



## **FSUG STRATEGIC PRIORITIES FOR THE NEW COMMISSION**

In addition to the specific sector and product risks highlighted in the Risk Outlook, we have identified a number of strategic challenges for the new Commission. These are:

- Better regulation to protect financial users and make markets work
- Understanding the impact of data and technology on financial users
- Financial networks, system resilience and cybercrime
- Tackling financial exclusion, under-provision and discrimination
- Promoting real competition and true innovation
- Financial intermediation and the real economy
- Reforming the asset management/ pensions industry
- Pensions decumulation
- Better representation and accountability

We recognise that there are already a number of specific legislative or regulatory initiatives underway to address these issues. However, it is our view that the challenges we have identified are so great and affect such a large number of citizens that new strategies are needed or existing strategies renewed. Strategic challenges require coordinated, long term strategic interventions.

### **Better regulation to protect financial users and make markets work**

As representatives of financial users we argue for better regulation, not necessarily more regulation, to ensure financial markets work for EU citizens. We have identified four key areas in which the approach to regulation followed by policymakers and regulators needs to be improved:

- **The 'silo' approach to regulation:** over time, financial regulation in key markets has tended to develop in silos with separate legislation and regulation for specific products and activities even though these products and activities may perform the same core function. The investment and related sectors is a good example of this with directives on MiFID, IMD, PRIIPS, AIFMD and so on. This has resulted in unnecessary complexity, overlaps and underlaps in consumer protection, and higher regulatory costs than necessary. In our view, this silo approach emerged because legislation and regulation has been designed to reflect the different legal and corporate needs of the financial services industry not to meet the needs of financial users and as a reaction to the numerous financial scandals and serious misconduct in the markets.
- **Regulatory philosophy:** in our paper New Model Financial Regulation, we argue that the dominant 'permissive' approach to regulation has not been effective in key sectors and should be replaced with a more precautionary, pre-emptive, interventionist approach to

regulation. Policymakers need to rethink competition. Financial users are not short of choice. But just because there are numerous providers and products in the market doesn't mean the market is working for financial users – indeed as we see from key sectors such as investment management product proliferation can be as damaging as too few choices (see Promoting real competition and true innovation). What matters is whether the market is producing the right outcomes.

- **Better monitoring and enforcement to make the single market work:** FSUG fully supports the development of the single market. A functioning, safe, efficient single market should bring significant benefits for EU citizens. However, as our Risk Outlook and reports of our visits to various Member States show, we are very concerned that in many cases poor value products and bad practices, not best value and good practices, are being exported to Member States. More generally, there are clear variations in the monitoring and enforcement of EU legislation in Member States which is limiting the potential value of the Single Market. Furthermore, we are not seeing the expected benefits provided by economies of scale in key sectors. In addition to improving the development of new legislation and regulation, better monitoring and enforcement should be a priority.
- **Tackling the redress deficit:** if the regulatory system is to be effective, regulation should protect financial users without stifling genuine financial innovation and real competition (ex-ante) *and* ensure financial users obtain appropriate redress and wrongdoers held to account in the event of regulatory breaches (ex-post). Certain Member States have been very efficient at ensuring individuals can obtain redress and implementing large scale redress programmes in the event of major misselling scandals. However, as our Risk Outlook and reports of our visits to various Member States show, this is certainly not the case in many other Member States. As a result, consumer detriment remains unresolved and a significant redress deficit exists.

## **Impact of data and technology on financial users**

Information plays a central role in all sectors of a modern economy. But it is particularly important in the financial services industry – at its core it is an information business. Information, if used properly, can lead to more efficient, well-functioning, safer and more resilient, flexible and responsive markets that meet consumers' needs and preferences.

But, information is power and power can be abused. If financial and personal information is not used within a proper social justice, regulatory and corporate governance framework, it can result in dysfunctional markets, market abuse, and serious consumer detriment including financial exclusion, price and service discrimination (red-lining) and abuse of fundamental rights.

Moreover, innovation in payment systems and financial services raise serious concerns regarding security for financial users (hacking, identify or data theft) and the faster obsolescence of legislation meant to protect consumers. The lack of alternative payment systems can prevent access to some goods and services to consumers who are not digital literate or cannot afford the necessary IT equipment.

There has been much hype about so called ‘big data’. But the value to financial institutions remains to be seen and we have yet to establish how much it will actually be used by financial services for retail financial services. Nevertheless, there have been rapid developments in information science, technological innovation and an increase in the sheer volume of data and information being accumulated in the hands of powerful financial institutions and associated services providers such as credit reference agencies.

This provides mainstream financial services institutions - who are seeing business models squeezed in a low return environment - with the imperative to undertake more granular segmentation to target better-off households and opportunity to ‘discriminate’ against financially vulnerable or lower income households and older people (age limits used as proxy in access to financial services and lack of accessibility of many new and cheaper IT tools used by providers to offer financial services).

Therefore, policymakers and civil society groups need to develop policies on the ownership and use of information as well as following closely technological developments, identify risks and assess whether new policies are needed to address them.

Tougher policies and controls are needed to address the following key issues:

- the impact on access to financial services; opportunities for further price discrimination;
- personal financial data as gateway for other services (e.g. rentals, telecoms, utilities, employment) and, vice-versa, data from other sources used in financial markets;
- the risks of red-lining;
- the risk of economic and social sorting;
- ownership, transparency, and rights of access to personal data;
- the ambit of application and dissemination of data;
- making sure that personal and financial information is stored safely and responsibly;
- security and safety of wireless and mobile payments;
- virtual currencies and online payments;
- new financial products relying on technology and their impact on financial users (eg. SMS loans); and
- legal obligations, consumer rights and consumer consent in a digital environment,.

FSUG is still developing its position and detailed policies on data and technology (in particular the use of credit scoring data).

### **Financial networks, system resilience and cybercrime**

While not an obvious priority for representatives of financial users, the security and resilience of our financial systems is critical. Unless the infrastructure and networks that underpin the banking and financial system are secure and resilient, the financial services industry cannot meet the important consumer outcomes – access, value for money, quality, efficiency etc.

This is increasingly important given the migration from ‘physical’ delivery of services to virtual platforms. Systems and networks are increasingly interconnected. The growth in corporate cybercrime and attacks on financial networks and systems is very worrying. Moreover, as we explain elsewhere, business models are under pressure from the new economic reality. There will be a

temptation for financial institutions to reduce spending on business activities which do not contribute to revenues and profits. This should be a higher priority in 2015.

However, as we explain above, individual consumers are increasingly at risk to cybercrime and fraud. For example, recent research quoted in the Economist suggests that half of Britons have experienced crime on-line. This type of crime appears to be seriously under-reported too<sup>1</sup>.

If these estimates are robust, then this represents a huge level of consumer detriment. Under-reporting makes it difficult to ensure this is given due priority and for the relevant authorities to allocate sufficient resources to tackle the problem and prevent it growing even further. The EU is becoming particularly vulnerable given the interconnectivity of our financial networks and the penetration of technology and on-line shopping and banking.

### **Tackling financial exclusion, under-provision and discrimination**

Millions of EU citizens already face a major problem with financial exclusion, under-provision, and adverse selection. But, major socio-economic, demographic, commercial, regulatory and technological trends present new threats. Low economic growth/ stagnation, low financial returns, squeezed household incomes, and dealing with the legacy of household debt may become the 'new normal' for the EU economy. Add to this the embedded inefficiencies in large parts of the financial sector, increased use of sophisticated data and technological driven customer segmentation, and tougher prudential regulatory requirements, we expect that growing numbers of citizens will no longer be commercially viable or attractive for mainstream financial services providers.

The result may be an increase in outright financial exclusion, discriminatory practices and/ or growing numbers of citizens being targeted by unscrupulous providers. Greater numbers of citizens will find it difficult to get access to suitable, fair, value for money products and services that meet their needs. Citizens will find it more difficult to build up financial resilience and financial security in the form of savings and insurance.

A range of policy measures should be considered to minimise the impact on vulnerable groups:

- Primarily, adopting a social justice approach/ mandated provision (eg. legal right of access to basic bank accounts)
- Otherwise, supporting alternative provision of products and services as Services of General Economic Interest ensuring cohesion and universal access
- Interventions to improve efficiency of mainstream financial services providers, to promote real competition and socially useful innovation.
- Much tougher consumer protection measures to protect citizens on the margins from unscrupulous providers.
- Interventions to promote savings, notably but not just, for vulnerable or financially excluded consumers, as a tool to deal with unexpected financial expenses and prevent over-indebtedness.
- Assess existing prudential regulations for impact on access and inclusion.

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<sup>1</sup> Thieves in the night, Economist, 20<sup>th</sup> December 2014

## Promoting real competition and true innovation

The EU needs financial services that are competitive and innovative from the perspective of financial users and the real economy. FSUG has identified a range of markets which are not providing good value or truly innovative products and services. The key markets include: the asset management industry; linked to this, the pension fund industry (both accumulation and decumulation products); unit linked insurance products; critically important intermediaries who have significant influence in the asset management, insurance and pension fund supply chains; savings products; lending markets – including to SMEs; and key banking activities.

Clearly, given the specific characteristics inherent in these markets, some tailored interventions may be needed to ensure markets work. But a general theme also emerges – the failure of competition to deliver in so many financial sectors. There is fierce competitive activity and constant product development. But choice and competition *per se* are meaningless concepts. What matters is competition that works in the interest of financial users and innovation that is socially useful<sup>2</sup>.

Improving the efficiency and innovation levels in financial services requires concerted interventions including:

- Structural reform of markets including distribution channels/ supply chain
- Actively promoting alternative providers/ new entrants
- Interventions to tackle conflicts of interest, especially in the supply chain
- Increased use of product governance powers to shape markets and influence product design
- Tough fiduciary duty obligations

More generally, the current approach to competition – creating the conditions in the hope that market forces will deliver has not been very effective. Other approaches such as ‘bounded competition’ should be considered.

## Financial intermediation and the real economy

FSUG tends to focus on ‘retail’ financial services – that is financial services aimed at retail customers and investors and SMEs/ micro-enterprises. However, we are very aware that market failure in the wholesale and institutional markets can be transmitted along the supply chain to harm retail users and/ or restrict access to much needed products and services. Moreover, if the economic and financial needs of households and the real economy are to be met, then it is critical that the EU’s wholesale and institutional markets are efficient at financial intermediation.

Financial intermediation involves intermediating savings/ deposits to provide access to credit (short/ long term, secured/ unsecured) for consumers, industry, and government (the bond markets) and allocation of capital to the economy through the asset management industry. In other words, financial intermediation is all about getting capital from where it is, to where it is needed. But this must be done in the most economically and socially useful way. Inefficient financial intermediation

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<sup>2</sup> We use six tests to judge whether a financial innovation is socially useful (or competition is working well to produce markets that work in the interests of financial users). The tests are – does competition and innovation: i. reduce costs/ enhance value for consumers; ii. make markets safer/ reduce risk/ help manage risk better; iii. improve access for consumers; iv. result in consumers making better choices and decisions; v. meet a hitherto unmet need for consumers; vi. result in more efficient allocation of resources within the financial system? Much of the ‘innovation’ and product development we have seen in financial markets over the past decades would not pass those tests.

leads to capital being misdirected to less productive economic activities or increased funding or borrowing costs for the economy and households.

There are concerns that the system of financial intermediation is still not allocating resources to economically useful, real economy activities. The dominance of the big players in the wholesale and institutional markets can stifle the emergence of innovative, alternative financial models to meet the long term financing needs of business. Value extraction and short termism in the asset management services not only damages financial welfare of investors and pension funds but also the firms in which capital is invested.

Financial market reform has so far understandably focused on financial stability, prudential regulation, and conduct of business issues. We hope this year the focus now turns to:

- making sure that the wholesale and institutional markets perform this critical financial intermediation function more efficiently in the interests of the real economy and financial users; and
- promoting innovative, more efficient, safe and resilient forms of financial intermediation.

With this in mind, we are very supportive of the Commission's major new initiative on the Capital Markets Union and look forward to working with Commission staff.

### **Reforming the asset management/ pensions industry**

As the recent FSUG report shows<sup>3</sup>, the asset management is not doing its basic job well – that is, providing decent risk adjusted returns at a reasonable cost.

The welfare loss to investors is huge. The FSUG report shows that underperformance of EU equity funds resulted in a welfare loss of Euro 277bn over 10 years. Active fund managers underperformed their benchmarks in 9 out of the 15 countries we analysed. The investment fund sector is one of the consistently worst performing consumer sectors in terms of customer satisfaction, confidence and trust<sup>4</sup>.

But the asset management/ private pension fund sector is expected to play an even greater role in consumers' lives due to pension reforms and transfer of risk from the state/ employers to individual savers. We do not think this is a very sensible move on the part of policymakers given the current state of asset management/ pensions industry.

Major structural reform is needed before it can be trusted with a greater role especially dealing with the damaging conflicts of interest in the supply chain, high costs and huge oversupply of providers and proliferation of investment products. We need better transparency on costs and charges at all points in the value chain, and a governance structure which eliminates or reduces conflicts of interest. MiFiD is only part of the solution, and does not of course cover pensions

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<sup>3</sup> See [http://ec.europa.eu/finance/finservices-retail/docs/fsug/papers/1411-asset-management\\_en.pdf](http://ec.europa.eu/finance/finservices-retail/docs/fsug/papers/1411-asset-management_en.pdf)

<sup>4</sup> See [http://ec.europa.eu/consumers/consumer\\_evidence/consumer\\_scoreboards/10\\_edition/index\\_en.htm](http://ec.europa.eu/consumers/consumer_evidence/consumer_scoreboards/10_edition/index_en.htm)

## **Pensions decumulation**

In the pensions field, policymaking at EU and national level has so far generally focused on the accumulation phase (see Asset Management above). However, more attention should now be paid to the 'decumulation' phase – that is, when citizens need to convert assets accumulated into a retirement income.

Improvements in longevity mean that the length of time citizens can expect to spend in retirement has significantly improved with the result that the income generated in retirement has to last longer. But FSUG has a range of concerns about the decumulation options and financial advice available to citizens who face very difficult decisions on how to generate an adequate retirement income.

The key concerns relate to:

- The lack of transparency, suitability, and value for money of existing conventional annuities products. Depending on the pension infrastructure, national annuities market performance and social protection system cover of health and long-term care needs, annuities are not necessarily the best option for everyone.
- Conversely, changing the basis on which annuities are structured (for example, by requiring more flexibility or switching) threatens to undermine the collective risk sharing principle and ultimately the long term viability of annuities.
- The sustained period of low government bond rates reduces the ability of decumulation products to produce a decent income in retirement – unless, that is, citizens are exposed to greater market risk in retirement. The ECJ decision prohibiting insurers taking gender into account when setting premiums also needs to be taken into account.
- While annuity products have been criticized, substitute or replacement strategies (asset management based products, income drawdown products, home equity schemes, property investments etc.) also involve considerable risks for retirees tied to low transparency, lack of independent advice on individualized mix of products in retirement, blurred fee structures, potentially higher advice and product costs, and outcome certainty.
- General concerns about the availability and quality of financial advice – at the point of retirement and ongoing advice.
- Many consumers exhibit low levels of financial capability even when dealing with comparatively straightforward annuity products. They may find it even more difficult to deal with more complex substitute products/ replacement strategies. The low levels of capability are not surprising given there is no opportunity to 'learn by doing'; consumers need to make complex decisions about products they have never used before.

## **Better representation and accountability**

Ensuring the interests of financial users are properly represented in the EU policy and decision making process has been a priority for FSUG (and its predecessor, FINUSE) for some time now.

It is perhaps not surprising that civil society has such little influence. The financial services lobby is very well resourced and influential. The extent of the mismatch between industry and civil society resources at EU level can be seen in the report *The Firepower of The Financial Lobby*<sup>5</sup>.

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<sup>5</sup> The Fire Power of the Financial Lobby: A survey of the size of the financial lobby at EU level, Published by Corporate Europe Observatory (CEO), The Austrian Federal Chamber of Labour (Arbeiterkammer) and The Austrian Trade Union

Some of the key findings are:

- 700 organisations represent financial interests at EU level (this includes financial institutions, consultants, public affairs/ PR agencies, and lawyers) compared to a total of 150 civil society organisations (NGOs, trade unions, consumer organisations)<sup>6</sup>. Indeed the number for civil society may overstate the influence of civil society as they may only have one staff member working on financial services (in many cases staff members cover a number of issues such as FS, transport etc).
- Post financial crisis, the industry had 2,100 encounters with EU policymakers, decision makers and regulators – seven times the number civil society had.
- Industry lobbies spend Euro 120m a year influencing financial services policy compared to civil society spend of Euro 4m – a ratio of 30:1.

The industry also dominates when it comes to the critical policy and technical advice stages of policymaking<sup>7</sup>. For example, of the 17 expert advisory groups which provide advice to the Commission, 70% had direct links with the industry, around 10% were from civil society organisations (just 0.8% were from NGOs and 0.5% from trades unions) with the balance made up from academics and national agencies. A similar picture can be found with the stakeholder advisory groups that provide advice to the European Central Bank (ECB) and European Supervisory Authorities (ESAs)<sup>8</sup> which make the detailed policy and rules. 74% of the members of the stakeholder groups were industry representatives.

Even looking at a small sample of responses to consultations demonstrates the imbalance in resources available to the industry and civil society to influence policy development.

**Table 1: under-representation of civil society in consultation process, 2012-14**

Consultation Description	Number of responses
ESMA MiFID	165 industry, 10 civil society (EU wide)
ESMA Remuneration Policies and Practices	32 industry, 2 civil society
ESMA Short selling	37 industry, 0 civil society
ESMA Credit rating agencies	7 industry, 0 civil society

We appreciate that improvements have been made – not least through the enhanced role for the FSUG. However, there is clearly much to be done and we urge the Commission to renew its efforts to improve user representation and accountability (including resources available) to counter the influence of powerful industry lobbies.

<sup>6</sup> Note representation can take a number of forms such as direct lobbying, responding to consultations, producing research aimed at EU policymakers, participating in expert or stakeholder groups – it does not necessarily mean the organisation has a permanent base in Brussels

<sup>7</sup> The report may overstate user representation – for example, it states that FSUG is composed of 11% industry representatives.

<sup>8</sup> European Banking Authority (EBA);