



Financial Services User Group's (FSUG)

response

**on the OECD draft
high-level principles
on financial
consumer protection**



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Introduction

The Financial Services User Group (hereafter: FSUG) was established by the European Commission to advise the European Commission and identify key issues that affect the interest of financial service users in the EU policymaking process¹.

FSUG members welcome the opportunity to contribute to the public consultation on the *OECD Draft High-level Principles on Financial Consumer Protection* (hereafter: OECD draft principles) and submit the following comments and suggestions developed jointly by the group members.

Summary response and general comments on the draft framework

The current crisis in the financial system has triggered unprecedented interventions by policymakers and regulators at global, EU levels and beyond. However, the long-term costs to the ultimate victims of financial institutions' and markets' behaviour (ordinary consumers, investors, taxpayers, the real economy and wider society) still have to be fully realised².

While they very much welcome the OECD set of principles, FSUG members would like to stress, that regulators should take care to identify the real sources of consumer detriment. Consumer protection regulators have tended to focus on detriment and behaviours at the point of sale in retail markets – for example, focusing on the relationship between sales people and consumers or on promotion and marketing. However, the real sources of detriment may occur further up the 'supply chain' due to the behaviours of institutional market actors or even in wholesale markets which is then transmitted down the chain to ordinary financial users.

In addition, regulators should abandon classical economic theoretical approaches to market regulation. The classical approach assumes that the role of the regulator is to create the 'conditions' for markets to work – e.g. by addressing information asymmetries. This approach has clearly failed in complex markets such as global financial services. Regulators need to adopt a more interventionist style of regulation with a clear aim to 'make markets work' in the interests of society. This requires a clearly defined set of consumer protection objectives and outcomes.

Consumers' problems arising from the financial crisis are diverse, yet some of them could be measured by their effects, namely: financial effects, such as, loosing deposits or savings (e.i. securities of Lehman Brothers), loss of houses (e.i. rising foreclosures), loss of investments (shrinking value, sales during the crisis), loss of capital due to low interest rates and rising inflation (e.i. access to credit). Moreover, effects on income, such as unemployment and cuts in social benefits (old age pensions, etc.), and finally

¹ For full terms of reference and more detail of FSUG, see http://ec.europa.eu/internal_market/finservices-retail/fsug/fsug_en.htm.

² However, FIN-USE (FSUG predecessor) has identified the major risks facing ordinary citizens, the wider economy and society. For more detail see *FIN-USE summary report on Reforming EU financial markets: Putting financial users at the heart of financial market reform*, June 2010, http://ec.europa.eu/internal_market/fin-use_forum/documents/index_en.htm.

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public effects, such as rising public debts and risk of rising inflation and taxes³. Against this background, FSUG strongly support that any attempt to draft principles for financial services consumer protection need to be translated into an effective regulatory model covering – but not limited to – the following core values: consumer detriment analysis, prioritised targets, transparency and accountability of the rule-making processes⁴, identifying effective interventions and benchmarks, and qualitative and quantitative impact assessments of performance.

We congratulate the OECD for facilitating and providing a preliminary draft of the principles. Notwithstanding, this version is still work in progress, FSUG looks forward to the final outcome and welcomes the initiative to promote by public consultation all stakeholders⁵ participation in the development of international financial services policy and rule making.

Nevertheless, concerns have been expressed among FSUG members due to the nature of the proposed principles, which are formally non-binding and complement and do not substitute any existing international principles and/or guidelines⁶. This voluntary approach makes it ineffective and problematic, carrying no value for lack of compliance but providing justification in the opposite case. Moreover, in case of conflict with other principles or guidelines it remains very unclear where it stands. In our view, a legally binding set of principles would appear to be better suited for sensitive areas such as financial consumer protection where level playing field considerations are particularly relevant.

Further, despite the significance of enhancing consumer confidence and trust in order to promote financial stability, growth, efficiency and innovation, the FSUG would like to highlight the critical importance of respecting the dignity and safeguarding the fundamental rights of financial users⁷, in particular of vulnerable groups. We would then, propose the addition of the following text on page 4, first paragraph of the draft framework should start with the words: "Respect for dignity and safeguard of fundamental rights of individuals..."

³ *More Information or Restriction of Financial Services Products for Consumers?*, Tiffe, A., 2011. Research paper presented at the International Association of Consumer Law Conference: Protecting Consumers in Economic Recessions, held in Brunel University, London, UK on 28 June 2011.

⁴ See e.g. *The Emergence of Global Administrative Law*, Kingsbury, B., Krisch, N. & Stewart, R.B., 68 L. & CONTEMP.PRO.

⁵ It also includes the idea of financial user interest groups, which are most significant element of civil society for the purposes of financial regulation in general, and financial consumer protection, in particular. In addition, it should be noted that when FSUG refers to 'financial users', it includes all end-users of financial services, including: retail consumers, retail investors, SMEs, pension scheme members and so on.

⁶ Principles show direction in which law must be applied, but always have to balance against other principles. Just to mention some, *United Nations Guidelines on Consumer Protection*, 1985, which have influenced developments in many countries; *World Bank Good Practices for Consumer Protection and Financial Literacy*, 2011, which outlined a model of consumer protection in financial services. In Europe, financial services regulation is in part a subset of consumer protection regulation. See e.g. *European Commission White Paper: Financial Services Policy 2005-2010*, COM(2005)629 Final, December 2005, *European Commission Consumer Policy Strategy 2007-2013*, etc.

⁷ As FSUG has recently advocated for in the letters to President Barroso & Commissioner Barnier on the withdrawal of legislative proposal on access to a basic payment account, 14.7.2011, http://ec.europa.eu/internal_market/finances-retail/fsug/opinions_en.htm.

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1 Legal and regulatory framework

As outlined in the previous section, consumers expect with great interest the assessment of the effects and the reversal of regulatory light-touch approach that was dominating in pre-crisis environment. Hence, FSUG suggest that any attempt to draft principles of financial consumer protection need to be translated into an effective regulatory model that takes into account consumer detriment analysis. Regulators must begin to evaluate markets from the consumer perspective rather than assume that free markets will automatically lead to positive consumer outcomes. This requires a major cultural shift on the part of regulators.

In this regard, consumer detriment may occur when consumers may not buy the most appropriate product or service, given their needs and preferences. This tends to occur in dense markets, such as the financial services, that usually offer complex products or services with high levels of risk to consumers, purchases are relatively infrequent, purchases are by financial users who have little or no knowledge of the product or service, and purchases are by groups in the population who have particular difficulty in obtaining and interpreting information. Taking into account the claim to advance access to socially responsible financial products and services that meets the needs of financial users not just the commercial interests of the market, FSUG realises that these issues should urgently be dealt with by sector-specific legislation. Regulators should be cautious about imposing 'one size fits all' solutions. In this sense, the specificities and difficulties of the financial products and services have to be borne in mind, and the information asymmetry inherent to the relationship⁸ between the financial industry and consumers deserves a specific regulation.

Concluding this issue, FSUG is of the opinion that efficient and protective product regulation must be envisaged as principle of financial consumer protection. In fact, product regulation is a regulatory tool that can directly address and control the characteristics of the product being sold. Among its advantages it should be considered that, on the one hand, designing a rule that bans certain products or product features, may sometimes be easier than trying to prescribe precisely the behaviour of providers or advisers. On the other hand, monitoring and enforcement of compliance with product regulation may be easier than with prudential regulation. A precautionary stance, however, could include for instance anticipating and addressing risk and problems throughout a product's life cycle, namely product design, marketing and advertising, and not solely in response to the onset of consumer detriment effects, which usually take place in sales and advice, after sales information and complaint handling.

In this regard, in recent response to the *Study on tying and other potentially unfair commercial practices in retail financial service sector in EU*, FIN-USE⁹ (FSUG predecessor) suggested as solution to set up a paritarian commission (consumer associations/financial industry and the national supervisor) in each Member State, with a clear mandate consisting of authorising each product which banks would envisage placing in the market place. This pre-authorisation would be a pre-requisite for the

⁸ Considering that the parties, especially in consumer transactions, have different market positions, or play different market roles, giving them far different degrees of bargaining power.

⁹ *FIN-USE response to consultation on the study on tying and other potentially unfair commercial practices in retail financial service sector in EU*, 14.4.2010, http://ec.europa.eu/internal_market/fin-use_forum/documents/index_en.htm.

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legality of the product, and would cover not only the financial product itself (contract, legal clauses, etc.), but also all the marketing aspects, all the publicity, the method in which the product is offered to consumers, and sold.

FSUG would therefore recommend the addition of the following text in principle 1, page 5: "Regulators should set compulsory minimum standards¹⁰ on financial products, and cover not only the financial product itself, but also all the marketing aspects, all the publicity and advertising, the method in which the product is offered, and sold so to ensure fair contract terms and charges, and comprehensibility. In circumstances where there is a significant risk of consumer detriment regulators should be able to take timely and decisive action through these powers to immediately prohibit products or to control product features. Financial service providers should be required to benchmark their products against a model product with compulsory minimum standards."

In addition, we advocate that 2nd paragraph should read: "(...) Strong legal and judicial mechanisms should exist to protect and compensate consumers from, and sanction, financial frauds and abuses."

FSUG also advise that 3rd paragraph should read: "All financial service providers, including agents and advisors¹¹ that deal directly with consumers, should be appropriately regulated and supervised."

Further, we would suggest an amendment so that the 4th paragraph should read: "Relevant non-governmental stakeholders should be consulted on an equal and balanced basis when policies (...) and the access of consumer organisations to such processes should be facilitated and enhanced."

Finally, we would like to stress that consultation is not enough. Effective representation and participation in the policy-making process is needed to ensure better regulation and avoid 'group-think'¹².

2 Role of oversight bodies

Setting up oversight bodies explicitly responsible for financial consumer protection and education is imperative. FSUG therefore welcomes this principle and stresses the importance to equip these oversight bodies with the necessary powers, competencies, resources, capabilities, governance, etc. However FSUG regrets that there is no indication on how oversight bodies are appointed and the need for such appointments to be transparent and independent from the financial industry. Finally FSUG believes that the role of oversight bodies should concentrate on practical outcomes of professional standards.

¹⁰ Compulsory minimum standards aim directly at ensuring that products with particular characteristics are not offered in the market. At the same time reduce search cost, due to the fact that consumers can be sure of certain level of product quality. Moreover, minimum standards should not be interpreted literally, given that in practice they range for very basic standards to very specific rules for specific features of products.

¹¹ Regardless they are/are not authorised or tied.

¹² For more detailed explanation see *FSUG Letter to President Barroso on financial user representation and effective consumer protection*, 4.8.2011, http://ec.europa.eu/internal_market/finservices-retail/fsug/opinions_en.htm.

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In a recent consultation response, FSUG have stressed the importance of oversight authorities' powers to be proportionate with the importance of default, size of its effects and the business¹³. Mechanism to advance accountability, such as publication of annual reports, describing general framework for intervention and regulation, review in progress, should be established.

We believe indicators should be developed in order to measure progress toward the achievement of their policy objectives. Moreover, remedies should be available to address serious failure of oversight authorities to meet their statutory objectives. Accordingly, these remedies may be positive in nature (e.g. mandating an increase in resources and expertise) or negative (e.g. termination of appointment). However, it is important to bear in mind that in any case such principle should be applied prudently so as to ensure the effective independence of the oversight bodies.

There is already a body of work produced by consumer experts which uses established consumer principles to evaluate whether or not markets are working for all consumers. These principles include: access; fairness (treating customers fairly/protecting them from unfair practices); competition, efficiency and real innovation; value-for-money; appropriate choices; quality; objective information and advice; security; accountability and representation.

Overall, regulators could use these principles to evaluate markets as part of a policy framework consisting of the following phases:

1. Defining strategic policy objectives and outcomes: Regulators in consultation with stakeholders must first define common objectives and outcomes for financial markets. These can be used to evaluate whether markets are working in the interests of financial users and whether regulatory interventions are working. The consumer principles outlined above provide a useful set of tests to evaluate markets.
2. Consumer welfare/detriment/risk analysis: Identifying and quantifying consumer detriment measured against the consumer principles.
3. Root cause analysis: Understanding why detriment/market failure happens (e.g. conflicts of interest/agency problems, anti-competitive practices, market inefficiencies, information asymmetries, structural barriers; and so on).
4. Policy interventions: Regulators should select the most appropriate and effective 'tool' (or combination of them) from the regulatory toolkit to address the detriment identified, e.g. product intervention/banning, new rules, disclosure, structural reform, financial education, fair ADR systems, strong collective actions schemes, and so on.
5. Prioritisation and judgment: Regulators need to prioritise issues given resource limitations. Regulators also need to establish the right balance between prevention and resolution. Critically, regulators need to decide when to intervene to achieve the desired outcome. The UK FSA for example is moving towards a philosophy of early intervention to prevent consumer detriment from escalating.

¹³ See *FSUG opinion on reinforcing sanctioning regimes in the financial services sector*, 14.2.2011, http://ec.europa.eu/internal_market/finances-retail/fsug/opinions_en.htm.

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6. Ongoing policy review: Is the policy intervention still appropriate, does it need to be reviewed or amended?

It is also important that regulators are required to evaluate markets from the perspective of all consumers not just the 'average consumer', 'middle-class' or wealthy consumers. Financially vulnerable consumers are often treated as second-class citizens within the regulatory system. They are less likely to get access to the market in the first place to find products that meet their financial needs. If they do get access to the market, they are more likely to be ripped off or receive poorer quality products and services. They are less likely to be aware of their rights to redress and to obtain the necessary compensation. Moreover, some of the solutions on offer can compound the original consumer detriment – for example, overindebted consumers being targeted by commercial debt management companies.

Finally, as has been already explained at our summary section, FSUG advocates that regulators should take care to identify the real source of consumer detriment.

Obligations to cooperate and exchange information between oversight bodies have to be secure. In this regard, FSUG recommend that 2nd paragraph of this principle should read: "Timely co-operation with financial oversight authorities and between authorities or departments in charge of sectoral issues should be promoted, while avoiding duplicative reporting (...)."

3 Equitable and fair treatment of consumers

Consumer vulnerability is a condition and not a status¹⁴. Traditionally, the descriptive analysis of consumers is far richer than the legal concept, which in broad lines assumes consumers are anybody acting outside their normal business¹⁵. Nevertheless, the legal concept, for comprehensible grounds, fails to analyse the extent of consumer vulnerability, which in consequence restricts the legal protection of the vulnerable to extreme situations¹⁶.

While FSUG welcomes the reference to the need to protect vulnerable groups in this principle, we believe that the text should go further and promote the development of understanding of the typologies of consumer vulnerability in financial services and identify gaps which could lead to improvements in stricter standards of protection targeted to them. In this regard, the level of protection and associated legal certainty can equally be adjusted¹⁷ depending on the needs of vulnerable groups. Thus, FSUG recommend the addition of the following text to principle 3: "(...).Special attention should be dedicated to the needs of vulnerable groups. Regulators should promote the development of understanding of the typologies of consumer vulnerability in financial services and identify gaps which could lead to improvements in stricter standards of protection targeted to these groups."

¹⁴ *Building understanding on the domain of consumer vulnerability*, Baker, S.M.; Gentry, J.W. & Rittenburg, T.L., 2005, *Journal of Macromarketing*, 25(2), 1-12.

¹⁵ *Consumer protection law*, Howells, G. & Weatherill, S., 2005, Aldershot: Ashgate.

¹⁶ *The notion of the empowered and informed consumer in consumer policy and how to protect the vulnerable under such a regime*, Stuyck, J., 2007, *Yearbook of Consumer Law*.

¹⁷ See European Union Directive 2005/29/EC on unfair commercial practices, Recital 19 and Article 5(3).

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Civil society, particularly consumer associations, have a major role to play in identifying, analysing and overseeing issues related to unfair commercial practices in financial services. FSUG therefore feels it is important to create and promote civil society networks, which have a key role to play in terms of exchange of information and good practices.

4 Disclosure and transparency

FSUG welcomes the reference to standardised pre-contractual disclosures in this principle. However, standardised information disclosure requirements should not be used to shift responsibility from firms to consumers. We would not argue with the need for consumers to read key information and answer questions honestly, but there is an unacceptable view in some sectors of the industry that complex and potentially detrimental products can be widely promoted, provided they are transparent through good disclosure. This is accompanied by an expectation that consumers can, and should, acquire the skills, knowledge and understanding required to deal with this complexity and choice, which places an unreasonable burden on the consumer and is not an approach adopted by other industry sectors.

While standardised disclosure is still in a process of development and experimentation, it should be taken into account the need to reduce the number of elements disclosed, to make the disclosures easier to read, to offer the disclosures at times when they are most useful and reduce the cognitive costs of information processing. Further, improve the process by which disclosures are created and revised, require seeking input of consumers as well as promote the periodical revision of disclosure and transparency standards. Comparable rather than similar levels of financial consumer protection should be provided for substitutive products.

Product risk¹⁸ is a key aspect of information disclosure. Hence, standardised information disclosure labels, may need to be developed within product categories, rather than across the entire financial product mix.

As a complementary measure to the above mentioned information disclosure provision, it is necessary to consider the development of risk guidelines to increase the awareness of risk related to financial products or services¹⁹. These guidelines could be provided to consumers before purchasing a financial product or service, and could be generally available through internet or by consumer organisations or authorities.

Thus, FSUG advise an amendment so that the 1st paragraph of this principle should read: "(...).Standardised pre-contractual disclosure practices should be promoted where applicable and possible to allow comparisons between products and services of the same nature and need to be achieved within product categories, rather than across the entire financial product mix. Specific disclosure mechanisms, including potential warnings, targeted and individualised disclosures²⁰, should be developed to provide information commensurate with complex and risky products and services. The

¹⁸ Risk associated with interest rates, principle value, inexistence of savings/investor protective schemes funds, and future payment.

¹⁹ An example is the introduction of the Financiële Bijsluiters in the Netherlands.

²⁰ For instance, to individuals paying minimum payments, or the lack of covertures for the non-existence of saving/investor protection funds scheme.

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development of risk guidelines to increase the awareness of risk related to financial products or services should be also advanced."

Finally, in order to avoid any reference to exclusionary practices, for instance 'redlining', which comes through 'profiling' and sometimes sophisticated methods of sorting and scoring. It is important to use a proactive language in order to counteract any exclusionary and discriminatory practices in markets for consumer services. Hence, we would suggest an amendment so that the 2nd paragraph of this principle should read: "(...) The provision of advice (...) should not be based only on 'profile' but instead on 'the consumer's needs'. (...)"

5 Financial education and awareness

FSUG believes that financial education is good in principle. However, there is very limited evidence that financial education actually works in changing consumer behaviour and most importantly acting as a constraint on market behaviour.

Financial education has limited effect on many consumers because of the aggressive market practices and inherent and growing complexity of financial markets. Hence, regulators must intervene to change provider behaviour and improve markets and then deploy financial education. However, both processes – financial education and regulatory intervention – can be certainly promoted and implemented simultaneously. The issue is how to ensure that financial information provided to consumers is reliable, independent and comprehensive.

Further, FSUG advise an amendment so that the 1st paragraph of this principle should read: "... and clear information on consumer protection and rights should be publicised, promoted, and easily accessible."

In the 3rd paragraph, the sentence "taking into account national circumstances" should be deleted.

6 Responsible business conduct of financial service providers and their authorised agents

FSUG stress the need to replace the term 'authorised agents' with 'financial intermediaries' in the title and within the body of the principle. In our view this principle should apply to both providers and all intermediaries, not just tied or authorised agents.

In addition, it is important that regulators understand that with regards to managing conflicts of interest that cause irresponsible business/market behaviours, disclosure is unlikely to be sufficient. Sometimes it is necessary to introduce structural reforms or ban certain market practices to ensure good conduct of business behaviours.

Moreover, we endorse the proposal made by Consumer International recommending to advance a 'legal duty of care' on intermediaries to oblige them to act in the best interest of their clients as exists in some countries.

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Since there is no reference for supervision of financial intermediaries, we suggest to add the following text at the end of the 2nd paragraph: "(...) Supervisory authorities should monitor whether financial intermediaries are involved in the provision of high-risk credit and other products, and take due action if needed."

7 Protection of consumer rights

To better reflect the wide scope of this set of key principles, we suggest the following amendment to this principle: "All rights of consumers including the rights to their deposits (...) and by appropriate control and protection mechanisms, including, where relevant, guarantee schemes."

8 Protection of consumer data and privacy

FSUG feel that this paragraph should be strengthened to ensure adequate protection of consumer data and privacy. We suggest the following sentence to be added to this principle: "Data controllers should ensure that financial providers and intermediaries respect the principles of data minimisation, data protection, informed consent, subject access rights and right to object to processing of data relating to her/him based on legitimate grounds."

9 Complaints handling

In order to promote accountability and transparency, FSUG welcome the reference to aggregate information with respect to complaints and to the proposal to make the aggregate data public.

As suggested in principle 6, we advise to replace 'authorised agents' by 'intermediaries'.

Moreover, after the final sentence, the following sentence should be inserted: "In appropriate circumstances, collective redress mechanisms should be put in place by the regulator²¹."

10 Competition

FSUG very much welcome this principle and stress the importance of an adequate implementation of both prudential and competition regulation to avoid oligopoly and protect consumers' rights. To strengthen this principle, we suggest to amend the 1st sentence of this principle as follows: "Nationally and internationally competitive markets should be promoted and the implementation of both prudential and competition regulation adequately monitored by the supervisory authorities in order to provide consumers with greater choice amongst financial services and place pressure on providers to keep prices competitive and service quality high."

²¹ More details on FSUG support to collective redress mechanism, see our response on the consultation *Towards a coherent European approach to collective redress*, 29.4.2011, http://ec.europa.eu/internal_market/finances-retail/fsug/opinions_en.htm.