A good investment

How the EU can better protect consumer finance

beuc

The European Consumers' Organisation

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Investments: not something for me?

Investing is not the exclusive preserve of society's most privileged members. Whether we see ourselves as investors or not, consumers are often exposed to financial risks:

- The ageing of the European population, combined with the financial situation of many Member States, makes it imperative – for those who can afford it – to supplement their legal pension with personal savings.
- In some countries, the supplementary pension is received at the end of a professional career in the form of capital. At that point, wise decisions need to be made so that this capital can cover the future needs of the pensioner.
- In some Member States, ensuring that children can do post-secondary studies presumes a significant financial participation, which in turn requires prior savings.
- Saving for the medium or long term means doing more than just making short-term bank deposits, where the interest often does not even keep up with the inflation rate.

Investing is a perfectly normal activity, and should not be equated with speculation or the reckless pursuit of financial gain.

Moreover, the financial crisis has shown us that many small savers had invested in financial instruments – often without realising it, and without anyone having clearly explained it to them like the structured products guaranteed by Lehman Brothers.

Putting the consumer in the centre

We request that the future regulation of financial products and their distribution be, wherever products intended for savers or retail investors are involved, elaborated on the basis of the needs and interests of consumers. This is not only the best way to protect their interests and to restore their confidence in the financial markets, but it is also an effective way to reduce the dissemination of ´toxic´ products and clean up the financial markets.

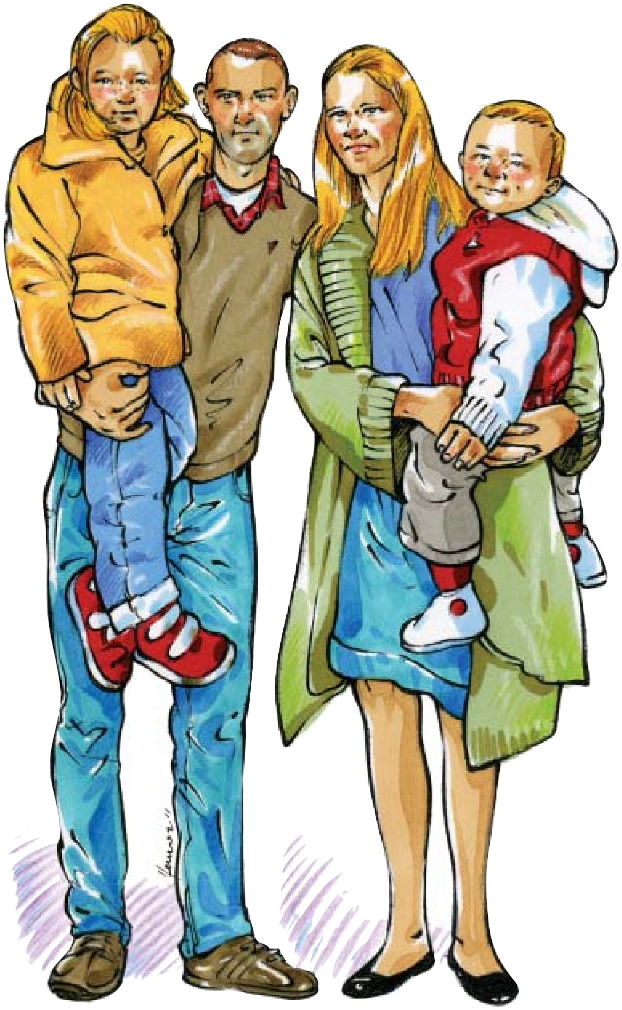
Anne is a 35 year-old Frenchwoman. She recently sold her small apartment near Lyon in which she lived with her daughter Sylvie.

Investment:
With the price of her apartment and her savings in the bank, she now disposes of a capital of €175,000, which she deposited in her bank to partially finance the purchase of a larger residence with her partner.

Loss suffered:
Her accounts were blocked from one day to the next because her bank ran into heavy difficulties. Stories in the press say that the bank's clients still have a slight chance of recovering their deposits in full. But if that shouldn't be the case, she will only be able to get back €100,000 under the current deposit guarantee system.

Why?
In many countries, the guarantee on deposits has a ceiling of €100,000, even if the amount over that is exceptional and only for a limited period. In the present case, Anne had just received the balance from the sale of her apartment and was preparing to use it again within a few weeks for the purchase of a new house. It would have been the same problem had the amount over €100,000 come from a large indemnity following a car accident, a severance payment, etc.

Matthew and Rachel are a young couple from Newcastle. Their two children, Mary and Steven, are still only in pre-school, but Matthew and Rachel have already decided to put some money aside for their children's studies. They also want to save up for their retirement.



Investment:
Matthew and Rachel put a large share of their savings in a "safe" investment issued by a reputable insurance company. On a scale of 0 to 6 (from least to most risky), their risk profile is considered to be level 1, meaning that Matthew and Rachel want to take only very modest risks for their investments. The advertising and all of the documents provided on this investment were extremely positive. The broker showed them that 5 similar investments that the company had launched up to then had all been highly profitable.

Loss suffered:
At the end of the 3-year investment, the "safe" investment had lost 55% of its value. In fact it was a structured product whose yield depended on the evolution of real-estate sector indices. When the real-estate bubble deflated, the value of the investment followed suit. The broker himself was not aware of the risks.

Why?
This situation could have been prevented if Matthew and Rachel had had access to objective and understandable information, if the intermediary who sold this investment product had truly understood the products he was selling and had been obliged to make a valid assessment of the needs of his clients, instead of pushing products for which he received a sales commission.

Simos and Ekatarina from Greece are 60 and 55 years old. They own a restaurant in the centre of Thessaloniki. They have three grown-up children who in the meantime have all moved out of their parents´ home.

Investment:
Their savings and investments are intended to constitute a large share of their pension and possibly to help their children. They do not wish to take the risk of losing a part of the savings they have accumulated up to now.

Simos and Ekatarina therefore subscribed to an investment called “Best Invest Plus 5x5”. They were certain to recover at least 100% of their capital after 5 years with, as they had understood it, a profit that could potentially amount to as much as 25% if certain shares selected for this investment evolved positively.

Loss suffered:
At the end of their investment, they did indeed recover 100% of their initial stake, but when one considers the rate of inflation over the entire investment period, the value of their capital in fact dropped by 10%. The conditions that had to be fulfilled in order to achieve a profit of 25% were particularly complex and the odds of actually doing so were low. On the other hand, the bank and the financial institution that had come up with this product and its grand-sounding name pocketed large commissions along the way.

Why?
This was a structured product, unnecessarily complex and incomprehensible for consumers. The costs on this type of investment, partially hidden, are very high. In addition, it is impossible to get a clear idea of the return that can be reasonably expected.

Olof is 68 years old. A retired tax accountant, he has been living in a small town near Stockholm for 3 years now.

Investment:
When he took his retirement, he received a supplementary pension capital. He wanted to convert this capital into a monthly annuity to supplement his pension. The bank proposed to him an investment that should enable him to receive an annuity of €750 per month.

Loss suffered:
The capital Olof received was placed in an investment fund that has suffered greatly from the stock market crisis. The initial capital melted away like snow in the sun. Olof no longer really has a choice: he must stop receiving the annuity and wait until the capital regains value. If he continues to make withdrawals while the capital is at its lowest point, everything will be consumed in a few years. Moreover, Olof has to preserve some financial resources in case he requires assistance or care later in life.

Why?
The type of investment proposed to Olof was not adapted to his needs and his financial situation. Although he absolutely needed this money, one recommended to him an investment that entailed substantial risks. The bank employee who recommended it did not do so in complete independence, because he had to meet sales targets that led him to take inadequate account of his client's needs.

Solutions for **better protection**

The deposit guarantee

The protection of bank deposits, i.e. liquid assets and savings in the form of deposits on current or savings accounts (see Anne's situation on page 2), is a fundamental protection. The modifications to existing legislation that are currently being discussed at European level might not make all of the improvements consumers are expecting. While the proposals for improvements which directly contribute to stabilising the banks form the object of broad consensus, this is not the case when it comes to giving "only" added protection to consumers. Protecting deposits that, due to some exceptional circumstance, temporarily exceed the ceiling of €100,000, would be a significant improvement for consumers, and one that would not entail high implementation costs.

Regulation of financial products

Financial products which are designed for retail investors, i.e. consumers and their families, should be marketed only after having been shown to be in compliance with the needs of the target public for whom they are intended. Unnecessarily complex products, or ones that afford no real added value for their target public, as in the case of Simos and Ekatarina, should be banned.

Certain national supervisory authorities have been moving in this direction. It is also a possibility raised by the European Commission, who are reviewing the Markets in Financial Instruments Directive (MiFID).

This approach is extremely interesting, because it would make it possible to clean up the market directly, to limit the risks of bad choices for consumers as well as the number of disputes in which consumers have great difficulty enforcing their rights. Furthermore, it could help the companies who issue or distribute such financial products to redeem their reputations.

Simplified information for every product

Every savings and investment product should be accompanied by a brief informational document, drafted in language that is readily understandable for consumers and presenting the essential characteristics of the product, including a synthetic risk indicator. This is something that Matthew and Rachel in particular did not have.

The key investor information document (KIID) that was designed for collective investment schemes (so-called UCITS) is a good example to follow. This concept should be extended to all savings and investment products that are offered to consumers, be it a bank deposit, a UCITS or an investment product in the form of life insurance, and whether the product possesses a European passport[1] or not. This is the direction that certain European initiatives, such as the future legislation on packaged retail investment products (PRIPs), need to go in.

Preventing conflicts of interest

It is essential that the products recommended to the saver-investor be in conformity with his needs and interests. As in the cases of Matthew, Rachel and Olof this is far from being the case at present. Conflicts of interest between the intermediary of financial products or advisor and the consumer are often the origin of bad decisions which prove very harmful for consumers. The commissions paid by the issuers of investment products to intermediaries, the targets assigned to agents and to bank employees as well as the way they are remunerated, can mean that all of these players are in the first place watching out for their own financial interest or their job security, to the detriment of the consumer's interests.

It is not enough that the intermediary or the bank employee be obliged to report the existence of conflicts of interest to the consumer for the latter to be capable of making a decision that is in conformity with his interests. Firstly it is necessary to reduce and eliminate the conflicts of interest themselves. An ´independent advisor´ should never be remunerated by an issuer of investment products and all those who are remunerated by an issuer should be regarded as simple sellers. An increasing number of Member States are moving in this direction and it is also an avenue proposed by the European Commission in its review process of the MiFID.

[1] The European passport permits investment service providers to furnish their services throughout the European territory, thus facilitating cross-border service provision

Summary of BEUC recommendations

Before making a decision, the consumer should have access to a **brief and understandable document** for every savings or investment product which describes the essential characteristics of the product - including the risk level and the costs - and which makes it possible to compare the product with the others on the market.

The **conformity of the products** with the characteristics of the target public and the latter's needs **must be verified** before they are marketed. A product that would be unsuitable for the intended public should not be distributed.

All financial intermediaries must be obliged to act honestly, fairly and professionally, in conformity with the interests of their clients. Special attention must be devoted to **preventing conflicts of interest**, such as compensation mechanisms or sales targets which encourage intermediaries to sell products which are inappropriate to the client.

Adopting high-quality legislation is one thing, guaranteeing that it is actually enforced is another. It is imperative that the **national and European supervisory authorities effectively monitor compliance with the rules**. Although this might already be the case in certain Member States, it definitely is not in the vast majority of them.

The liability regime of financial services providers should be improved. The burden of proof must be on the side of the firm. Genuinely independent Alternative Dispute Resolution **(ADR) procedures** should exist in each Member State and **collective judicial redress must be put in place**.

GLOSSARY

DGS: Deposit Guarantee Schemes protect money on people's current bank accounts, saving accounts, term deposits etc. EU protection per consumer and per bank has been increased from a minimum €20,000 before the recent financial crisis to the present level of €100,000.

MiFID: Markets in Financial Instruments Directive. One of the aims of this Directive (2004/39/EC) is to protect investors e.g. by obliging financial advice to be suited to the financial profile of the consumer.

UCITS: Undertakings for Collective Investment in Transferable Securities. These are regulated collective investment schemes in which many investors invest collectively and the assets of which are managed by a financial institution. Due to the European Passport of these products, they can be marketed all over the EU.

PRIPs: Packaged Retail Investment Products. With a lot of investment products, such as UCITS, you do not invest directly in a share or a bond, but in a project containing series of underlying bonds, shares and other assets – these are called packaged products. The PRIPs initiative aims to harmonise investor information and selling practices among different types of packaged products currently regulated in various ways.

KIID: The Key Investor Information Document (KIID) is a standardised document, normally no more than 2 pages in length, limited to the key information and drafted in plain language. The KIID aims to make the information readable for the investor and enable them to compare different investment products. Currently, at EU level this KIID is only applicable to UCITS.

Synthetic Risk Indicator: One of the most important elements of the KIID is a risk indicator combining most of the different risks associated with the investment product.

Structured products: These are complex investments made up of a portfolio containing derivatives and securities. Payoffs and components vary from product to product. Some structured products are "principal protected" which means the initial investment sum should be reimbursed at the end of the investment.

Intermediary: Investment products or insurances are sold through distributors. This can be a seller or agent employed by a bank or insurance undertaking. It can also be a self-employed intermediary who sells products from one or more financial institution and is paid by commission on products sold.

AT Verein für Konsumenteninformation - VKI
AT Arbeitskammer - AK
BE Test-Achats/Test-Aankoop
BG Bulgarian National Association Active Consumers - BNAAC
CH Fédération Romande des Consommateurs - FRC
CY Cyprus Consumers' Association
CZ TEST - Czech association of consumers
DE Verbraucherzentrale Bundesverband - vzbv
DE Stiftung Warentest
DK Forbrugerrådet - FR
EE ETL - Eesti Tarbijakaitse Liit
EL Association for the Quality of Life - E.K.PI.ZO
EL General Consumers' Federation of Greece - INKA
EL Consumers' Protection Center - KEPKA
ES Confederación de Consumidores y Usuarios - CECU
ES Organización de Consumidores y Usuarios - OCU
FI Kuluttajaliitto – Konsumentförbundet ry
FI Kuluttajavirasto
FR UFC - Que Choisir
FR Consommation, Logement et Cadre de Vie - CLCV
FR Organisation Générale des Consommateurs - OR.GE.CO
HR Croatian Union of the Consumer Protection Associations - Potrosac
HU National Association for Consumer Protection in Hungary - OFE
IE Consumers' Association of Ireland - CAI
IS Neytendasamtökin - NS
IT Altroconsumo
IT Consumatori Italiani per l'Europa - CIE
LU Union Luxembourgeoise des Consommateurs - ULC
LV Latvia Consumer Association - PIAA
MK Consumers' Organisation of Macedonia - OPM
MT Ghaqda tal-Konsumaturi - CA Malta
NL Consumentenbond - CB
NO Forbrukerrådet - FR
PL Polish Consumer Federation National Council - Federacja Konsumentów
PL Assocation of Polish Consumers - Stowarzyszenie Konsumentów Polskich
PT Associação Portuguesa para a Defesa do Consumidor - DECO
RO Association for Consumers' Protection - APC-Romania
SE The Swedish Consumers' Association - Sveriges Konsumenter
SI Zveza Potrošnikov Slovenije - ZPS
SK Association of Slovak Consumers - ZSS
UK Which?
UK Consumer Focus

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