



## Financial Services User Group (FSUG)

# FSUG Meeting in Warsaw - 16-17 June 2014

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### Lessons learned

For each of the last three years the FSUG has organized one of its meetings in an EU member state outside Brussels. Our host this year was our Polish FSUG member Marcin Kawinski. We met on the 16<sup>th</sup> and 17<sup>th</sup> June 2014 at the Warsaw School of Economics. The two day meeting was extremely well organized and insightful. The following details issues raised and discussed:

#### **1. Polish economy and retrospective analysis of consumer protection in Poland**

The meeting began with a presentation on the Polish economy giving emphasis to demography. This was a key in understanding a number of the issues in the development of financial services in Poland. The ageing of the population combined with low birth rates has impacted significantly on financial products such as pensions and insurance.

For the FSUG, it was interesting to understand that the national context in which EU Directives and Regulation are applied in the financial services market in Poland. For example, in Poland, the judicial system plays an important role in determining how financial services operate and which types of financial products are available. It also has an impact on the enforcement of legislation including EU Directives such as the MCD and the CCD.

#### **2. Pension reforms in Poland and interest of pensioners**

In Poland, as in many EU countries, pension reforms were introduced to limit the expected impact of demographic change on the public purse. Unfortunately, recent decisions have been taken to change the pension landscape, which are based on short term political objectives rather than sound structural reasons underpinning rationale social welfare policies. Recent reforms will not improve the disadvantages faced by low income earners in the economy and the system will continue to favor high income earners.

State pensions are under the threat of being unsustainable in the long term and need to be reformed. The threat of unsustainable state pensions will lead to lower financial benefits encouraging the emergence of private pension products. Evidence from European studies of these private schemes has been critical of their performance and overall contribution they make to economic welfare of European states.

### **3. The Polish market of mortgage credit – systemic and consumer issues**

In Poland, the number of homeowners is very high, as in many other countries of the former communist bloc. The mortgage credit has become the main product provided by universal banks (very few by specialized banks) where the main source of funding comes from deposits.

Poland has the highest mortgage credit market in foreign currency in Europe. Most Poles considered taking out a mortgage in Swiss francs or euros because of the lower interest rates up until 2009. Between 2006 and 2011, about 60 per cent of all new mortgages were denominated in a foreign currency, mostly Swiss francs. In 2009 Poland's zloty fell sharply, making Swiss franc mortgages much riskier than either the borrowers or lenders had anticipated. Since then, under pressure from the KNF (the national bank), banks have been reluctant to offer forex loans.

The mortgage credit interest rates (variable rate) rates tend to be high and are based on a index + fixed margin (similarly to Hungary and Romania).

The KNF has issued new rules requiring customers to make a mortgage down payment of 5 to 10 per cent, designed to limit the risk of real estate price bubbles.

The KNF has recommended changing the maximum allowed loan-to-value (LTV) ratio for a housing mortgage from 100 per cent to 85 per cent within three years of the regulations taking effect, or 90 per cent if the amount exceeding 85 per cent is insured.

Mortgage holders will also have to pay back their loans within 25 years under most circumstances, with a maximum 35 years, curbing the practice of extending the life of a loan to make payments more affordable.

### **4. Abusive clauses**

Issues related to abusive clauses in Poland are regulated by the Civil Code.

To be abusive, a clause needs to be a part of a model (standard) contract between a business and consumer and thus not having the opportunity of being individually negotiated, contrary to good practice.

Poland has a unique approach in Europe to abusive clauses as it has a special register where the abusive clauses are listed which should suggest they are redundant and the market should stop using them. It was reported that some 5.000 abusive clauses have been identified. The lack of consistent enforcement, however, has resulted in the register not being as effective as it was intended. In financial services contracts, there is some evidence

where consumers that had suffered prejudice and went to court could not rely on precedents or case law to uphold their rights. Court rulings were given out on an individual basis and could go either way despite a clause being identified as abusive by a national register. In effect, this means that financial institutions have no incentive to remove abusive clauses from their contracts since the enforcement of the law is inefficient.

The FSUG, however, considers that the existence of a database of abusive clauses is in itself a very useful development which should be encouraged in other Member States.

## **5. "Bancassurance" from consumer perspective**

There seems to be important issues with "bancassurance" in Poland which are detrimental to consumers. The very high fees charged by banks seem to demonstrate that consumers do not benefit from real competition between providers.

There is also lack of understanding among consumers of the exclusion clauses and the level of fees, in particular among older people, which is worrying from the perspective of consumer protection.

Most complaints concern 2-3 large banks (with head offices in other EU countries). It seems that these banks who operate in various EU countries do not apply the same governance rules across EU member states but rather adapt to the local context if that enables them to make more profit at the detriment of the consumer.

In 2013, the Ombudsman received 16,516 complaints, of which 1,604 were related to insurances distributed by banks. The nature of the problems included:

- Rejection of claims due to a situation not covered by insurance
- Insurance sold in banks offering very limited coverage and including a high number of exclusions
- Denial of a refund of the cost of insurance in case of early repayment
- Miss-selling of unit linked insurance – especially the very important problem represented by liquidation fees which was set at huge levels – first year 100%, and in the next ones – 90%, 80% and so on.

An interesting characteristic of the Polish market is represented by the fact that insurance companies are obliged to send all the terms and conditions of the contracts to the Polish Insurance Ombudsman. In this context while the Ombudsman does a good job in raising issues of concern to consumers, the office is essentially advisory and has no formal powers of mediation or arbitration. In other words the Ombudsman acts as just one of many consumer bodies. Given that trying to obtain redress through the courts is time consuming and uncertain, there is really no effective route for Polish financial services consumers to resolve complaints against a firm and get compensation where due.

## 6. Key information document for investment insurance

During the presentation and following discussion on Key information document for investment insurance (unit linked life insurance contracts), several detrimental aspects were identified.

Central Eastern European (CEE) countries' consumers typically contract into these unit-linked life insurance contracts in order to combine life insurance and savings into one product. In discussing the simple information card of a unit-linked life insurance policy in Poland (the initiative of Polish Insurance Association), the fee structure of unit-linked life insurance contract was focused on. A number of FSUG members expressed their concern as to the extremely high level of fees paid by the consumers for such products. They also raised concerns about the transparency, the complexity and multi-layer structure of those fees. One particular element adding to the complexity and to the poor performance of these products in Poland is that providers mix life insurance features with death benefits. In most western EU countries unit-linked contracts are simpler and clearer by providing only life benefits and not charging extra fees for different and specific death benefits. This led to a debate on the real value of these products when considering a high level of yearly contract terminations and cancellations.

In order to bring more light into this potentially detrimental impact on CEE countries' consumers, the FSUG members have decided in their programme of work to compare the typical unit-linked life insurance contract fee structures to increase the awareness of this issue.

FSUG members agreed that purchased unit-linked life insurance contracts in the CEE countries' represented poor value as the fee structure effectively delivers negative real value. These products should therefore be scrutinized by national or even supra-national regulators to test, whether unit-linked life insurance contracts actually have under typical market conditions an added value for consumers and to consider whether there is a high probability of detriment caused to consumers by purchasing such products. To the knowledge of some FSUG members, the Czech National Bank in 2012<sup>1</sup> expressed its dissatisfaction with the fee structure level and the lack of transparency. On top of that, Czech National Bank in 2013<sup>2</sup> issued warnings about using unit-linked products as savings products due to their poor value to consumers.

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## **7. Collective redress in Poland**

The Polish collective redress action is a closed system where the class is determined before the material and legal aspects of the case are addressed. The collective action leads to a declaratory judgment and requires individual follow-up proceedings to determine the damages and compensation. So far only a limited number of cases have been trialled under this legislation. Courts are not experienced in this field yet; however they are gaining more knowledge on the execution of this legal procedure. So far some cases (e.g. the case of mortgages in non-Polish currencies) have been successful. However, problems arise when it comes to the individual compensation proceedings (difficult, expensive and very long). The unfamiliarity of enterprises with the Polish collective redress system does not attribute to a smooth execution as well. On paper, the system of collective redress in Poland appears to be working however, in practice it does not work as well as it should for consumers of financial services. Failure of redress schemes in practice means that a 'redress gap' exists. A redress gap is where a market failure/detriment is not redressed. We fear that significant redress gaps might exist also in a number of member states. There appears to be a lack of capacity among consumers' organisations to address this issue.

## **8. Enforcement of Consumer Credit Directive**

Consumer Credit Directive (CCD, directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC) was adopted by the European Parliament in 2008 with 2 year transposition period for the Members State. In Poland CCD was implemented into the national law in 2011. Due to the importance of the regulation for consumers, the enforcement of the directive has been monitored constantly by the Office of Competition and Consumer Protection ((UOKiK).

When analysing enforcement of CCD it should be noted that it is a maximum harmonisation directive and the final outcome depends very often on other conditions (such as, the level of development of the financial market, average level of financial literacy among consumers, etc.) existing in each of the Member States. However the general aim of the directive should be achieved regardless the feature of particular markets. Local differences cannot undermine the main goals of directive. From this perspective implementation of the directive should be followed by effective enforcement.

As a result of controls three main reports on issues concerning enforcement were published, which presents main issues linked to enforcement. Advertisement, mandatory information and wording of contract were examined by the Office of Competition and Consumer Protection to check and monitor a level of enforcement.

Within advertisements, very often, similar catchphrase appeared. For example, that a person applying for a loan would not be checked by the Credit Information Bureau. Some of the shadow banking institutions provide information which suggests certainty that a loan will be granted. The wording used in advertisements quite often was very far from truth. Frequently, information given concerning the cost of credit was incorrect (for example in one case APR declared was 125.64% but the real APR was 2333.95%). Monitoring of the shadow banking institutions also discloses unauthorized usage of market certificates and presenting as special conditions granted by the law.

Some problems emerged concerning required mandatory information. Regardless of the institutions providing the credit passive disinformation occurred. Often the ability to absorb and access mandatory information is problematic, for example, the timing of the presentation of the information on TV. Sometimes the mandatory information was incorrect due to mistakes in calculations.

Critical information was found to be limited or non-existent. The list of deficiencies include: the lack of information about all the costs and charges concerning the loan; no mandatory information at all, on the way rates of credit or on interest rate on debt are calculated on overdue debt and conditions relating to changing the agreement, and information about the vindication procedure; misleading or no information about the amount of credit due to be paid back. Problems with regard to early payment and withdrawal from an agreement were also observed.

The above examples provide problems with enforcement of the EU law. However, it should be noted that many firms comply with the directive. There is strong evidence that a sustainable business in this sector can prosper when complying with regulation. The lack of knowledge, competence and the pursuit of excessive profits seem to be the main cause of non-compliance. Non-compliance of this nature increases the desire for more systemic law enforcement, especially in the area where asymmetry of information, knowledge and skills appeared so strong. Finally it should be mentioned that controls run by the Office of Competition and Consumer Protection revealed that implementation of the directive requires amendments that should provide unambiguous definitions, which would result in better understanding of directive aims.

## **9. Consumer protection**

An important issue raised by a presentation by a senior expert from the Office of Competition and Consumer Protection was the growth of pay day lending and the resulting consumer detriment. A discussion proceeded focusing on the extremely high interest rates and high default rates. Evidence from research in the UK indicates that profitability of pay day lenders in the main if not solely comes from defaults. Thus the business model itself arguably is detrimental to consumer needs. The UK is in the process of setting an interest

cap that will reduce consumers to high levels of interest. It was agreed to send the Office a copy of the Research Report.

Proper transposition of EU legislation is crucial but not enough. Enforcement is key and should be monitored as closely to ensure that Member States and financial institutions respect the spirit of the aim of EU legislation.

A few steps have been taken at national level to improve consumer protection. Although there are many authorities responsible for the protection of consumers, they are not sufficiently powerful enough to ensure all consumer protection regulation is enforced. Furthermore, consumer associations in Poland tend to be weak and therefore are limited in their ability to lobby and make representations to the authorities. .

While EU legislation states that it is the duty of Member States to support consumers' organisations, it is not the duty of the EC to check that this is done in an effective way and encourage exchange of good practice between Member States. There is an obvious role for the FSUG to raise awareness of the danger of weak consumers' representation/capacity at national level.