



Ref: Input from the Financial Services User Group (2022-2025 mandate) to the Survey of the European Commission's Directorate-General on Financial Services, Financial Stability, and Capital Markets Union on *Suitability and Appropriateness Assessments: Questions to Consumer Associations*

BACKGROUND

As part of the preparatory work for the EU Strategy for Retail Investments (follow-up initiative under Action 8 of the 2020 Capital Markets Union Action Plan), the **European Commission's DG FISMA**¹ services seek to improve the legal framework of the suitability and appropriateness assessments as part of the process of distribution of retail financial services and products.

The FSUG received an invitation from the DG FISMA services to respond to a questionnaire (below) as part of this initiative. The questionnaire is an evidence-gathering exercise on the mis-selling of financial products.

GENERAL COMMENT

The Financial Services User Group (FSUG) welcomes the opportunity to provide input to the evidence-gathering exercise on mis-selling of financial products **of the European Commission's services in the context of suitability and appropriateness assessments**. We appreciate that the Commission is **conducting a wider investigation into this phenomenon, as suggested by the FSUG's [response](#)** to the 2018 study on distribution of retail investment products.

However, as a group of experts representing consumers in financial markets, the FSUG draws the attention to the very short deadline to provide input. In particular, to be effective and provide added value, individual experts within the FSUG need more time to aggregate data and agree on the document to provide **"anecdotal" evidence**, in particular for a topic that is so high on the priority list for consumer representatives.

The FSUG strived to collect high-level evidence and cope with the deadline, but points to the **European Commission's services that** the current exercise should not be considered fulfilled until the FSUG has sufficient time to finalise a full response document.

In addition, the FSUG highlights the lack of working definitions to this survey. In particular, the questions herein address *mis-selling* of financial products despite the fact that there is no regulatory prescription, nor a common understanding, on what *mis-selling* means.

To this end, the FSUG proposes the **European Commission's services the following: *mis-selling* of financial products occurs when product manufacturers or intermediaries (distributors) advise on, sell, or distribute to "retail" clients² financial services and/or products that are:**

- complex,³ for the purpose of MiFID II-regulated products; or
- complex and not meeting the demands and needs of the "retail" client,⁴ for IDD-regulated products; or
- *inappropriate*⁵ with regards to the client's knowledge and experience in relation to the advised financial service and/or product, for both MiFID II- and IDD-regulated products; or

¹ Directorate-General on Financial Services, Financial Stability, and Capital Markets Union.

² As per Art. 4(11) read in conjunction with Annex II of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast), ELI: <http://data.europa.eu/eli/dir/2014/65/oj>, hereinafter (MiFID II).

³ As required by Art. 25(4) of MiFID II.

⁴ As required by Arts. 20(1) and 22(1) of Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast) ELI: <http://data.europa.eu/eli/dir/2016/97/oj>, hereinafter IDD.

⁵ Per a contrario to products and services being *appropriate*, as required by Art. 25(3) MiFID II.



- *unsuitable*⁶ with regards to the client's knowledge, experience, financial situation (including the ability to bear losses), and investment objectives, in relation to both MiFID II- and IDD-regulated products; or
- *unsuitable* in relation to income, expenses, other relevant financial and economic circumstances,⁷ with regards to mortgage credits regulated by the Mortgage Credit Directive;⁸ or
- *unsuitable* and *inappropriate* in relation to the risk tolerance and ability to bear losses of the client,⁹ with regards to crypto-assets; or
- the *residual category* of products that are not in the best interests of the client.

In relation to the last category, the FSUG draws the attention to the *general duty of care* in "retail" investor (consumer) protection law: the obligation to act honestly, fairly, and professionally in accordance with the best interests of clients (Art. 24(1) MiFID II, Art. 17(1) IDD, Art. 7(1) MCD, potentially Art. 65 MiCAR). In this sense, we see the general duty of care as an overarching principle, on the basis of which the distribution rules are built. For situations where there is the choice out of a **range of for instance "suitable" products**, mis-selling should also be considered where advice is given for a product that does not cater best the interests of the client.

1. Can you quantify/ do you have anecdotal evidence that mis-selling has increased over the last 5 years across the Union and/or in particular Member States? If yes, please specify the product category.

Consumer protection associations in retail financial services have compiled, throughout the years, a plethora of reports, studies, and other quantifiable evidence on mis-selling cases. For instance, BEUC published:

- a position paper providing evidence at national level on the detrimental effects of mis-selling due to "inducements" – [The Case for Banning Commissions in Financial Advice](#);
- evidence in relation to mis-selling as part of the [Response to the Consultation on the EU Strategy for Retail Investments](#);
- a campaign, The [Price of Bad Advice](#), providing a user-friendly, interactive map of mis-selling cases across the EU.

At the same time, BETTER FINANCE compiled ample evidence of "scandals" (cases where breaches of consumer rights in "retail" financial services occurred, mostly mis-selling) in two research & policy papers, referred to in their response to the consultation on the RIS:

- The [Mis-Selling of Financial Products Briefing Paper](#) (April 2017), and
- The [Collective Redress Booklet](#) (June 2019);
- The [Response to the Consultation on the EU Strategy for Retail Investments](#) (2021);

Finance Watch also collected evidence on mis-selling of consumer credit in a recent (2021) paper [New data on consumer credit mis-selling, poor lending practices expose EU Consumer Credit Directive \(CCD\) shortfalls](#).

In terms of anecdotal evidence, BETTER FINANCE pointed out in the [Individual Redress Tools for "Retail" Investors report](#) (2022) that mis-selling also occurs frequently at individual level, cases which are not reported: neither to supervisory authorities, financial ombudsmen or alternative dispute resolution bodies, nor to consumer organisations.

⁶ Per a contrario to products and services being *suitable*, as required by Art. 25(2) MiFID II.

⁷ Per a contrario to mortgage credits that are *suitable*, as required by Art. 22(3) MCD.

⁸ Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010, ELI: <http://data.europa.eu/eli/dir/2014/17/oj>, hereinafter MCD.

⁹ As required by Art. 73 of the amended proposal for an EU Regulation on Markets in Crypto-Assets (MiCAR).



In terms of anecdotal evidence, the FSUG draws the attention that mis-selling is particularly difficult to quantify at individual level both by regulators and by consumer protection organisations due to the legal protection awarded to distributors and product manufacturers. Particularly, case-by-case assessments are needed to determine whether the advice or distribution of financial products were in line with the law due to the legal assumption awarded through the conflicts of interest policies under MiFID II¹⁰ and IDD.¹¹ Furthermore, MiFID II does not clearly provide investors with private law remedies to seek redress and compensation by national courts, dissuading them from coming forward. In any event, evidence of investment products mis-selling tends to surface long after the actual events. Hence, while it may be too soon to showcase evidence of mis-selling, such practices may be taking place in the shadows.

Nevertheless, **BETTER FINANCE** and **BEUC's active campaigns against "inducements" in retail financial services** should provide a good starting point for gathering "anecdotal" evidence.

In addition, **the European Parliament's Economic and Monetary Affairs (ECON) Committee commissioned** four reports on mis-selling of financial products, providing a generous list of mis-selling cases in the Single Market for financial services:

- [subordinated debt and self-placement](#);
- [mortgage credit](#);
- [marketing, sale, and distribution](#);
- [compensation of investors in Belgium](#).

Moreover, in its [latest consumer trends report from 2021](#), EIOPA highlighted that an increasing number of consumers are taking out unit-linked products for which they have limited understanding and some of which are highly complex. In the same report, EIOPA raises concerns about unit-linked products showing high costs and complex structures with high commissions increasing concerns relating to possible mis-selling and value for money.

2. If you have not observed an increase of mis-selling, do you have nonetheless evidence that mis-selling remains an issue to tackle?

The ample evidence collected over long periods of time referred to in point 1 above – see also BEUC's campaign [The Price of Bad Advice](#) – is alone sufficient to maintain mis-selling a high priority on the agenda of EU policy makers and supervisory authorities.

Data from BETTER FINANCE's research on in the French life insurance market shows the detrimental effects (and, in essence, the mass mis-selling) of financial products due to the commission-based model.

(BETTER FINANCE) French UL insurance - Performance and charges (2020)			
	5Y annual av. return*	funds' ongoing costs	total ongoing cost*
French equities 2016-2020			
Classic	4.07%	1.98%	2.88%
Clean share classes	5.52%	1.14%	2.04%
ETFs	6.06%	0.52%	1.42%
Mixed "moderate" 2016-2020			
Classic	1.89%	1.96%	2.86%
UL clean shares	3.60%	0.91%	1.81%
European bonds 2016-2020			
Classic	0.86%	0.96%	1.86%
UL clean shares	1.27%	0.50%	1.40%
ETFs	1.52%	0.17%	1.07%

* excluding additional charges if under delegated management; Source: BETTER FINANCE, 2022

As seen in the table above (courtesy of BETTER FINANCE), the commission-based model dominated the market for life-insurance contracts and the results speak for themselves: costs are considerably high across all three types of asset allocations in life insurance contracts for the classic distribution, whereas exchange-traded funds and "clean share" unit-linked contracts both perform better and cost less.

¹⁰ Arts. 16 and 23 MiFID II.

¹¹ Art. 28 IDD.



In the updated study (with 2021 figures – example of French equity funds/units) shows the striking dominance of the commission-based model based on the market share: 93% of contracts which are 12 times as costly compared to the “independently” advised index-tracking ETFs, which performed twice better. These figures must be put in context, namely that the unit-linked market for French insurances is more than half a trillion (€500,000,000,000).

(2021 data)	Average charges (unit + contract)	Market share	Net performance (cumulative)	
Classic units	2.98%	93%	36%	← advised
Clean share units	2.02%	1%	44%	
Indexed units	1.18%	2%	58%	
Index ETFs	0.25%	-	68%	← non-advised

Source: BETTER FINANCE own composition based on Good Value for Money data (2022)

In our view, where evidence shows the clear and consistent large cost inefficiency and underperformance of certain products towards others, it is clear a *mis-selling* as it is in no investors’ “best interest” (Art. 24 MiFID, Art. 17 IDD) to pay more and get less.

In fact, BETTER FINANCE’s report on the [Correlation Between Cost and Performance in EU Equity UCITS](#) (2019) provides ample statistical evidence for its key finding “the more you pay, the less you get”.

Table EX.5. Standardized regression coefficients of explanatory variables

Source	Value	Standard error	t	Pr > t	Lower bound (95%)	Upper bound (95%)
Tracking error	0.061	0.029	2.065	0.039	0.003	0.118
Benchmark return	0.763	0.029	26.244	< 0.0001	0.706	0.821
Average Charges	-0.077	0.029	-2.639	0.009	-0.135	-0.020

Source: Correlation report, p. 17.

Finally, what the 2008 financial crisis has shown is that the mis-selling of investment products increases when financial service providers are under severe pressure and scrutiny to meet capital requirements and to safeguard financial stability. In essence financial service providers pass such (justified) pressure and costs to consumers and investors, in a form of regulatory arbitrage. Following the alert issued by the European Systemic Risk Board, financial service providers, once more, appear to be facing macro-prudential risks. Under such conditions, there is a high risk that financial service providers may engage in mis-selling practices to circumvent the pressure to meet capital requirements and prudential financial rules. Accordingly, addressing issues of mis-selling is most timely and relevant.

Mis-selling is not just an issue of products, which are so bad that they cause scandals or at least obvious losses being sold. The damage done by (regular) inferior quality products being pushed into the market, against consumer interests, is extensive in its own right and may, by volume of losses, be the larger problem because of its systemic prevalence.

- For data on this issue please see ESMA from this year: https://www.esma.europa.eu/sites/default/files/library/esma_50-165-1677_asr_performance_and_costs_of_eu_retail_investment_products.pdf
- The inducement-based advice system causes mis-selling of this “regular” across most of the volume in retail investments.
- This is the case because the highest commissioned product is the most attractive to sell, but the cost of this distribution system is recouped from the products returns. This leads to the net returns (after costs) being too low for the risk of the product meaning the product is of poor quality. This is adverse selection; the worst products are the best to sell.

Among the large mis-selling cases that maintain this topic a priority for consumer protection, we wish to highlight that the advent of “retail” ESG-investing in an uncertain legal environment (due to the incomplete taxonomy) will open a new era of mis-selling of “sustainable” financial products.



The alleged greenwashing case of DWS seems nothing short also of mis-selling¹² and many others may still burn low at the moment. **The fact is, based on BETTER FINANCE's research**, there is little alignment between sustainable/ESG ratings in listed companies and the portfolios of mutual investment funds, which raises the question, put simply.

The reality is that mis-selling, in these cases, will be very difficult to legally demonstrate given the absence of a complete taxonomy. Moreover, as acknowledged through the most recent sustainability / appropriateness requirements for advisers and sellers, incorrect assessments and explanations given to consumers – albeit unintentional – may give rise to many more cases in the future.

The same goes for crypto-assets and crypto-investments: further clarity is needed to prevent mis-selling in this field as well.

3. If you have observed an increase of mis-selling, can you quantify/ do you have anecdotal evidence if that phenomenon is more relevant under advice or in execution only services?

In the FSUG's view, as highlighted above, mis-selling by definition only occurs at the distribution point of financial services and/or products, i.e., with advised services and execution-only. The FSUG holds that mis-selling is intrinsically linked to conflicts of interests, biases against the general duty of care, and the commission-based model. As far as conflicted distribution is still the dominant model across the EU – as evidenced by the 2018 EC study¹³ but also BETTER FINANCE's report on [Evidence Paper on the Detrimental Effects of Inducements](#) (2022) – it will not be addressed.

Based on the evidence briefly mentioned above, mis-selling is more on the rise than on the decrease, as, for example, the unit-linked market in France has been growing strongly in recent years, now representing about 2/3 of the retail funds distribution, at the expense of retail fund sales through more direct and less costly distribution channels.

4. Can you name the key drivers for such increase (if any) of mis-selling?

The FSUG reiterates the answers to Questions 1 and 3 above: mis-selling essentially originates in the **misalignment of distributors' interests with that of the clients in whose "best interests" the former must act. At the same time, replacing price and performance competition in the market of "retail" financial products with the market share of captive distribution channels and the size of inducements also misaligns the interests of product manufacturers and their clients.**

For instance, research in academic literature by BETTER FINANCE on the correlation between fund net flows and commissions paid to distributors highlight that sales become insensitive to past performance. In other words, competition on price and performance is replaced with competition on the size of inducements as investors will be directed to these funds regardless of whether the asset manager has delivered on its investment objectives and horizon or not.

There is also the issue of the uneven regulatory levels between securities and insurance markets, i.e. between MiFID II and IDD. In particular, IDD-regulated savings products dominate the financial balance sheets of EU27 households, and in certain cases – such as France – constitute the **largest category of "investments", even larger than banking products.**

This comes from the lack of "*coherence of EU rules across legal instruments*", which is a stated objective of both the Capital Markets Union action plan and of the *intended* EU Strategy for Retail Investments.

Moreover, the revised Markets in Financial Instruments Directive did not deliver on its promise to develop "**independent advice**" – albeit legally possible – because of the regulatory loopholes that allows

¹² See Adrienne Klasa, Patrick Temple-West, Stefania Palma, Joe Miller, 'ESG's Legal Showdown: 'There's Nothing to Suggest DWS is a One Off' (FT.com, 14 June 2022), available at: <https://www.ft.com/content/1094d5da-70bf-40b5-98f4-725d50620a5a?shareType=nongift>, accessed 5 October 2022; see also Laurence Fletcher, Joshua Oliver, 'Green Investing: The Risk of a New Mis-selling Scandal' (FT.com, 20 February 2022) available at: <https://www.ft.com/content/ae78c05a-0481-4774-8f9b-d3f02e4f2c6f?shareType=nongift>, accessed 5 October 2022.

¹³ Study on the distribution systems of retail investment products https://ec.europa.eu/info/publications/180425-retail-investmentproducts-distribution-systems_en



selling to be labelled still as “advice”. Furthermore, in insurance distribution the legal hypothesis is the opposite, where the commission-based model is the rule, and independent distribution the exception.

In the dominant life insurance and pension retail investment products, there is not even the legal concept of “independent advice”, although most commission-based “advisors” brand themselves as “independent” ones.

5. If you have observed an increase of mis-selling, could you quantify or estimate a rough split between complex and non-complex products, per type of investment service (advised-non-advised services)?

The FSUG points to the paradox that the majority of mis-selling cases originate with advised services; here, the FSUG notes that “advised” services, unfortunately according to the applicable EU law, comprise “non-independent” advice (captive networks and in-house services), which are a pure form of selling of financial services and products.

For instance, BETTER FINANCE’s report on [Simple Products for Retail Investors](#) (2022) shows that neo-brokers, or otherwise traditional execution-only investment firms, generally do abide to the limitations of complex products, except for structured products (the retail distribution of which has been appropriately halted in Belgium).

BETTER FINANCE continues to point that EU law raised the standard of *simplicity* too high in relation to insurance-based investment products: the reality is that most insurance-based investment products (IBIPs) are complex to begin with and should be, by default, categorised as such. In our view, unit-linked insurance are complex product to grasp by consumers, and the PRIIPs KID, by being not intelligible, not comparable, and not disclosing the total cost of such products to consumers is not helping at best.

6. Can you quantify how many transactions have retail clients made over the past 5 years on an annual basis and on average?

The FSUG cannot provide this kind of data at such a short notice. However, studies published by consumer protection organisations, for instance BETTER FINANCE’s [Study on the MiFID II and Implementation Survey](#) (2020) and the [The New Retail Investing Environment](#) (2022), may be a good starting point.

7. Do you think the client would benefit if some elements of a new suitability assessment and of the final assessment report are proposed in a standardized format? (Y/N/Don’t know – please motivate your reply)

The FSUG advised the European Commission services that it would not address the issues that generate mis-selling by requiring a new report that cannot be adequately verified by consumers, nor by supervisory authorities. In essence, the problems that lie at the origin of mis-selling are the destruction of competition between product manufacturers (competition on cost and performance) and the inadequate pre-contractual disclosures.

8. Do you agree that the client will benefit if financial intermediaries alongside a suitability assessment also offer to provide a list of suitable asset classes? (a) for advised services and (b) for non-advised/execution-only services. (Y/N/no opinion – please motivate your reply)

The FSUG is of the view that such a list would only further the information overload that consumers are faced with and will push the latter to disengage with disclosures. The FSUG advises the European Commission services to consider replacing the current paradigm of financial regulation where the responsibilities of financial services providers are waived through disclosures and shifted towards consumers in a growingly complex and difficult to understand environment. This aligns with the Commission’s misplaced focus on consumer education as a silver bullet, ignoring other measures needed to educate financial advisors to ensure they understand what they sell. The ARCO case study included in the study for the European Parliament on Belgium (see question 1, page 27) highlights that “advisors”



often lack the capacity to understand or willingly misrepresent the risk/reward profile of financial investment products.

Then again, the issue with conflicted advice or selling stems from the *adverse selection* bias: if the commission-based model is not addressed, then even the list of asset classes for advised and non-advised services will be unsuitable and, in the end, constitute mis-selling. The root of the problem is not necessarily transparency, or lack of understanding on either side of the sales process.

Finally, some products are constructed in such a way in terms of complexity, biased outcomes, or fee structure, that they should not have any target market. Only product-level regulation can address this problem.

9. How long does it take on average for a client to perform a suitability assessment (please specify for online and in person if applicable)? Same question for an appropriateness assessment?

The FSUG cannot provide evidence on this topic in such a short notice.

10. How many complaints have you received from clients about having to participate in a suitability assessment, in the past 3 years, on average, in % of the total amount of client that did the assessment over the same period?

The FSUG will attempt to compile evidence (if available) on this question at a later stage and submit it to the European Commission.

11. How many complaints have you received from clients about having to participate in a appropriateness assessment, in the past 3 years, on average, in % of the total amount of client that did the assessment over the same period?

The FSUG reiterates the answers to Questions 9 and 10 above.

12. How many clients complain about the length (in %) and how many over the usefulness (in %) of the suitability assessment?

The FSUG reiterates the answers to Questions 9 and 10 above.

In the meantime, however, the FSUG would like to point to the EC study on Disclosure, inducements, and suitability rules from this year that clearly shows that there is a problem with the quality of suitability assessments in the market. The study points out that **'an important share of conversations that resulted in product suggestions covered only minimal or hardly any information about clients' and that 'investor knowledge appears to be the least systematically covered'**. Moreover, many conversations also did not address the question of family status (which is linked to the client's capacity to bear losses) or more generally the client's wealth and assets. Moreover, the timing of the suitability assessments are often only very late in the process at the contractual stage, resulting in the fact that the objective of the suitability assessment, i.e. using information about the client to provide advice, is often not fulfilled.

13. How many clients complain about the length (in %) and how many over the usefulness (in %) of the appropriateness assessment?

The FSUG reiterates the answers to Questions 9 and 10 above.

14. Do you believe that having some standardised set of elements to be part of those assessments would be beneficial for the firms and its clients? if yes, what elements/information should be standardised? (Y/N/no opinion – please motivate your reply)

No input can be given by the FSUG at this stage.