



The Consumer Voice in Europe

**Proposals for**

**DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL  
on markets in financial instruments repealing Directive 2004/39/EC of  
the European Parliament and of the Council**

**&**

**REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL  
on markets in financial instruments and amending Regulation [MiFIR]  
on OTC derivatives, central counterparties and trade repositories**

**BEUC position**

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## Summary

BEUC welcomes the proposal of the European Commission of 20 October 2011 to change and improve existing rules (called Markets in Financial Instruments Directive – MiFID) to better protect consumers in the area of investment services. Several surveys of the Commission and consumer organisations have revealed that there were many shortcomings in this area.

The main improvements in comparison to the current MiFID legislation are the following:

- Structured deposits are included in the scope of the directive;
- Corporate governance is improved at the management level;
- New rules to avoid conflict of interest in the area of independent financial advice;
- Recording of orders collected by telephone is made compulsory;
- Complex UCITS are excluded from execution-only services;
- Reporting of investment advice is made compulsory;
- Better harmonisation of the sanction regime;
- Product intervention by competent authorities is made possible.

However some measures are missing. The main BEUC requests are the following:

- A more detailed directive to avoid poor implementing rules;
- Employers selling investment products to their employees should not remain out of the directive scope;
- Assessment of investment products before they are marketed to consumers should not only be mentioned in the recital but also covered by binding provisions;
- Avoidance of conflicts of interests in other services than truly independent advice should be better addressed;
- Telephone recording should be compulsory for all investment advice, not only for orders;
- Suitability and appropriateness test should be improved;
- Tying and bundling practices involving investment products should be banned;
- Additional complex UCITS should be excluded from execution-only investments, not only the structured ones;
- On-going supervision of conduct of business rules should take place in all Member States;
- Consumer organisations should be entitled to take action to ensure that MiFIR and national provisions of MiFID are applied.

## Introduction

### The importance of investment for consumers

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 state pension with personal savings.
- In some countries, the supplementary pension is received at the end of a working life 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.

### How do retail investors behave?

When designing legislation, legislators should take behavioral economics in account. People do not take decisions based only on rationality. A survey conducted by the European Commission in 2010 indicates that *"a growing body of evidence shows that the "standard" model of a rational self-interested economic agent does not adequately describe human decision-making<sup>1</sup>".*

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<sup>1</sup> «Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective - Final Report»; November 2010; See page 5.  
[http://ec.europa.eu/consumers/strategy/docs/final\\_report\\_en.pdf](http://ec.europa.eu/consumers/strategy/docs/final_report_en.pdf)

Other findings of this survey should be taken into account to help retail investors to make better investment decisions. One of the most important is the fact that consumers rely on financial advice<sup>2</sup>:

- *Consumers' reliance on advice makes issues of trust and persuasion of key importance in the retail investment market.*
- *Consumers are often confused about the true nature of their investment.*
- *Advice is ubiquitous in the retail investment market. Nearly 80% of investments are made in a face-to-face setting, usually with an employee of the investment provider or a professional advisor. 58% of investors say their final choice of product was influenced by an advisor, while the advisor initiated the purchase on a quarter of occasions.*
- *Trust in advisors is high, but consumers are often unaware of potential conflicts of interest.*
- *People struggle to make optimal investment choices, even in very simplified investment tasks.*
- *Investment decisions are prone to biases and framing effects.*
- *The impact of disclosing conflicts of interest is context-dependent.*

This is the reason why the authors of the EC survey have made the following recommendations<sup>3</sup>:

- *Do prioritize financial advice for policy: Financial advice is critical for RFS<sup>4</sup> markets, in particular for less "capable" consumers.*
- *Don't take for granted that consumers are sufficiently wary of potential conflicts of interest:*
  - *Both with respect to existence and size of individual commissions,*
  - *and with respect to the implication of "tied" sales.*

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<sup>2</sup> *Ibid.*, pp. 5 - 11

<sup>3</sup> *Consumer Decision-Making in Retail Investment Services - A Behavioural Economics Perspective*; Presentation made for the conference "Behavioural Economics, so what: Should Policy-Makers Care?" organized by the European Commission on 22 November 2010; see slide 34.  
[http://ec.europa.eu/consumers/conferences/behavioural\\_economics2/docs/decision\\_technology\\_22112\\_010\\_en.pdf](http://ec.europa.eu/consumers/conferences/behavioural_economics2/docs/decision_technology_22112_010_en.pdf)

<sup>4</sup> Note from BEUC: RFS means retail financial services

- *Don't count on the impact of unspecific disclosure of conflicts of interest:*
  - *Disclosure has to be specific and clearly visible;*
  - *Negative "knee-jerk" reactions seem less likely when there is communication.*
- *Don't trust solely in disclosing conflicts of interest: This may be insufficient, in particular when buried in "communication".*
- *Without changed incentives, don't count on advisors as a cure for customer misperceptions, errors, or potential "biases"*

### **The need for an improvement of the current legislation**

There is an abundance of evidence which shows the need to improve the MiFID directive and a better implementation of it, especially in the field of investment advice:

- In the last Consumer Market scoreboards<sup>5</sup> published by the European Commission, investments, pensions and securities are found towards the bottom of the rankings for several criteria like comparability, overall satisfaction and trust. They are ranked 26<sup>th</sup> out of 30 based on the Market Performance Indicator.
- A survey published in December 2011 by our UK member Which?<sup>6</sup> shows the poor quality of investment advice given by banks and building societies. Many advisers showed a poor understanding of the risks of investing, and were prone to making misleading statements about the features and costs of available products. Many failed to provide mystery shoppers with even basic information that they should have been told when getting financial advice. One of the biggest failings found during the investigation was the recommendation of products that far exceeded the risks the Which? researchers were willing to take. Complicated and high charging investment bonds were recommended by 17 of the advisers spoken to – more than three times the figures gathered in Which?'s last investigation two years ago.

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<sup>5</sup> Consumer Markets Scoreboards published by the European Commission, DB SANCO. [http://ec.europa.eu/consumers/consumer\\_research/editions/cms6\\_en.htm](http://ec.europa.eu/consumers/consumer_research/editions/cms6_en.htm)

The ranking of 51 different groups of products and services is based on a Market Performance indicator (MPI). MPI is a composite index based on the results of survey questions on four aspects of consumer experience: 1) the ease of comparing goods and services; 2) consumers' trust in suppliers to comply with consumer protection rules; 3) the experience of problems and the degree to which they have led to complaints; 4) consumer satisfaction

<sup>6</sup> See WHICH? article *Investment advice on the high street* in annex.

- A market survey conducted in 2011 (to be published) by our Norwegian member on sales of investment products shows that 32% of the tests fails to portray a correct picture of the consumers financial situation and that merely 39% of the tests evaluate consumers knowledge and experience satisfactorily. Only 47% of the consumers were satisfied with the way the seller of financial products conducted the tests<sup>7</sup>.

- A survey conducted in 2009 by the Norwegian Consumer Council revealed that: *"In more than half of their meetings with clients, financial advisors failed to comply satisfactorily with all their statutory obligations and the requirements for good consulting practice. Advisors repeatedly failed to highlight the total costs of an investment and written documentation presented during client meetings was frequently deficient. Information relating to risk was also often inadequate and customers were given little time to consider their options"*<sup>8</sup>. The Norwegian Consumer Council view is that: *"A number of financial institutions seem largely to want to sell a standard product rather than offer advice tailored to the customer's individual situation and requirements."*

- A survey<sup>9</sup> commissioned by the European Commission, DG SANCO, based on a mystery shopping exercise, has revealed that financial advice is too often of poor quality. The main findings are the following:

- *Advisors were often only able to gather basic information relating to the shoppers' profile. When it came to gathering more in-depth information about the shopper's profile, efforts appeared to be lacking.*
- *Although the shoppers' risk appetite appeared to have been profiled by most advisors, the recording of the profiling process seemed weak in a significant number of cases.*
- *There is a tendency for most advisors to overlook the shoppers' education level and profession.*
- *Advisors appeared to be more interested in the amount that the shopper is able to invest, rather than the shoppers' ability to finance such investments.*

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<sup>7</sup> Mystery shopping on sales of financial products, the Norwegian Consumer Council, (To be published in 2012).

<sup>8</sup> See in annex, The Norwegian Consumer Council's package of proposals for cleaning up the savings market - Survey of financial advisory services, 2009, page 18.

<sup>9</sup> *Consumer Market Study on Advice within the Area of Retail Investment Services – Final report*; Synovate Ltd.; 2011; [http://ec.europa.eu/consumers/rights/docs/investment\\_advice\\_study\\_en.pdf](http://ec.europa.eu/consumers/rights/docs/investment_advice_study_en.pdf)

- *Information provided on product investment risk was not comprehensive and may be misleading at times.*
- *Generally, advisors seemed fairly forthcoming about certain fees and charges related to making the investment. However, the limited instances of disclosure relating to remuneration fees may be indicative of only partial information transparency and it was not clear whether all investment costs (e.g. annual fund management charges) were being effectively communicated.*
- *Very few advisors mentioned conflicts of interest or inducements during the engagement.*
- *While advisors were not observed to be entirely comprehensive, they were generally perceived to be fairly proactive and unbiased in their information provision.*
- *About 43% of products can be deemed to be broadly „suitable under a relatively simple rubric (i.e. basically fulfills shoppers needs in terms of investment liquidity and risk level) – while the remaining 57% were assessed as broadly „unsuitable under a relatively simple rubric (i.e. did not fulfill shoppers needs in terms of investment liquidity and risk level).*



## ***Analysis of the proposed provisions***

### ***MiFID Article 1: Scope***

BEUC fully supports the inclusion of structured deposits in the MiFID scope (Art. 1.3).

Such deposits are complex investment products and are offered to consumers in several Member States. As they are not regulated at EU level as investment product, banks may advise or offer such structured products without carrying any suitability or appropriateness test. This regulatory loophole has to be addressed. It is important to consumers to have consistent regulations, tackling in a similar way products that present similar economic characteristics and answer to the same consumer needs.

### ***MiFID Article 2: Exemptions***

BEUC expresses its concerns about the exclusion of investments provided by the employers as foreseen by article 2.1, e) and f). There is no serious reason to exclude investment services provided by an employer to its employees. Consumers should not be less protected when their employer is involved than when investment advice is issued by an investment firm. During the recent financial crisis and the economic recession that has followed it, a lot of employees and their families have lost a lot of their savings due to the dramatic loss of value of their employer's shares. Concentrating investment risk and the risk to lose his salary on the same company are not reasonable, unless the employers' shares represent a small part of the employee savings and investments. Unfortunately, this is generally not the case. Employees do not necessarily have any knowledge and experience with investing in shares. When employers propose shares from the company or a parent company to their employees, the latter are not really free to buy them or not; there is some peer pressure: through buying their employers' shares, employees are expected to show that they believe in the future of their company. They are often proposed at a price lower than market, which constitutes a clear incentive to buy these shares. Unless the employer's shares are offered for free as a gift or a bonus on certain occasions, offering shares by the employer should be assimilated to an investment advice.

The exclusion foreseen by Article 2.1, e) should be abrogated and Article 2.1, f) should be amended.

### ***MiFID Article 9: Management body***

BEUC welcomes the improvement of corporate governance proposed in article 9, especially paragraph 6 (c) specifying that the management body shall *'define, approve and oversee a policy as to services, activities, products and operations offered or provided by the firm, in accordance with the risk tolerance of the firm and the characteristics and needs of the clients to whom*



*they will be offered or provided, including carrying out appropriate stress testing, where appropriate.* BEUC considers this measure as an adequate reaction to miss-selling practices as revealed by the financial crisis. It takes the problem at the source, avoiding that too complex or too risky products are offered to retail clients. It also contributes to restore consumer confidence in the financial sector.

A serious assessment of new products is not only necessary to protect consumers and to prevent excessive market risks linked to massive mis-selling practices. Several distributors of structured products issued by Lehman Brothers (LB) have had to guarantee their clients against the LB default. Such interventions have an important pro-cyclical effect. In Belgium, a bank that was already supported by public authorities, put recently 263 million euro aside to face the consequence of mis-selling 600 million euro of a 'first to default' structured product affected by the Greek sovereign debt crisis. By consequence, the financial stability will also benefit from such a provision.

## ***MiFID Article 16: Organisational requirements***

### **Article 16.3: Conflicts of interest**

Conflicts of interest between service providers and clients are a key issue in financial services in general and investment services in particular.

Avoiding conflict of interest should be a priority. Conflicts of interest are damaging to consumers because they do not receive the best advice they pay for (in general indirectly through the costs charged on their investment and passed on to the advisor). As they undermine consumer confidence in their intermediaries and increase the risk of large mis-selling practices, they are also damaging for investment firms and the financial stability. It is not surprising that the Member States like UK and the Netherlands<sup>10</sup> where important mis-selling of investment products occurred are those that are taking the best measures to avoid conflicts of interest. In the best interest of all parties, EU legislation should also learn lessons from those experiences. The wording of article 16.3: "*...with a view to taking all reasonable steps designed to prevent conflicts of interest...*" is too vague and weak to effectively prevent damaging conflict of interest and ensure consumer protection. As the current legislation did not succeed to avoid damaging conflict of interest, the Level 1 directive must give a stronger signal to ensure that implementing measures will be more efficient.

See further details about conflict of interest in the discussion of Articles 23 and 24.

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<sup>10</sup> The Dutch initiative is limited to the insurance products.

### **Article 16.7: Telephone recording**

Paragraph 7 of Article 16 of the Commission proposals demands telephone recording at least when services of reception or execution of orders on behalf of clients are provided.

The Commission proposal focuses on orders and on a short conservation period. This can be explained by the will to detect and prove market abuse practices, which is a good measure to improve market efficiency and consumer confidence in financial markets, but is not driven by consumer protection needs.

To better protect consumers, there is a need both to extend the obligation of recording communications and increase the shelf life of records. BEUC supports the harmonisation of telephone and electronic recording when the contact with the consumer leads or could lead to giving personal recommendations (financial advice) or collecting orders. Recording of face to face meetings where advice is given would also be of use to consumers and advisers in situations where a dispute arises. This is consistent with paragraph 6 of the same article: *"An investment firm shall arrange for records to be kept of all services and transactions..."*

This can be justified by the following reasons:

- Recording helps to prevent conflicts between retail clients and investment firms. When conflicts are not prevented, recording helps to solve them in the respect of the rights of all parties. It happens too often that consumers trapped in a conflict with a bank are unable to lift the burden of evidence about the information or the advice that was given before the investment decision. Nowadays, when conversations are recorded by a firm, records are only used by the firm if it is in its own interest.
- This is the only way to avoid abuses of financial advice given by telephone and followed by a recommendation to give the transaction order through the execution only platform of the firm.
- Recording is also a good means to detect insider trading when information is given by telephone without collecting the order at the same moment.

The conservation period should be equal to the investment period plus one year. The records and documents should be stored at least as long as the consumer cannot face the real consequences of the investment he has been advised on. A period of three years is definitely too short. Investments are generally made for a longer period than 3 years and the return of some products, like structured products, remains uncertain until the very end of the investment. In Denmark and Belgium, where BEUC members are represented in alternative dispute resolution bodies in charge of financial services, it has been observed that consumers who file a complaint about their litigious investments have generally been advised more than three years before realising that financial advice they received was wrong.

### ***MiFID Article 22: General obligation in respect of on-going supervision***

Article 22.1 of MiFID provides that the national competent authorities monitor the activities of investment firms so as to assess compliance with the operating conditions provided for in this directive (chapter II, from Art. 21 to Art. 35, including the provisions to ensure investor protection) without specifying what they should do to achieve this objective. The Commission proposal does not bring any changes to this paragraph.

As demonstrated by the findings of a BEUC study on *"Financial Supervision in the EU: a consumer perspective"*<sup>11</sup>, the current monitoring varies a lot from one member state to another leading to poor consumer protection in some countries. For example in Germany, there is no public body in charge of consumer protection in the financial services area; in many other member states consumer protection does not constitute a priority for the supervisory authorities. While the conduct of this aspect of financial supervision at national rather than EU level is well justified on the grounds of efficiency, ***the activity of national supervisors necessitates a certain minimum degree of harmonisation*** to ensure an effective high level of public enforcement for the benefit of all EU consumers.<sup>12</sup>

BEUC has recently adopted a position paper<sup>13</sup> calling EU policymakers to adopt the necessary measures to ensure that powerful and independent Financial Consumer Protection Authorities (FCPAs) exist in every Member State.

This is the reason why Article 22 should be completed in order to ensure effective supervision; a specific role should also be given to ESMA.

### ***MiFID Article 23: Conflicts of interest***

In most member states, access for consumers to truly independent and affordable advice is limited or nonexistent. Most of the advice is given by agents or sales employees who are remunerated or whose performance is measured in terms of target sales of investment products creating added value for the firm, often in conflict with the consumer's interest.

Article 23 (former Article 18) of the current directive has not been significantly modified by the Commission proposal. The way conflicts of interests are currently prevented or disclosed is not satisfactory. In general, existing disclosure takes the form of a discrete short ex-ante summary, and it is difficult to obtain more information even when asking for. Also evidence from the UK shows that merely disclosing inducements does not lead to the appropriate degree of consumer protection<sup>14</sup>. Bank employees are under pressure of sales targets and variable

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<sup>11</sup> See [www.beuc.eu](http://www.beuc.eu)

<sup>12</sup> EC consultation on *"Reinforcing sanctioning regimes in the financial services sector"*, December 2010: [http://ec.europa.eu/internal\\_market/consultations/2010/sanctions\\_en.htm](http://ec.europa.eu/internal_market/consultations/2010/sanctions_en.htm)

<sup>13</sup> For more details, see the BEUC position paper in annex

<sup>14</sup> [http://www.fsa.gov.uk/pubs/other/CRAreport\\_menu.pdf](http://www.fsa.gov.uk/pubs/other/CRAreport_menu.pdf)

remuneration (bonuses). They are complaining that they are no more in position to give advice in the best client's interest and that they have to sell products even if they are not the most suitable for the client.

As until now the implementation of current article 18 in Level 2 and Level 3 measures is not satisfactory, BEUC asks that the avoidance of conflicts of interest should be further detailed in the Level 1 directive.

Product providers should play no role in determining the remuneration of the investment adviser and should be prohibited from paying commission or providing any other type of service which might influence the advice provided by the intermediary. The remuneration scheme and sales objectives of salespeople in an investment firm or a bank should not be designed in such a way that salespeople are induced not to take the interest of their client as first guide for their recommendations. BEUC supports also a ban on inducements for all investment advice services, including those provided by independent advisers, portfolio management and all sorts of restricted advice (advice that is based on a less than independent analysis of the market for products and services).

### ***MiFID Article 24: General principles and information to clients***

#### **Article 24.3**

BEUC supports the new wording of art. 24, paragraph 3 as it avoids misunderstanding about the nature and the scope of the investment advice. But information specifying that advice is independent or not - whether it is based on a broad or on a more restricted analysis of the market and whether an on-going assessment of the suitability of the recommended financial instrument takes place or not - should not only be provided once, generally when the relationship is initiated, but also when advice is given at the same time the investment firm specifies how this advice meets the personal characteristics of the client (see new Article 25, paragraph 5).

#### **Article 24.5 and 24.6: Ban on commission**

As proposed in Art. 24, paragraph 5, BEUC fully supports that when investment advice is provided on an independent basis, advice must be based on a sufficiently large market analysis and the advisor should not receive any commission from a third party. However, the Commission proposal only prohibits independent advisor to receive *monetary* benefits. BEUC considers independent advisors should not receive any benefit from the provider, monetary or not. Secondly, he should not be authorized to run another business that would be commission based if it can create conflicts of interest.

BEUC also supports the ban on commissions for portfolio managers as proposed in paragraph 6. The consumer totally relies on the portfolio manager who chooses investment products without his control. This service is more than advice; it is a mandate and it is essential that the proxy exclusively serves the interests of the client who gives him the mandate.

However, if only those two types of services become commission free, conflicts of interest will continue to affect the majority of investment advice given to consumers, except in the few member states where independent financial advisors are largely available and in the member states where the commission ban is (or will become) broader than what is currently proposed by the European Commission. If the Commission proposal remains unchanged, financial advisors who currently call themselves *independent* would just have to change their “logo” to other attractive words like *professional* advisor. The consumer won’t be able to understand the difference unless really independent advisor business is well developed in his country.

BEUC supports a general ban on commissions and inducements for advisors and intermediaries who recommend financial instruments. After 4 years since the current MiFID has entered into force, we think that it is the best and most effective way to avoid conflict of interests and stimulate the sales of financial instruments serving the client’s benefit rather than benefit of the distributors or advisors. It is also the best way to stimulate the sales of investment products that are less commission charged than they currently are.

As an alternative, if financial instruments free of commissions and inducements are not available, all commissions and inducements should be passed on to the client. But even in this case, commissions or inducements linked to the volume of financial instruments distributed should be prohibited as they create high conflicts of interests between advisors and their clients.

Additionally, business models based on commissions, inducements or remuneration schemes designed in such a manner that they are detrimental to the quality of advice or recommendation given to the consumer are not compliant with Article 24.1<sup>15</sup>.

Finally, BEUC thinks that as long as commissions, inducements or remuneration schemes are designed in such a way that they can impact advice or recommendation given to the consumer, the investments’ intermediary should not be authorised to call himself ‘advisor’ as it is essential that an advisor must be in position to be trusted by the consumer. Biased advice is not advice; this is just a sale argument.

### **Article 24.7 Tying and bundling**

The new paragraph 7 addresses the cross-selling practices among investment services. BEUC supports the approach adopted by the Commission in its directive proposal.

Which?, our British member, reports that tying practices happen frequently on the British market. In particular high interest rates are given on deposits sometimes tied with complex products as structured products or structured deposits,

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<sup>15</sup> Article 24.1: *Member States shall require that, when providing investment services and/or, where appropriate, ancillary services to clients, an investment firm act honestly, fairly and professionally in accordance with the best interests of its clients and comply, in particular, with the principles set out in paragraphs 2 to 8 this Article and in Article 25.*

sometimes with high charged products<sup>16</sup>. Test-Achats, our Belgian member, reports a case where clients were teased with a very high interest rate on a short term deposit if they invested a same amount in a UCITS or a structured product; this is not acceptable because UCITS and structured products are from a completely different risk and complexity class than plain deposits. They do not respond to the same needs. In some Nordic countries, access to the best interest rate for a mortgage credit requires borrowers to invest in UCITS, shares or savings accounts. Such practices are detrimental for consumers as they are stimulated to borrow a higher amount to be able to invest! Due to the new CRD IV rules, banks may be tempted to offer better savings or loan rates to consumers investing in their capitals. In such cases, the decision to invest is influenced by the best rates' conditions and not by a proper assessment of the investment itself. Hundreds of thousands of Belgians, who as customers of cooperative banks (e.g. BACOB Bank), had to contribute to the capital of these banks. After these cooperatives banks were absorbed by other banks, the customers' investments lost most of their value due to the financial crisis and the subsequent loss of value of the new owners. They were not aware of the risks taken.

BEUC is particularly worried when an investment is bundled with another investment, a bank deposit or another financial service. Bundling increases the complexity of the package in comparison with the products analysed separately. Consumers seeking a good deal tend to focus on the product they want and may not understand or fully appreciate the risk of the attached investment product. The risk for biased and unsuitable consumer's decision therefore increases and should be carefully examined.

Such practices should be banned.

## ***MiFID Article 25: Assessment of suitability and appropriateness and reporting to clients***

### **Article 25.1 and 25.2: Suitability and Appropriateness test**

Surveys conducted by the European Commission and consumer organisations have revealed that investment advice is of crucial importance for the consumer<sup>17</sup> and the current implementation of MiFID is of poor quality<sup>18</sup>.

The quality of the suitability test (Article 25.1), including the questions asked to the clients, varies from one member state to another and from one bank to another. Some questions asked to clients are drafted in such manner that they

<sup>16</sup> See WHICH? Article "Tied up in knots" in annex.

<sup>17</sup> See *Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective - Final Report*, mentioned in our introduction, page 3 and footnote 1.

<sup>18</sup> See *Consumer Market Study on Advice within the Area of Retail Investment Services* mentioned in our introduction, page 5 and footnote 9; and the surveys conducted by the Norwegian Consumer Council and Which?, our UK member, mentioned in our introduction, page 5.



suggest answers to be given by clients. In some banks or investment firms, answers to the questionnaire are not drafted by the clients but by the bank's employees or investment firm's employees. The time allowed to the client interview can be really short and often not sufficient; the importance of the suitability test is not explained to the client and the interview is presented as a compulsory and annoying formality. This must be improved. As the implementation measures of the current directive did not succeed to create a generalised high quality of the suitability assessment, the MIFID (level 1 directive) should give an impulse in this direction adopting more detailed provisions. The European Securities and Markets Authority (ESMA) should be mandated to develop guidelines in this regard.

Additionally, as provided by Art. 22.1, national competent authorities in all member states should assess the compliance of service providers with this obligation.

Article 25, paragraph 2 provides that *'investment firms, when providing investment services other than those referred to in paragraph 1, ask the client or potential client to provide information regarding his knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the investment firm to assess whether the investment service or product envisaged is appropriate for the client.'*

When asking their clients to provide requested information, questionnaires from some service providers are reduced to a minimum, leading to poor appropriateness tests. If your bank sold you one or two structured products with principal protection (the initial invested amount is supposed to be reimbursed at the end of the investment), it does not mean you have the necessary knowledge and experience for all kinds of structured products or even derivatives. Furthermore, derivatives differ a lot from each other.

BEUC<sup>19</sup> asks for better appropriateness tests. ESMA should be mandated to develop guidelines in this regard. Additionally, as provided by Article 22.1, national competent authorities in all Member States should assess the compliance of service providers with this obligation.

### **Article 25.3: Execution-only service**

The Commission's directive proposal maintains the execution-only service for non-structured products (see Article 5.3, a) (iv)). Until now, all UCITS are considered by the MiFID as non-complex products, even if it does not match the reality: since the implementation of the UCITS III Directive, many complex UCITS have been offered to consumers.

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<sup>19</sup> OCU, the Spanish BEUC member would like to add an additional measure: a warning should always be given to the consumer; this warning should mention the most important risk (e.g. you could lose nn% of your investment), with a link to the KIID of the investment product; the consumer should indicate that he read the KIID before he would be allowed to validate his order.



BEUC<sup>20</sup> supports the Commission proposition to exclude structured UCITS from the non-complex products category.

However, the limitation to exclude only structured UCITS from the execution-only service<sup>21</sup> is too restrictive to encompass all complex UCITS. Limiting the scope of complex UCITS to those that provide investors *at certain predetermined dates* with *algorithm-based* payoffs is too restrictive. Many other UCITS present risks that are difficult for the client to understand. Those UCITS, which are also complex, should be also excluded from the execution-only service. There are a lot of examples of complex non-structured UCITS including synthetic exchange traded funds (ETFs), actively managed UCITS adopting constant proportion portfolio insurance (CPPI), variable proportion portfolio insurance (VPPI), etc. The MIFID (level 1 directive) should give a broader definition of complex UCITS and ESMA should be mandated to develop guidelines to identify them.

### **Article 25.5: Reporting to clients**

Paragraph 5 of Article 25 provides that *'when providing investment advice, the investment firm shall specify how the advice given meets the personal characteristics of the client.'*

BEUC fully supports that it must be explained to the client how the advice given meets his personal characteristics. In our view, this is elementary to put the consumer in a position to make an informed choice.

However, it is unclear if the report should be given in a written form or if verbal information is sufficient. A report in a durable medium is necessary; otherwise the client can neither prove whether he received advice nor, if applicable, that this advice was not suitable. The information should be written and guidelines should be drafted to ensure a minimum quality level of the report.

In Germany, where financial advisors are already obliged to do so, our German member, VZBV, is of the opinion that many reports are substandard; instead of giving clear explanations to the client, the report is full of liability disclaimers. To ensure that reports are drafted in a way that meets the objective of this provision, clear guidelines should be developed by ESMA.

### **MiFID Article 73 - 78: Administrative sanctions**

BEUC strongly supports the improvements of the sanction regime proposed by the Commission, in particular by:

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<sup>20</sup> With the exception of VZBV, German BEUC Member, who thinks that all orders should undergo an appropriateness which is lighter than the suitability test applying to investment advice. This increase consumer protection against the consequence of aggressive marketing and fraud practices consisting in verbal investment advice combined with the recommendation to transmit the order through an execution-only service.

<sup>21</sup> Article 36, paragraph 1 of Commission Regulation 583/2010 : *Structured UCITS shall be understood as UCITS which provide investors, at certain predetermined dates, with algorithm-based payoffs that are linked to the performance, or to the realisation of price changes or other conditions, of financial assets, indices or reference portfolios or UCITS with similar features.'*

- Imposing sanctions on both individuals and financial institutions responsible for a violation (Art. 73.2);
- Systematically publishing sanctions (Art.74). This should be done as early in the process as is feasible;
- Defining a sufficiently high level of administrative fines to allow national authorities to impose effective, proportionate, and dissuasive fines (Art. 75.2);
- Taking into account appropriate criteria, including aggravating and mitigating circumstances, when applying sanctions (Art.76).

BEUC supports the protection of whistleblowers and the obligation, for financial institutions, to have in place specific procedures for their employees to report breaches internally (Art. 77).

### ***MiFID Article 79: Right of appeal***

Article 79 paragraph 2 provides that one or more of the following bodies: public bodies, consumer organisations and professional organisations, may be entitled to take action before the courts or administrative bodies to ensure that national provisions for the implementation of MiFID are applied. Generally, the national provisions entitle only the supervisory bodies to act in this regard. Experience demonstrates that consumer organisations are very active in bringing injunctions at national level; so in order for consumers to maximally benefit from the provisions on injunctions, consumer organisations should be designated as qualified entities both for national and cross-border cases.

It has to be taken into account that, in some countries like in Germany, there is traditionally mainly private enforcement undertaken for example by consumer organisations like VZBV and not much public enforcement of consumer protection. This concretely means that it would not be possible to rely on public enforcement to help consumers obtain redress.

Even where they would have adequate powers, public authorities often have limited resources or do not necessarily see it as their priority to engage into ordering compensation for individual consumers.

Therefore, BEUC strongly supports that consumer organisations should be entitled to take action to ensure that national provisions for the implementation of the MiFID are applied, notwithstanding whether public authorities are also entitled to act so or not.

### ***MiFID Article 80: Extra-judicial mechanism for investors' complaints***

BEUC fully supports the obligation for Member States to be required to set up efficient and effective alternative dispute resolution bodies and the obligation for the investment firms to adhere to one or more ADR bodies.

As more and more online brokers operate at cross border level, BEUC fully supports the compulsory cooperation between the ADR bodies to solve cross-border disputes.

Investment services are long-term services. This is the reason why BEUC would oppose any blanket restriction to consumer access to ADR schemes based only on a time limit in function of when the original advice was given rather than when the consumer first became aware of their grounds for complaint.

### **Burden of proof and collective redress**

It is particularly difficult for clients to be compensated when they suffer damages due to negligence or fault from their investment firm. The distribution of financial instruments guaranteed by Lehman Brothers is a good illustration of such problem: infringements are difficult to be proven by consumers which makes any individual action almost impossible. For example, in Belgium only wide inquiries carried out by the 'inspection des services économiques' made possible to prove malpractices and aggressive sales of those structured products.

BEUC considers also that if there were an increased possibility for retail investors to get compensation when justified, it would be an important incentive for the industry to improve the quality of its financial services.

Therefore, BEUC strongly supports that, beyond the compulsory adhesion of investment firms to independent ADR bodies,

- the burden of proof must be on the side of the investment firm. This can be more efficient than other detailed provisions;
- collective redress must be put in place in each Member State to enable European consumers to collectively bring a case before the court to obtain compensation for loss or damage caused by the same financial service provider or intermediary.

### ***MiFIR Articles 32 - 33: Product intervention by competent authorities***

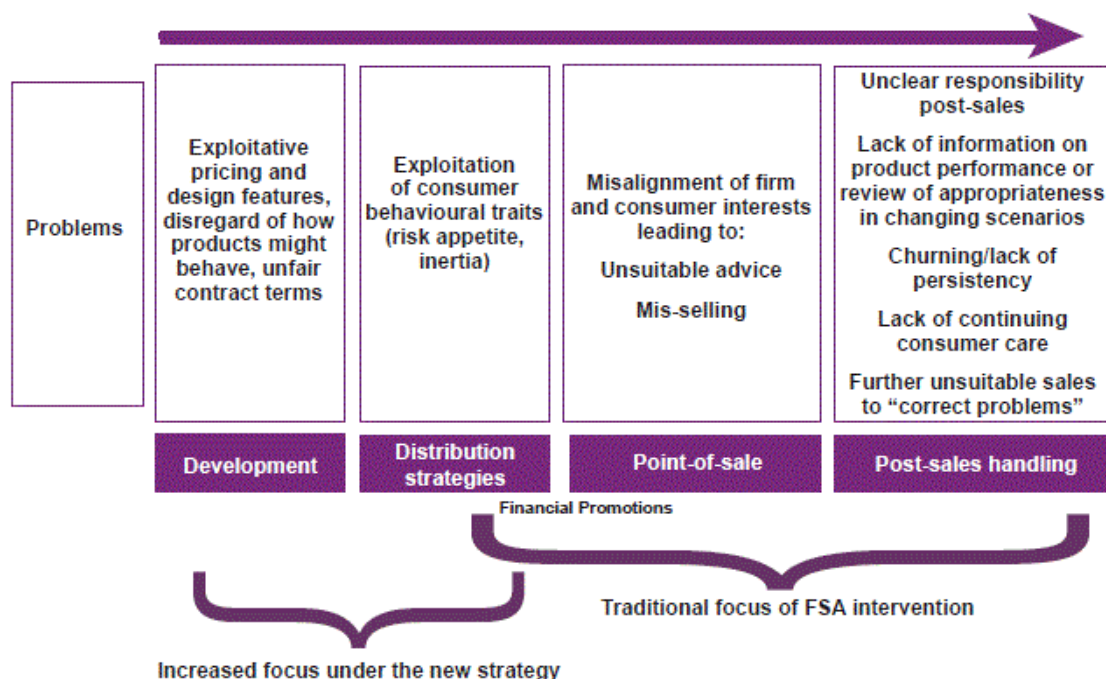
BEUC strongly supports the empowerment of competent authorities to prohibit or to restrict (a) the marketing, distribution or sale of certain financial instruments or financial instruments with certain features; or (b) a type of financial activity or practice when it raises significant investor protection concerns.

As described by the UK Financial Services Authority (FSA)<sup>22</sup>, the origin of detriment for the client can be found at different levels in the product life: at the development level when designing distribution strategies, at the point of sales and at the post-sales handling.

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<sup>22</sup> See: FSA, Discussion Paper DP11/1, Product Intervention, p.19 - [http://www.fsa.gov.uk/pubs/discussion/dp11\\_01.pdf](http://www.fsa.gov.uk/pubs/discussion/dp11_01.pdf)

**Figure 2: Where problems can occur in the product life cycle**



Improving the suitability of consumers' investments with their needs, avoiding large scale mis-selling which is detrimental both for consumers and industry, can be done by regulating at the different stages of the product life. Product information, suitability of investment advice, avoiding conflict of interest in the distribution, etc. are traditionally addressed by existing EU legislation. As proposed by Articles 32 and 33 of the MiFID and suggested by the FSA, more attention should be given at an earlier stage of the life cycle. The different available techniques are complementary and no one should be put aside. Intervening at an earlier stage is one of the best means to avoid dissemination of too complex or too risky products for the targeted public. Better product design and better client segmentation are key elements in that way. The experience has shown that this does not happen naturally.

For instance, Article 32 allows competent authority to prohibit investment products that are indubitably unsuitable for the targeted consumers, and to allow their distribution only to more sophisticated or professional investors who are really able to understand those products and the risks they involve. Preventing the dissemination of such products is a powerful tool to avoid mis-selling and consumer detriment. It contributes to make the retail financial market cleaner for consumers and improves their confidence in the market. The UCITS regulation, before the UCITS III directive, is a good example of what can be achieved in retail investment product regulation. Direct market intervention on specific products is already known in EU. Banning practices and products is not new in the EU. Ban on un-supported (naked) short-sales has been used in several states during the

2008 financial crises. Both Lithuania (2011) and Norway (2008) has banned sales of structural products (including structural deposits) to the consumer sector after gross mis-selling practises.

However, some of the restrictions foreseen to prevent excessive use of this power may paralyse it when urgent measures are required. Competent authorities should be authorised to take action immediately, on a temporary basis, when they can proof that any delay could cause irreversible damage to consumers. In that case, the competent authority should inform competent authorities of other member states which may be significantly affected by the action, in place of consulting them as provided by article 32.2, d). The one month 'freezing delay' after having informed ESMA and other competent authorities foreseen by article 32.3 should never apply in this case.

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