross border markets, which should be underpinned by having effective authorities supervising and enforcing investor protection in each member state. If so, more cross border participation could spark more competition in this market and lower costs and charges for retail investors.

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7 *"Towards an EU single market for personal pensions An EIOPA Preliminary Report to COM "*, Eiopa, 2013, p 81.

8 *"Pension Savings: the real return" ,Better Finance, 2013* http://www.betterfinance.eu/fileadmin/user_upload/documents/Research_Reports/en/Pensions_Report_2014_FINAL_-_EN_FOR_WEB.pdf

9 "*Better pensions*", Which?, 2015 http://www.staticwhich.co.uk/documents/pdf/better-pensions-report---march-2015-397468.pdf

Boosting retail participation in UCITS will also require the reduction of selling Alternative Investment Funds (AIFs), which have much lower investor protection standards, to retail investors. In many national markets, AIFs holdings are higher than UCITS.

Regarding cross-border access, the role of intermediaries is crucial, with many of them merely selling 'home-made' funds. In Belgium, there is even a legal barrier to promote UCITS from other member states if they are not on the list of the National Competent Authority. Some intermediaries with an execution only service even don't give access to those UCITS as long as they are not on that list.

Q18) How can ESAs further contribute to ensuring consumer and investor protection?

Since its creation, the track record of ESAs on contributing to consumer and investor protection is modest at best. The ineffective regulatory structure, the lack of resources to fulfil its mandate appropriately and unbalanced governance catering for industry needs are among the main impediments.

The problems with the ESAs governance are twofold: first of all, the Board of Supervisors of each ESA is composed of the member states national authorities, who often have a different structure regarding investor protection. Consequently, many national authorities in charge of consumer protection cannot participate in the voting on consumer protection issues, negatively affecting outcomes for consumers. Secondly, the ESAs stakeholder groups suffer from unbalanced representation of stakeholders. Consumer advocates are especially underrepresented and have limited access to the technical and research resources needed to participate fully in discussions and challenge industry views. To this end, it would make sense to pay reasonable expenses to stakeholder group members from consumer or academic organisations.

Regarding regulatory infrastructure, BEUC has always advocated that with the current set-up, where each European Supervisory Authority both handles prudential and conduct aspects, the former will always be at the centre of priorities. To this end we urge the Commission again[10] to consider a 'twin peak' model in the long run, with the creation of one single Financial Consumer Protection Authority, in charge of all conduct aspects of financial services legislation, regardless of who is the provider (banking services, insurance providers, pension or investments fund). In member states where this twin peak model has been established, consumer protection has been higher on the regulatory agenda (NL, UK, BE among others).

Lastly, we would like to point to the fact that the ESAs have not made the most of their current powers. They have never made use of their banning powers[11], nor have they adequately complied with their duty to analyse and report on e.g. long term and pension investor trends, including actual net performance. A lack of resources and associated human capital to work on consumer protection seems to be the root cause of this. This is particularly worrying as:

- The duties and mandates of the ESAs have been recently extended due to recently adopted legislation (e.g. more duties for ESMA under MiFID).

[10] *"Review of the European System of Supervision: BEUC response to the consultation of the European Commission",* BEUC, 2013 http://beuc.eu/publications/2013-00558-01-e.pdf

[11] ESAs and NCAs should e.g. ban toxic retail investment products such as "closet trackers", which are marketed as actively managed funds, but in practice copy an index. In those cases ETFs are much better value for retail investors as charges are here just a fraction of the closet tracker.

- This is not compensated with higher budgets; on the contrary the work of the ESAs is jeopardised by budget cuts in 2015. EIOPA has even admitted in a recent statement that consumer protection will be de-prioritised due to budget cuts12.

Overall it is apparent that the current ESA framework is not sufficient for ensuring investor protection. Therefore it is absolutely necessary that the ESAs are reinforced, especially since it is an explicit goal within the CMU to boost retail investment, which further strengthens the need for investor protection.

Next to these general remarks, we would like to point to the increasingly important role the ESAs play in adopting secondary legislation. Also at this stage, the ESAs have to show more resolve in ensuring investor protection. More specifically, we would like to point to the following two specific files, both very relevant in restoring investor trust, where the ESAs have an important role to play in to safeguard investor protection

- MiFID II: many important provisions regarding investor protection are currently under discussion on level 2. We regret ESMA watering down its technical advice concerning inter alia inducements13. It is crucial that the Commission takes a more balanced position in adopting the final delegated acts.
- KID: improving disclosure and shedding light on the complex investment products retail investors across Europe have to deal with is a key component of investor protection. The look and feel of the final Key Investor Document should sufficiently reflect the intentions of the legislators. To this end, we call on the ESAs to adopt measures that cater for: 1) full and upfront transparency on all costs, including implicit costs embedded in the product. The overall aim should be to give the retail investor an ex ante, full picture on how much he will have to pay for a certain product. 2) The summary risk indicator is a key component of the KID and should be designed in order to properly alert consumers to potential risks of the financial product. 3) A well-designed comprehension alert.

Q19) What policy measures could increase retail investment? What else could be done to empower and protect EU citizens accessing capital markets?

As laid out in our general remarks, any drive towards increasing retail investment should be based on improving investor protection and trust.

Therefore BEUC would like to stress that restoring investor trust depends – among other factors – on three core issues: having simple, transparent and comparable products to choose from, the provision of unbiased advice and being able to rely on strong supervisors who remove unsuitable products from the market. This could spark real competition, bring prices and charges down for individual investors and facilitate access to the best products and services.

[12] https://eiopa.europa.eu/Pages/News/EIOPA-explains-implications-of-its-budget-cuts-for-the-year-2015.aspx

[13] http://beuc.eu/publications/eu-regulator-waters-down-financial-markets-rules-after-industry-pressure/htm

However, market outcomes have been mixed in addressing the issues above. Competitive forces have not led to better services and prices for consumers, but more to an ever-increasing influx of often opaque, complex and highly-charged financial products, which are not always designed to cater for their financial needs.

In general, investor protection has been traditionally pursued by disclosure requirements, conduct-of-business rules and financial education. However, there is growing sense that a mere empowerment of consumers and detailed business rules "on the books" are not enough to prevent unsuitable or even toxic products being marketed and sold to retail investors.

Accordingly, fixing the retail investment market will require additional direct regulatory action, including opening the toolbox of product intervention. This includes banning powers for competent authorities to remove unsuitable products from the market, product governance and the development of more simple and transparent investment products (see question 20).

Product governance could be a (very careful) first step towards a more ex-ante approach in avoiding consumer detriment. Obliging firms to take into account the consumer interest at every stage of the product design process (by e.g. internal product approval processes, target group for each product to be assessed, appropriate charging structures, carrying out stress tests…) could give the necessary incentives to create product which truly addresses consumer needs. However we will have to evaluate whether this soft approach would effectively entail benefits for end-users. By all means we should prevent this from becoming a mere tick-box exercise for compliance officers. Enforcement by supervisors of these requirements will play a vital role here.

Additionally, the current disclosure practices are also not doing their job in giving retail investors the simple and reliable information they need to make informed decisions. While the recently adopted KID for PRIIPS legislation addresses this challenge, we would like to point out that:

- This will require appropriate measures in the level 2 implementing stage.
- UCITS are exempted from the KID until 2019 – this should not be exempted further.
- PPs and individual shares or bonds should have a KID or the summary prospectus should be aligned with the KID.

Finally, we would like once again to point to a fundamental flaw in financial markets today: the widespread use of commission and fees which conflicts with a need for neutral advice to consumers across Europe. Accordingly, we reinstate our demand for a ban on inducements in order to tackle the rampant conflicts of interest, which will erode investor trust only further in the future. First assessments in countries which have adopted such a ban (UK[14] and NL[15]) are providing evidence for its necessity.

[14] *"Post-implementation review of the Retail Distribution Review – Phase 1"*, Financial Conduct Authority, 2014 http://www.fca.org.uk/your-fca/documents/post-implementation-review-of-the-retail-distribution-review-phase-1

Q20) Are there national best practices in the development of simple and transparent investment products for consumers which can be shared?

As stated in our answer to Q 19, market outcomes are suboptimal in delivering good value retail investment products. There is no real single market bringing effective competition to the benefit of retail investors.

To this end, the toolbox of product intervention should be further opened. National practices which deserve further scrutiny include the "Simple Products Initiative"[16] in the UK, which could improve the access to basic good-value financial products for those consumers who do not manage to deal with the complexity of the market. While it is challenge to incentivize providers to accommodate this, the NEST investment proposition[17] is very good example of its potential benefits.

Also, Belgium's Financial Services and Market Authority (FSMA) voluntary moratorium on the distribution of complex products to retail investors[18] is an interesting case. However, such a voluntary approach should not discourage more direct intervention of regulators.

In general, product regulation is key for the development of simple, easily comparable and good value investment products.

Q24) In your view, are there areas where the single rulebook remains insufficiently developed?

In the struggle to avoid regulatory arbitrage we would like to stress the importance of having a proper alignment of the Review of the Insurance Mediation Directive and MiFIDII concerning investor protection.

[15] http://www.gfk.com/nl/news-and-events/press-room/press-releases/paginas/consument-bespaart-15-door-provisieverbod.aspx / http://www.afm.nl/nl-nl/professionals/nieuws/2014/nov/speech-tk-rovisieverbod

[16] https://www.gov.uk/government/news/simple-financial-products-a-step-closer

[17] https://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/Developing-and-delivering-NESTs-InvestmentApproach,PDF.pdf

[18] http://www.fsma.be/en/OtherNews/Article/nipic/nipic.aspx