

## **ESAs CONSUMER PROTECTION DAY**

Prague, 23 June 2017

### **Speech:**

### **Consumers and consumer detriment – a perspective from Central and Eastern Europe**

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*Note: Monique Goyens delivered a shorter version of this speech at the ESAs Consumer Protection Day.*

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I am glad to take part in the Consumer Protection Day organised this year in Prague. First of all, I would like to thank the three supervisory authorities EBA, ESMA and EIOPA for accepting BEUC's proposal to organise this event in this part of Europe and to focus more on consumer problems in financial services in Central and Eastern Member States.

In this speech I will give you an overview of the consumer experience in financial services in Central and Eastern European countries, the quality of public and private enforcement, and the supervisors' engagement with consumer representatives in those countries. Then, I will put forward our views on the functioning of EBA, ESMA and EIOPA, their role in consumer protection, and what reforms need to be carried out at EU level to improve the consumer experience across all EU countries.

### **What is the consumer experience in Central and Eastern European countries?**

We surveyed BEUC members to identify the main problems experienced by consumers in retail finance and the types of issues that are most widespread. Their feedback shows that consumers across Europe experience similar issues, while in Central and Eastern Europe those problems are probably more acute. I will explain the reasons later below.

Problems exist in all areas (retail banking, payments, consumer credit, mortgage credit, life insurance, non-life insurance, investments) and are related to misleading advertising, unclear pre-contractual information, complex and low value products, aggressive marketing, irresponsible lending, high fees and penalties, misleading advice. Here are some examples from the region:

#### **Slovenia:**

- **Credit:** Banks have a discretionary right to change the fixed interest rate of the mortgage credit in case of a change of general economic circumstances. There are variable rate credit contracts with an interest floor to protect the bank, but without a ceiling i.e. the consumer is fully exposed to the upward variation of interest rate. Loans in Swiss franc have been a huge problem in the past years.

- Investment: There has been mass mis-selling of unit-linked life insurances. There were sales of a bank's own shares and subordinated bonds to consumers which were later bailed-in, with a total loss for retail investors. Cheaper index funds and Exchange Traded Funds are being blocked out of the market so that expensive actively-managed funds can be sold. There are excessive fees to be paid by small investors - 150 euros for transferring securities to another provider (this blocks competition).

### Lithuania:

- Insurance: Up to 50% of life insurance premiums may go as a bonus to the salesman.
- Credit: Interest rates are high despite the low cost of financial resources on the market – there are many examples of consumer credit with 35-45% annual percentage rate, and mortgage credit with 6-7% annual percentage rate. There is misleading advertising like “we offer you consumer credit at 8%” (while the effective rate (annual percentage rate) is 36% - this leads to over-indebtedness).
- Investment: DNB bank sold synthetic debt paper to many consumers in 2007-2008. This product was sold as risk-free, while in fact it was as risky as options gambling. More than 600 families lost a total of 35 million euros. Some retail investors lost the collateral – family house, flat, or land.

### Slovakia

- Credit: Irresponsible lending is a huge problem. Many banks and non-banking lenders grant loans to consumers without a creditworthiness check. Credit cards (revolving credit) come with very high interest rates, plus credit is rolled over repeatedly with high interests and penalties charged on the consumer. Peer-to-peer lending platforms are not regulated in Slovakia. Several Czech platforms provide loans to Slovak consumers without a creditworthiness check. As a result of irresponsible lending, a lot of consumers are over-indebted.
- Life insurance: There is a big ongoing case - an insurance company experiences financial difficulties and risks not meeting its commitments. Thousands of consumers have running contracts with that company. As the company started selling its assets, the Central Bank put it under forced administration to make sure consumer contracts will be honoured.

### Poland

- Credit: There is a big problem with loans in Swiss Francs. There are issues where consumer credit has been advertised as 0% interest, while the cost of credit insurance is added later on.
- Investment: Mis-selling and high cancellation fees related to unit-linked insurance products in recent years. Many consumers have complained that those policies were sold as a risk-free substitute to bank term deposits, while risks and cancellations costs were not properly shown.

### Romania

- Credit: Loans in Swiss franc were sold to consumers in a misleading way – promoted as the most stable currency in the world. This was the most significant trap in which consumers were attracted, with dramatic consequences for tens of thousand of families. There were

very expensive loans (before the crisis – up to 11% + EURIBOR in case of mortgages in euro; 9% + LIBOR in case of mortgages in Swiss franc). The interest rates are still high in Romania, regardless of the current low interest rate environment.

- Excessive fees: For example, a €50 fee for a credit transfer of €79 from a euro account in Romania to a euro account in the Netherlands in 2015.
- Unfair/abusive clauses: Thousands of decisions in Romanian courts (in individual or collective cases against banks) in favour of consumers.

## Cyprus

- Investment: In the past years, convertible bonds (CoCos) were heavily promoted to ordinary depositors who happened to have considerable deposits e.g. people who received their pension bonuses or people who decided to settle back in Cyprus and transferred their savings from abroad. These consumers were attracted by a relatively high interest rate and persuaded to buy those bonds. In the meantime banks suffered huge losses and the bonds lost their value resulting in massive losses for consumers, who are still struggling for redress.

## Macedonia

- Credit: Banks don't communicate clearly on eligibility criteria for loans, while charging administrative fees to consumers where it's clear the applicants are ineligible;
- Excessive bank fees: banks charge high fees for processing a complaint, for putting a stamp on a bank statement, for blocking and unblocking bank accounts in enforced payment procedures.

## Quality of public enforcement

BEUC members assess the quality of financial supervisory authorities as follows:

- In most countries, there is no specific supervisory authority in charge of financial consumer protection;
- Supervisors don't have a clear and strong mandate for consumer protection;
- Supervisors don't have sufficient resources and qualifications to fulfil their tasks;
- Supervisors don't have product intervention power, e.g. to ban complex or toxic financial products;
- In most countries penalties imposed on firms for misbehaviour are not dissuasive and are not disclosed on a regular basis.

Examples:

- **Cyprus:** The supervisory authority is the Central Bank of Cyprus, with no mandate for consumer protection. The competent authority for consumer protection is the Consumers Protection Service of the Ministry of Commerce, Industry, Energy and Tourism. Their mandate in financial affairs is limited to specific provisions of national laws.
- **Slovenia:** Only the general inspectorate that supervises non-bank loans has a mandate to protect consumers. Other sectoral supervisors have a mandate for prudential issues, while being in theory also responsible for consumer protection.

- **Lithuania:** The Bank of Lithuania deals with both banking sector oversight and consumer protection. The supervisor is more inclined to care about commercial banks' balance sheets first and only then about consumers. There is a clear conflict between prudential and consumer protection objectives.
- **Slovakia:** The Central Bank of Slovakia is in charge of both prudential supervision and consumer protection. Consumer protection is not high on their agenda. They have a legal power to ban and sanction in case of misbehaviour, but in practice they do not act.

It is important to keep in mind that supervision-related problems are not specific only to Central and Eastern European countries, but exist also in several other Member States. For example, the German consumer organisation vzbv considers that supervisory fragmentation works to the detriment of consumers. The German supervisor BaFin has been equipped with a mandate for 'collective' consumer protection in 2015. This means that BaFin is not responsible for protecting individual consumers but has to focus its work on structural problems. BaFin has to deal with both, prudential supervision and consumer protection. Unfortunately, there are further actors that have some minor but important responsibilities in supervising the financial sector and that don't have a consumer protection mandate. For instance, supervision of insurance brokers is carried out by trade offices (which means there is no supervision) that don't have a consumer protection mandate. There are huge differences in the effectiveness of supervision between BaFin and the rest.

### Quality of private enforcement

- Out-of-court redress bodies in most countries are not fully independent;
- ADR decisions are not binding, so firms may ignore them if the decisions are not in their favour;
- Consumer awareness about the ADR bodies is low; they are mostly unknown to consumers.

While consumers' financial difficulties in CESEE countries can partly be explained by the lack of a regulatory framework in certain areas (such as sales commissions that cause mis-selling and unsuitable products sold to consumers), to a big extent the poor consumer experience can be explained by lack of efficiency of supervisory and redress bodies.

### Cooperation between supervisors and consumer organisations

Cooperation between supervisory authorities and consumer organisations is unsatisfactory. Consumer representatives are not being consulted in the context of the supervisors' work:

- Some BEUC members reported that in their country there is no formal cooperation framework with the supervisory authority, such as a stakeholder platform providing opinions on relevant financial topics;
- Stakeholder consultative platforms seem to exist in the area of payments;
- In other areas, consumer representatives have only occasional meetings with supervisors;
- The existing platforms are not enough to influence the decision making of the supervisors. Often, the objective of the meetings is informative, plus to have a formal evidence that civil society has been engaged.

## Are CESEE consumers subject to double standards?

CESEE countries are mostly dominated by Western and Northern financial institutions. For example, in Lithuania more than 90% of banking assets are controlled by foreign lenders.<sup>1</sup>

There are indicators of double standards applied by pan-European financial institutions in those countries, to the detriment of consumers. In their home countries those institutions are unlikely to behave the same way, as they would be stopped and fined by the supervisory authority, and would likely reimburse consumers for any damage suffered. Again, this fragmentation of the Single Market results from diverging efficiency of supervision and redress across EU countries. Consumers affected by similar problems are being treated differently across Europe.

Example of loans in Swiss Francs: During the 2000s, millions of consumers in Central and Eastern Europe (Hungary, Romania, Bulgaria, Croatia, Latvia, Serbia) took out personal loans and home loans denominated in Swiss Francs. In most cases, banks would push consumers to take those loans and mislead consumers regarding the risks, advertising these loans as a safe option. An example of advertising by a bank in Lithuania: *“The Swiss currency is traditionally considered one of the best choices for consumers”*. When the Swiss franc rose sharply against other currencies, consumers’ monthly repayments soared leaving many of them owing more than their houses were worth. But a different treatment was reserved to consumers depending on the country. While some member states took early action to help consumers (laws in Hungary, Croatia allowing consumers to convert their loans into local currency at a favourable exchange rate), several other countries did not intervene leaving consumers to negotiate individually with their banks. A good example is France: 4,600 people took out loans in Swiss francs from BNP Paribas in 2008 and 2009 and the case is being taken very seriously by French institutions. The prosecutor has recently decided to sue BNP in a criminal court for unfair commercial practices. French consumer associations UFC-Que Choisir and CLCV have launched several actions, including a group action, to help victims get compensated. One of the BNP managers told the investigating judge that her warnings regarding the unsuitable nature of FX loans for consumers were ignored by the hierarchy.

## Lack of coherence between the EU approach to regulation and supervision

Most retail finance laws originate at EU level: the Payment Accounts Directive, the Insurance Distribution Directive, the Payment Services Directive, the Markets in Financial Instruments Directive, the Regulation on Packaged Retail and Insurance-Based Investment Products, the Mortgage Credit Directive, the Consumer Credit Directive, or the Deposit Guarantee Schemes Directive to name just a few.

By contrast, Member States have full discretion about how to enforce them at national level. Sectoral EU regulations and directives merely ask that Member States designate a competent authority responsible for implementation and oversight, and for it to apply dissuasive sanctions in case of law infringement.

This approach lacks coherence and is against the EU plans to create a Single Market in financial services and a capital markets union. You cannot have a single market without guaranteeing all consumers a high level of protection irrespective of their country of residence within the EU. Likewise, you cannot convince consumers to invest more directly in stocks and bonds (the idea behind the Capital Markets) without ensuring their fair treatment everywhere within the EU.

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<sup>1</sup> <https://www.ft.com/content/33aa7868-595f-11e6-9f70-badea1b336d4>

## Prudential supervision versus conduct of business supervision

There are many definitions of conduct of business risk:

- European Banking Authority: Conduct risk means the current or prospective risk of losses to an institution arising from inappropriate supply of financial services including cases of lawful or negligent misconduct.
- EIOPA: Conduct of business risk refers to the set of risks you face when insurance companies or intermediaries conduct their business in a way that has the potential to cause you harm.
- UK's Financial Conduct Authority: Consumer detriment arising from the wrong products ending up in the wrong hands, and the detriment to society of people not being able to get access to the right products.

While these definitions slightly differ, it is clear that consumer protection is at the heart of the conduct of business supervision. Also, it is obvious that macro and micro-prudential supervision pursue a different objective from conduct of business supervision, although they are closely interlinked. Thus, a clear separation between these objectives is required in order to avoid conflicting objectives. This is called the twin-peaks supervisory model.

Such a reform has already been implemented in some Member States, where the dedicated authorities have a clear mandate and toolkits to defend the interests of financial consumers. For example, AFM in the Netherlands, FSMA in Belgium, and FCA in the UK. According to BEUC members, those reforms greatly contributed to raising the profile of consumer protection and putting consumer interests at the centre of the supervisors' work.

## We urgently need EU level convergence with regard to conduct of business supervision

BEUC believes that in order to achieve EU level convergence on conduct of business supervision, in all EU countries there should be financial supervisors with strong consumer protection mandates, sufficient resources, and the power to fulfil their mandates.

An important task for the three ESAs is to work towards supervisory convergence. BEUC values the work being carried out by the three ESAs in the area of consumer protection. We actively contribute to the ESAs' Stakeholder Groups, respond to relevant public consultations run by the ESAs, contribute to the consumer trends reports, as well as engage in bilateral meetings with them.

That being said, one fact seems to be undisputed: the ESAs' current consumer protection mandate is limited. The ESAs' representatives have on various occasions stressed their willingness to work more on consumer protection issues, and they welcomed their ongoing review as an opportunity to further progress towards supervisory convergence and to enhance consumer protection. Furthermore, the ESAs deal with both prudential and conduct of business supervision, where the main priority and resources are allocated to the prudential oversight. Consumer protection comes last in the lists of the ESAs' objectives.<sup>2</sup>

But even with the existing tools the ESAs could do more for consumers, e.g. they could ban toxic products or activities. Yet, this power has not been used so far. In this context, we look forward to see how ESMA will use its specific product intervention powers granted by the MiFID Directive (those powers will be effective from 2018 onwards).

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<sup>2</sup> Article 1 of the Regulations establishing the ESAs

The existing tools available to the ESAs for improving the supervisory and enforcement practice on the national level, such as recommendations, guidelines and peer reviews are insufficient and have in fact no effective binding power.

We also note serious problems related to the ESAs' governance structure:

- The Management Boards as well as the Boards of Supervisors are composed of the Member States authorities, which may, in many cases, limit the efficiency and independence of the ESAs and prevent them from taking decisive actions in the interest of the whole EU and all European consumers.
- Not all national authorities that are in charge of consumer protection in financial services are represented on the Boards of Supervisors. This makes it difficult for consumer protection issues to get as much attention as other issues that directly come under the responsibility of all members of the Boards of Supervisors.

BEUC considers that the ongoing review of the ESAs carried out by the European Commission is an excellent opportunity to implement an in-depth reform and harmonise the quality of supervision and enforcement everywhere in the EU to better protect the users of financial services. BEUC calls on the EU policy-makers to:

- Set up a separate EU supervisor that would focus on defending consumer interests in financial services.
- Provide a mandate to the EU consumer protection supervisor to achieve supervisory convergence, i.e. ensure the development, implementation and monitoring of minimum standards of conduct-of-business supervision at Member State level.
- Grant the EU consumer protection supervisor direct supervisory and effective product intervention powers with regard to cross-border issues, as well as EU-wide negative trends.
- Reform the ESAs' governance (Management Board and Board of Supervisors) aimed at improving their operational efficiency and ensuring supranational orientation of their work.
- Provide the ESAs with sufficient resources to adequately fulfil their tasks.

In this context, we are strongly concerned by the worrying developments on the other side of the Atlantic: the attempt to roll back the financial reform implemented following the financial crisis (the Dodd-Frank Act) and to weaken the powers of the Financial Consumer Protection Bureau. Now is not the time to weaken consumer protection in financial services. The exact opposite is required in order not to repeat the mistakes that led to the huge financial crisis and massive consumer detriment.

To conclude, let me insist on the following point. In a single market consumers should have the same rights, the same experience, irrespective of where they live within the EU. The ESAs have a great role to play in this harmonisation.