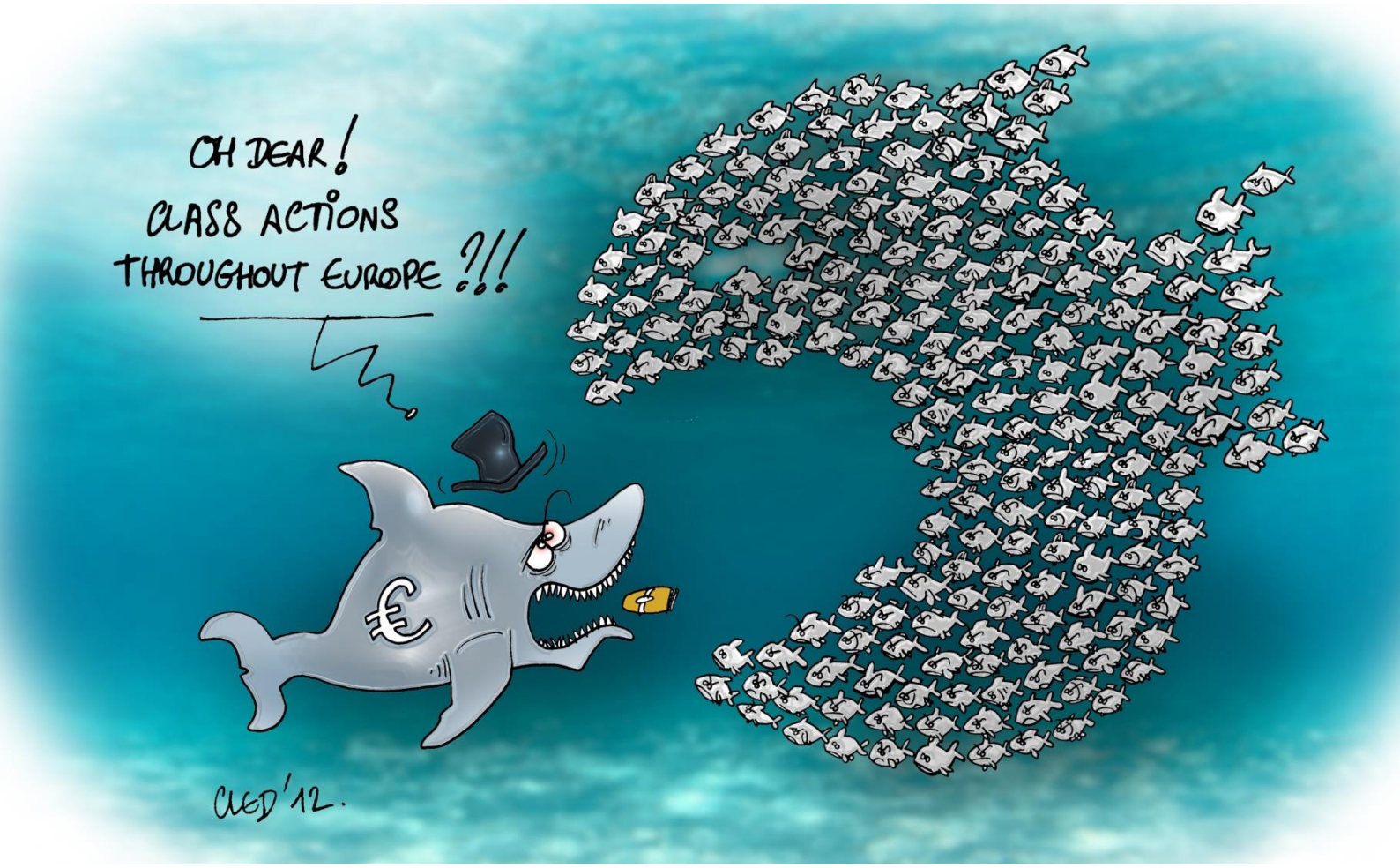
BETTER FINANCE

The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

A major enforcement issue: the mis-selling of financial products



Briefing Paper – April 2017

Better Finance, the European Federation of Investors and Financial Services Users, is the public interest non-governmental organisation solely dedicated to the protection of European citizens as financial services users at European level.

Our Federation acts as an independent financial expertise and advocacy centre to the direct benefit of European financial services users, promoting research, information and training on investments, savings and personal finances. Since the Better Finance constituency is made of the organisations representing individual and small shareholders, fund and retail investors, savers, pension fund participants, life insurance policy holders, borrowers, and other financial services users, it has the interests of all European citizens at heart.

Background

"Retail" financial services are still ranked as the worst consumer markets in the entire European Union according to the European Commission's Consumer Scoreboard[1]. Better Finance believes that financial markets should serve the interest of end-users and welcomes the European Authorities' efforts to curb the mis-selling of financial products:

- Recently the ECON Committee of the European Parliament has decided to work on the mis-selling of financial products,
- and the European Commission launched a public consultation on the operations of the European Supervisory Authorities ("ESAs") and on how to improve their work[2].

This paper tries to assess the regulatory and, more importantly, the supervisory (public enforcement) developments regarding the actual protection of savers, individual investors and mortgage borrowers since the 2008 financial crisis, in particular regarding the mis-selling of savings, investment and mortgage products.

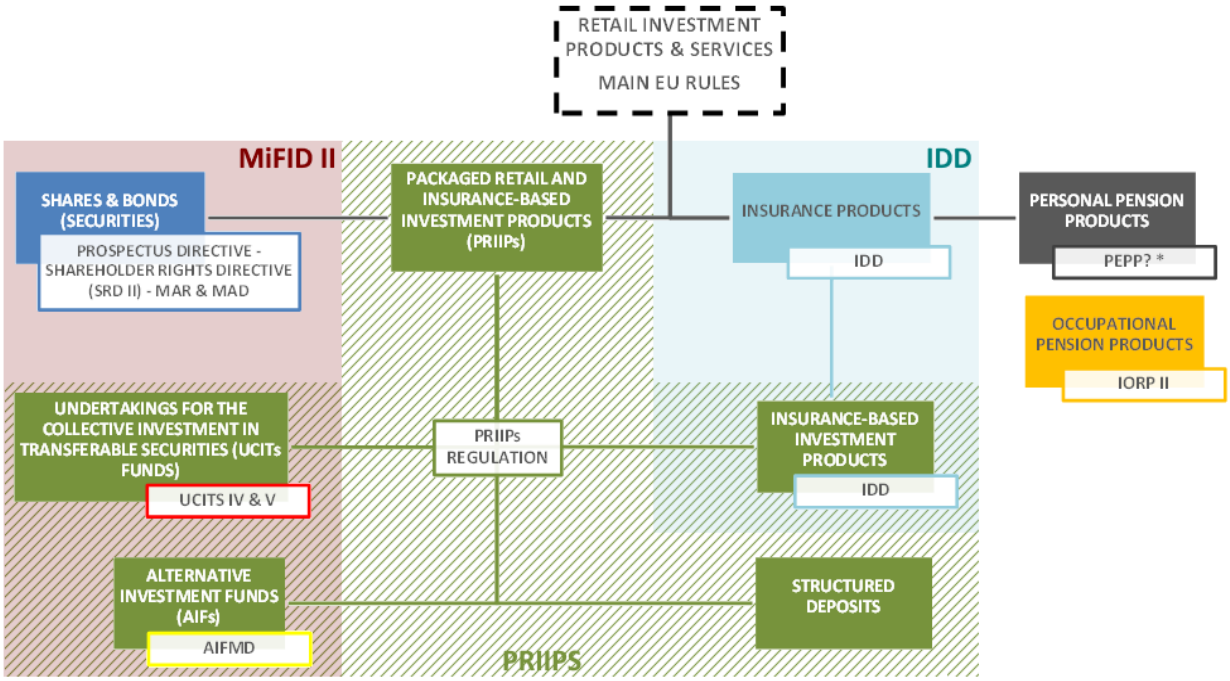
The first section describes the current EU Law landscape with regards to the conduct of business. The second section highlights the key provisions on information and on prevention of conflicts of interest. Moving on from there the paper identifies selected actual cases of tentative private enforcement against mis-selling of financial products. The fourth section looks into how public enforcement and supervision address these issues; and finally, Better Finance makes proposals on how to improve the enforcement of conduct of financial business rules.

[1] EC Consumer Scoreboard 2016, page 18: "The bottom three services markets are those related to 'real-estate services', 'mortgages' and 'investment products, private pensions and securities', as was already the case in 2013.

[2] Public consultation on the operations of the European Supervisory Authorities: https://ec.europa.eu/eusurvey/runner/esas-operations-2017

1. An extended package of EU Law on financial conduct of business

The 2008 financial crisis led European policy makers to issue a large package of new financial rules (directives and regulations), many of them addressing conduct of business and investor protection. These EU "level I" rules have now entered into force or are about to, in particular:



1.1. Rules applying to equity, bonds and investment funds

- <u>All "financial instruments"</u>: MiFID I and II:
  - The Markets in Financial Instruments Directive I (MiFID I) entered into force on 1/11/2007[3].
  - The Directive on Markets in Financial Instruments MiFID II will apply from 03/01/2018 (extended from 3rd January 2017)
- <u>Shareholders rights</u>: SRD 2 (amending Directive 2007/36/EC regarding the encouragement of long-term shareholder engagement):
  - The Council formally adopted the new directive on 03/04/2017.

[3] Directive 2004/39/EC of the European Parliament and the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32004L0039&from=EN

  - It will be published in the EU's Official Journal and will enter into force 20 days after. Member States will have 24 months after the entry into force to transpose the new directive into national law (03/04/2019).

- Equity and bonds issues: Regulation on the prospectus to be published when securities are offered to the public or admitted to trading (2015/0268(COD)
  - The text was agreed on 25/01/2017 by the ECON Committee;
  - It has now to be formally accepted by the Council.
- Capital Market abuse:
  - The Market Abuse Regulation[4] applies since 3/07/2016.
  - Sanctions on criminal acts related to market abuses: the Market Abuse Directive[5] entered into force on 3/07/2014.
- Investment funds: AIFMD, UCITS IV and V directives on investment funds and the UCITS funds KIID (Key Investor Information Documents) Regulation:
  - The Directive that defines the role of managers for Alternative Investment Funds, AIFMD[6], applies since 22/07/2013.
  - UCITS IV and V directives and implementing regulation on investment funds:
    - The UCITS IV Directive[7] applies since 30/06/2011.
    - The Regulation on the Key Investor Information Document (KIID) for UCITS funds[8] applies since 01/07/2011.
    - The UCITS V Directive[9] entered into force on 18/03/2016.

[4] Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0596&from=EN

[5] Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive): http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0057&from=en

[6] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010: http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:174:0001:0073:EN:PDF

[7] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast): http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:0032:0096:en:PDF

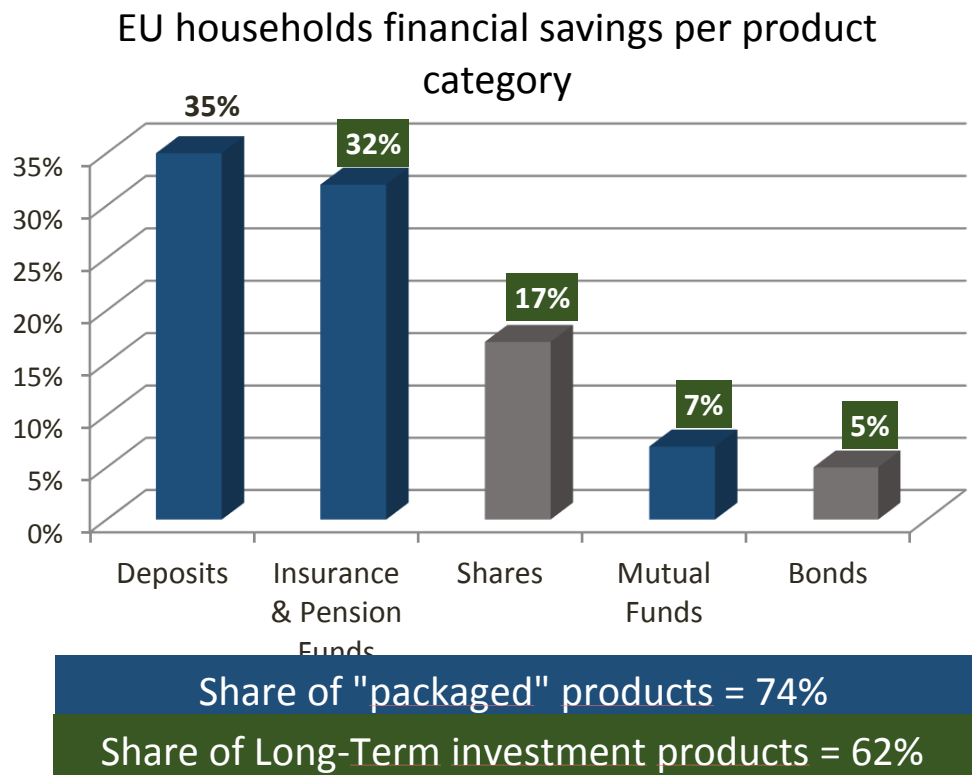
[8] Commission Regulation (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper or by means of a website: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:176:0001:0015:en:PDF

[9] Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0091&from=EN

1.2. Rules applying to other savings products

More than 75% of retail financial savings are excluded from MiFID provisions and they are covered by other EU rules that are different from MiFID and, more often than not, less protective, such as IDD, IORP, etc.

Figure 1: Retail Financial Services - Savings



Source: Better Finance's Pension Savings report 2016 edition

- Bank Savings: regulation on the requirements for a prudential banking system- CRD IV (26th June 2013):
  - The Regulation[10] with regard to regulatory technical standards for own fund requirements for institutions: entered into force on the 28/06/2013 and it applies since 1/01/2014.
  - The Directive on the requirements for a prudential banking system[11]: entered into force on 17/07/2013 and applies since 31/12/2013:

[10] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0575&from=EN

[11] Directive 2013/36/EU of the European Parliament and the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:176:0338:0436:En:PDF

→ Title III: "*Requirements for access to the activity of credit institutions*"

- Life insurance: the Insurance Mediation Directive (IMD, 2002) will be replaced by the Directive on the distribution of Insurance Products[12], "IDD". The Directive will have to be transposed by 23/02/2018.
- Occupational pensions: IORP II, Directive on occupational retirement provision's activities and supervision[13]. The new rules entered into force on 12 January 2017 and Member States will have 24 months after the entry into force to transpose the new directive into their national law (in other words by 13/01/2019).
- "Packaged retail investments" (in particular investment funds and life insurance): the PRIIPs Regulation on the Key Information Document (KID) will apply by 1/1/2018 (extended by 1 year after decision from the EC)[14]. It will replace the KIID Regulation for UCITS funds.
    - Commission Delegated Regulation of 8 March 2017 supplementing the Regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs)[15].
- Mortgages: Directive on Mortgage Credit[16]. It applies since 21/03/2016.

In all, the most important post-crisis EU investor protection rules are yet to be implemented almost ten years after the crisis (MiFID II, SRD II, Prospectus, IDD, IORP II, PRIIPs), and one of the key improvements in terms of investor information (the 2010 "KIID" Regulation for funds) will be dismantled by 1/1/2018. Clearly, the post 2008 crisis EU regulatory priority has been on prudential issues, not on user-protection.

[12] Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast): http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L0097&from=en

[13] Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (recast): http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L2341&from=EN

[14] Regulation (EU) No 1286/2014 of the European Parliament ad of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs): http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R1286&from=EN

[15] Commission Delegated Regulation (EU) 2017/653 of 8th March 2017 supplementing Regulation (EU) 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (PRIIPs): http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0653&from=EN

[16] 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: http://eur-lex.europa.eu/legalcontent/EN/TXT/PDF/?uri=CELEX:32014L0017&from=en

2. Key provisions on information and on prevention of conflicts of interest: Are they consistent?

Better Finance's experience shows that there is ample room for significant improvements in the enforcement and supervision of EU rules, since several key EU regulatory provisions regarding retail investor, saver and mortgage borrower protection are in our view not adequately enforced. This situation is especially worrisome in the case of the key EU provisions related to information disclosure and the prevention of conflicts of interest in the distribution ("inducements") of retail financial services.[17]

2.1. Information and inducements in MiFID I and II

In 2014 the co-legislators adopted MiFID II, which will become applicable on the 3rd of January 2018[18]. One of the objectives of this new regulation is to improve consumer protection in general and, more particularly, to strengthen the risk disclosure and information duties on the investment firm's side.

On 25 April 2016, as part of level-2 measures provided for MiFID II / MiFIR, the Commission adopted the Delegated Regulation regarding organisational requirements and operating conditions for investment firms, very relevant in light of this paper, and adding somewhat to MiFID I, as the "*regulation clarifies that such information would also include an explanation of the risks arising from insolvency of the issuer and related events, such as bail in*"[19].

- Fair, clear and not misleading information:

Article 27.2 of the MiFID I implementation directive[20] sets out requirements for marketing communications with respect to the obligation in Article 19(2) of the MiFID I Directive that information addressed to clients, including marketing communications, should be fair, clear and not misleading:

"The information referred to in paragraph 1 shall include the name of the investment firm.

It shall be accurate and in particular shall not emphasise any potential benefits of an investment service or financial instrument without also giving a fair and prominent indication of any relevant risks.

[17] For further information on this section please read Annex 1.

[18] MiFID II / MiFIR will replace MiFID I on the same date.

[19] Commission Delegated Regulation (EU) of 25/04/2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive: https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2398-EN-F1-1.PDF

[20] Official Journal of the European Union (L 241/26) of 2.9.2006 on implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:241:0026:0058:EN:PDF

It shall be sufficient for, and presented in a way that is likely to be understood by, the average member of the group to whom it is directed, or by whom it is likely to be received.

It shall not disguise, diminish or obscure important items, statements or warnings."

MiFID II (articles 24, 44.2(b) and (d), 44.5(a), and 44.6 (a) and (e)) did not change these information rules.

- Conflicts of interest:

As expressed in recital 39 of the MiFID I implementing Directive 2006/73/EC of 10 August 2006, "*for the purposes of the provisions of this Directive concerning inducements, the receipt by an investment firm of a commission in connection with investment advice or general recommendations, in circumstances where the advice or recommendations are not biased as a result of the receipt of commission, should be considered as designed to enhance the quality of the investment advice to the client*".

MiFID II reinforces rules to prevent conflicts of interest in the distribution of securities and investment funds by distinguishing "independent" advice from "non-independent advice". "Inducements" such as commissions paid by the provider to the distributor will be forbidden for independent advice[21]. This does not apply to non-independent advice.[22]

Information requirements and the rules on prevention of conflicts of interests in the distribution of insurance and occupational pension products are, in our view, less protective of financial users, even in the new IDD and IORP 2 legislations.

2.2. Information and inducements in Life Insurance

- Directive on Insurance Distribution (IDD)[23]:
  - Article 17 "General Principle"
  - Article 19 "Conflicts of interest and transparency"
  - Article 20 "Advice, and standards for sales where no advice is given"
  - Article 27 "Prevention of conflicts of interest
  - Article 28 "Conflicts of interest"
- Directive on the activities and supervision of institutions for occupational retirement provision (IORP I)[24]:
  - Article 11 "Information to be given to the members and beneficiaries"
  - Article 13 "Information to be provided to the competent authorities"
  - Article 18 "Investment rules"

[21] Relevant Articles in MiFID II: Recital 56, Article 23 (1) and (2)
[22] Relevant Articles in MiFID II: Recital 56, Article 24, 4(a) and 7(a) and (b)
[23] For further information please read Annex 1.
[24] Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32003L0041&from=EN

- Directive (EU) 2016/2341 on the activities and supervision of institutions for occupational retirement provision (IORP II, 14/12/2016):
    - Article 8 "Legal separation between sponsoring undertakings and IORPs"

Article 19 "Investment rules"
    - Article 36 "Principles"
    - Article 37 "General information on the pension scheme"
    - Article 38 "General provisions"
    - Article 41 "Information to be given to prospective members"
    - Article 45 "Main objective of prudential supervision"

2.3. Inconsistencies in the EU investor protection rules

- MiFID II vs IDD

MiFID II covers "financial instruments" (securities and funds) whereas IDD rules cover insurance products. However, there are some inconsistencies between MiFID II and IDD.

Regarding the provisions of information, both documents state that all product information provided should be "fair, clear and not misleading". However, the IDD delegated acts have not been finalised yet, and it remains to be seen how consistent they will be with the MIFID II delegated acts.

But, on the conflicts of interests and inducements, while MiFID II requires investment firms "to identify and to prevent or manage conflicts of interest", IDD puts the responsibility with intermediaries and insurance providers who should "take all appropriate steps to identify conflicts of interest", and when these are identified, to take "reasonable steps designed to prevent conflicts of interest". Obviously the requirements in IDD are weaker.

- MiFID II vs PRIIPs

Better Finance finds inconsistencies between EU rules applying to different products (i.e. investment funds on the one hand, and insurance-based investment products on the other), but also to those applying to the same products, in particular for investment funds between MiFID 2 and PRIIPs.

Whilst calling for transparency on performance, the European Authorities ended up doing the exact opposite and severely reduced transparency on net performance and fees of long-term investment products by eliminating all requirements for disclosure of past or net performance.

The elimination of all information on past relative performance and on the product's benchmark in the PRIIPs KID, and their replacement by future absolute performance information violates the MiFID II information rules in at least two ways:

- On the one hand the performance scenarios to be used in the PRIIPs KID are based on historical data anyway, in clear violation of MiFID provisions[25] [26]

[25] MiFID II Delegated Regulation, Chapter II, Section 1, Article 44, 6a: "*Where the information contains information on future performance, investment firms shall ensure that the following conditions are satisfied:*

1. *the information is not based on or refer to simulated past performance*"

- On the other hand, eliminating prominent warnings that information based on past performance and information on future performance do not constitute reliable indicators of future performance, also violates MiFID II rules.[27]

The new rules further contradict MiFID II provisions at the detriment of investors as follows:

- Future performance scenarios based on past performance will be highly "misleading" for several other reasons[28], in particular:
  - Absolute performance without reference to a benchmark has little to no meaning and is misleading over the mid- to long-term as it is nominal (not real, i.e. after inflation).
  - The impact of charges on performance is only required to be disclosed for the "intermediate" scenario, which consequently could be interpreted falsely as being the most probable scenario.
  - Based on four future scenarios, the information on performance provided will not be clear and understandable to the majority of EU savers, violating the above-mentioned article 24 of the MiFID II Directive on clarity.[29]

The new rules also contradict the European Commission's CMU Action Plan which aims to improve the transparency of the performance of long-term savings products.

Surely these misalignments of the PRIIPs Regulation with MiFID II and UCITS significantly undermine investor protection.

[26] MiFID II Delegated Regulation, Chapter II, Section 1, Article 44, 5a: "*the simulated past performance is based on the actual past performance of one or more financial instruments or financial indices which are the same as, or substantially the same as, or underlie, the financial instrument concerned*"

[27] MiFID II Delegated Regulation, Chapter II, Section 1, Article 44, 6e: "*Where the information contains information on future performance, investment firms shall ensure that the following conditions are satisfied:*

2. *the information contains a prominent warning that such forecasts are not a reliable indicator of future performance."*

[28] MiFID II - Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments, Section 2, Article 24, 3: "*All information, including marketing communications, addressed by the investment firm to clients or potential clients shall be fair, clear and not misleading*."

[29] MiFID II Delegated Regulation, Chapter II, Section 1, Article 44, 2d: "*the information is sufficient for, and presented in a way that is likely to be understood by, the average member of the group to whom it is directed, or by whom it is likely to be received*"

3. Are they enforced? Selected cases of mis-selling

Better Finance found evidence of numerous mis-selling cases, most often arising from misleading information and/or conflicts of interests in the distribution.

3.1. Shares, preferred shares and bonds (in particular those issued and sold by banks):

CRD IV and Basel III regulations lead many banks to issue great amounts of new equity or equity-like instruments (such as preferred shares, subordinated bonds and CoCos[30]), including to the retail clients of those banks.

Selected cases:

- Natixis shares (France, 2006)[31]:

Natixis is a bank which includes two very large retail networks: the French savings banks, and the French cooperative banks ("banques populaires"). In 2006 Natixis sold new shares to about 1.5 million retail clients at €19,55. By March 2009, the share price was down to € 0.80. The first complaints were filed on 10 February 2009 for misleading information, incorrect financial statements and fictitious dividends.

Detriment remediation status: For the main complaint, the statutory auditors were heard by the judge for the first time in 2015! This very slow instruction is still going on. One client/shareholder won a case against its local cooperative bank in 2013 for mis-selling.

- Fortis shares (2007):

Fortis, one of the largest Belgian banks at the time, participated in a consortium of banks in acquiring ABM AMRO, which was at the time the largest-ever bank acquisition. The transaction put a strain on Fortis's balance sheet just as the financial crisis began to emerge.

When the bank started to face drastic liquidity problems in 2007, resulting in a precipitous drop of its stock price, the Belgian, Dutch and Luxembourg governments stepped in and partially nationalised Fortis in 2008. Dutch and Belgian shareholders' associations demanded a review of the takeover, considering that an unfair deal had been forced on shareholders.

On 10 January 2011 the "*Stichting Investor Claims Against Fortis*", a specially formed Foundation representing investors from across the world, brought a shareholder action against Fortis for defrauding investors in its acquisition of ABN AMRO. The Foundation alleged that Ageas, formerly known as Fortis, and its officers and directors, misled

[30] Contingent Convertibles (CoCos) are convertible notes which can be changed into equity, "contingent" on a specified event such as the stock price of the company exceeding a particular level for a certain period of time. Some CoCos are designed to convert into shares if a pre-set trigger is breached in order to provide a shock boost to capital levels and, more generally, reassure investors.

[31] Better Finance's response to ESMA's consultation on MiFID II / MiFIR: http://betterfinance.eu/fileadmin/user_upload/documents/Position_Papers/Financial_Markets_Infrastructure/en/PP-_Response_to_ESMA_Consultation_MiFID_II_22052014.pdf

investors about the bank's financial health from the fall of 2007 up to before the 2008 government bailout. (Other foundations were also organized: Stichting Fortis Effect and Dutch and Belgian shareholder groups VEB and Deminor.

Detriment remediation status: In March 2016, Fortis and several shareholder organizations reached a collective settlement providing €1.204 billion to harmed investors. The Fortis settlement represents the largest ever under Dutch collective settlement procedures. In May 2016 Ageas, Stichting Forsettlement and the above-mentioned claimants' organisations submitted a joint request to the Amsterdam Court of Appeal to declare the settlement agreement of 14 March 2016 binding in accordance with the Dutch Act on Collective Settlement of Mass Claims (WCAM). The Amsterdam Court of Appeal will make a decision regarding the request to declare the settlement binding on Friday 16 June 2017.

- Dexia shares (2007):

In September 2008, Dexia, a French-Belgian bank specialised in lending to local governments that ran into trouble with its U.S. bond insurance unit FSA, which was hit hard by the subprime housing crisis and suffered as a consequence of the collapse of U.S. investment bank Lehman Brothers.

Dexia was one of the largest Belgian banks. In 2008 the French and Belgian governments injected 6.4bn € to keep it afloat. In October 2011, the Belgian government decided to dismantle Dexia and changed its name to Belfius. The holding continued to generate significant losses and the Belgian and French governments had to inject another 5.5bn € in 2012.

Three bailouts later, Dexia shareholders had lost fortunes, but not all were affected in the same way. Those who bought their shares directly lost everything. Others, however, had invested in Dexia via Arco, the investment section of the Union of Christian Workers ACW, were covered by a measure taken by the Belgian government earlier that extended the state guarantee for bank savings to investments made via Arco.

Detriment remediation status: Lawyers representing ordinary shareholders, including several represented by Better Finance's Belgian Member Organisation VFB, described said protection as unfair and brought their case all the way to the European Court. At the end of 2016, the plan to compensate 800,000 members of the Arco co-operative for at least some of the money they lost in the collapse of Dexia bank was ruled to be illegal by the European Court of Justice in Luxembourg.

- Bankia preferred shares (Spain, 2009):

In July 2010, Bankia was created from the merger of seven Spanish saving banks. Some of these Saving Banks had sold preferred shares to retail investors with the claim that the shares generated a fixed but not guaranteed dividend. Even if the returns from these products were higher than the fixed income products, the returns clearly did not compensate for the risks involved. Subsequently, the value of the shares dropped from €2 to €0.01. As a consequence, retail investors suffered serious financial detriment. The fact that consumers were given insufficient information at the time of the subscription combined with the impossibility of withdrawing the invested money, lead to numerous protests and consumer claims. ADICAE (The Spanish Association for Retail

Investors and Financial Services Users), a Better Finance Member Organisation, informed consumers and gathered a 3,052 number of claims.

Detriment remediation status: In February 2017, the Constitutional Court of Spain established the nullity of the preferred shares but it rejected the idea of collective redress as an adequate solution to this issue. ADICAE is now offering the clients who suffered damages the possibility of filing damages individually.

- Slovenian banks' subordinated bonds (2013-2014)[32]:

The Bank of Slovenia decided to expropriate all holders of subordinated bonds and shares in the five biggest Slovenian banks (NLB, NKBM, Abanka, Probanka and Factor Banka), bailed-in to refinance these institutions. Subordinated bonds in a sixth bank (Banka Celje) were wiped out in December 2014. The bail-in rules oblige private shareholders and depositors to automatically bear losses equivalent to 8% of the bank's liabilities before any public intervention takes place.

In each case the bail-in consisted of a complete wipe-out of all subordinated bonds, including those sold to retail investors at the counters of said banks. Individual investors received no compensation and had no legal means to challenge the bail-in decisions.[33]

At the European level bail-ins are regulated by the Bank Recovery and Resolution Directive (BRRD), which was not due for transposition into national law until 2016. To justify the decision to expropriate subordinated bondholders, Slovenian authorities insisted instead on the binding nature of a 2013 Banking Communication by the European Commission.

Better Finance believes that this is an unfair approach which "*privatises the profits but socializes the losses*"[34], as it harms non insider investors and depositors instead of the persons responsible for bank failures, such as bank executives and supervisors.

Detriment remediation status: On 19 July 2016 the European Court of Justice ruled that the EC Banking Communication was not binding on member states but added that applying the bail-in rules as outlined in this communication does not violate the principle of protection of legitimate expectations, provided that the measures "*must not exceed what is necessary to overcome the capital short-fall of the bank concerned*"[35].

On 27 October 2016 the Slovenian Constitutional Court issued its final ruling on the Slovenian Banking Law as amended in November 2013 to allow for bail-in, whereby:

- the court declared this law violated the right of expropriated investors to effective judicial protection;

[32] Better Finance article: "*Slovenian Bail-In Highlights Perverse Facet of Banking Union*"
[33] See VZMD, the Pan-Slovenian Shareholders' Association, for more information: www.vzmd.is
[34] Better Finance article: "*Slovenian Bail-In Highlights Perverse Facet of Banking Union*"
[35] Judgment of the Court (Grand Chamber) of 19 July 2016 (request for a preliminary ruling from the Ustavno sodišče Republike Slovenije — Slovenia — Validity and interpretation of the Banking Communication from the Commission — Interpretation of Directives 2001/24/EC and 2012/30/EU — State aid to banks in the context of the financial crisis — Protection of the interests of shareholders and others

- the court ordered the National Assembly to remedy the established unconstitutionality by adopting new legislation ensuring efficient judicial protection for expropriated investors, including improved access to information;
- the court declared, following the earlier ECJ ruling, that the wipe-out does not violate the constitution, provided it "does not exceed what is necessary to overcome the capital short-fall of the bank concerned";
- the court stressed that whether the above condition was actually met will have to be determined for each individual bank by ordinary courts, where the expropriated holders should file actions for damages incurred.

  - Volkswagen (2015):

"*This is a case of deliberate and massive fraud*" (U.S. District Judge Sean Cox)

In September 2015, the US Environmental Protection Agency brought the fact to light that Volkswagen was committing fraud by making its cars look more environmentally-friendly during tests. The company publicly admitted the fraud and estimated that 11 million cars were involved in this huge case of falsified emissions reports.

Individual shareholders and retail investors were not informed in a timely manner and have suffered detriment following the scandal which they should be compensated for.

From the moment the scandal erupted, Better Finance has kept retail investors in Volkswagen informed and gathered investor claims in order to help them obtain redress for damages[36].

Detriment remediation status: The Company has openly admitted the fraud and has compensated car owners in the US. However it still refuses to discuss any compensation for the damage caused to Volkswagen investors and to car owners in the EU. The company should have disclosed this information at a far earlier stage[37].

Several legal proceedings are pending in Germany and all over the world, and Dutch Foundations such as the Volkswagen Investor Claim Foundation (which Better Finance supports) have attempted to obtain a settlement from the issuer, who has refused to discuss the matter so far.

  - Investment funds:

→**Closet Indexing**[38]: up to 15 % of equity UCITS funds are potentially falsely active (according to ESMA), but so far, to our knowledge, no action has been taken against any such fund except in Norway.

In addition Better Finance found that more than 40% of these suspicious funds identified by ESMA fail to report the past performance of their benchmark alongside the past performance of their funds in the Key Investor Information Document (KIID), even though ESMA had performed a review of the disclosure documents of these funds

[36] www.stichtingvolkswageninvestorsclaim.com

[37] Better Finance Press Release: "DIESELGATE: Update from Stichting Volkswagen Investors Claim"

[38] For more information please see:
- Press Release on our Closet Indexing Study
- Press Release on the www.checkyourfund.eu website launched by Better Finance

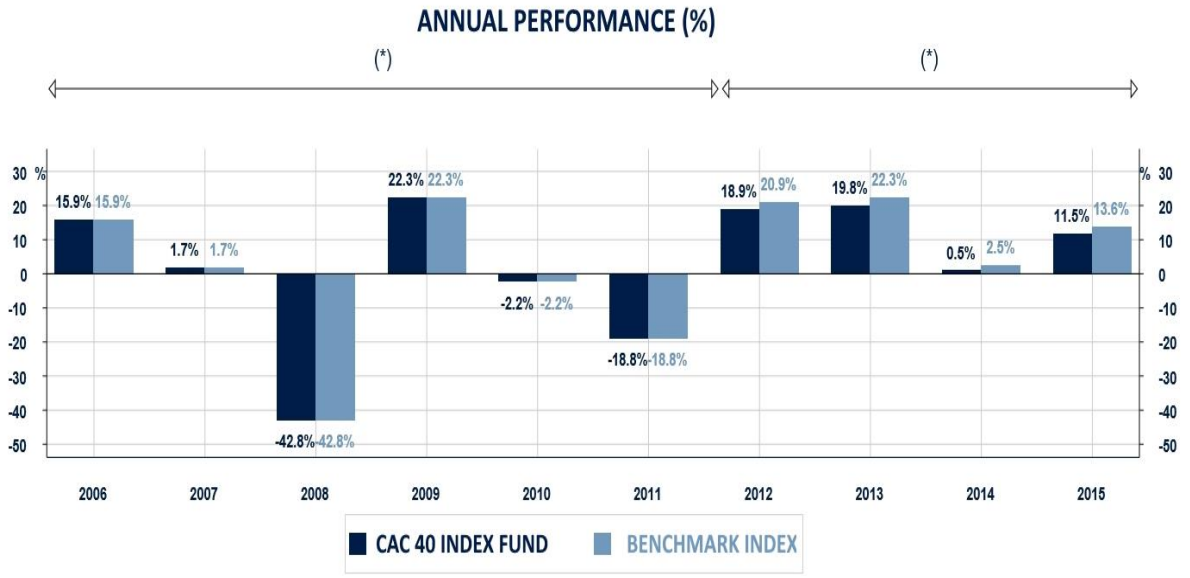
without identifying this gross violation of EU Law. This is an outright violation of articles 7.1 (d) and 18 of the UCITS funds KIID Regulation[39]. Worse, ESMA's recommendation to fund investors with regard to closet indexing was to mention that "*although past performance is not a reliable guide to future returns, there may also be value in assessing whether a fund has been able to achieve the objectives referred to in the fund documentation*". However, without the disclosure of the past performance of the benchmark alongside the past performance of the fund in the KIID it is impossible to follow this recommendation. And all the rules applying to past performance disclosures of the products and of their benchmarks will be eliminated next year when the PRIIPs Regulation replaces the exiting regulation of the UCITS funds' KIID.

Detriment remediation status: Better Finance has written to ESMA and to the European Commission. ESMA has responded that it will contact the national competent authorities. The Commission has not responded as of 24 April 2017. Better Finance is also currently contacting several NCAS to ask them to better enforce the KIID Regulation's provisions.

→ **Grossly misleading fund KIID and marketing information** (retail index fund case signalled by four complaints in five years to the competent NCA on the same product with very little correction, no remediation and no sanction to our knowledge)

The following fund claims to be an "index" fund with the stated objective of replicating the performance of the French blue chip equity index (CAC 40). In reality, after 10 years, its performance is eight times lower than that of the index (+5% versus + 41%).

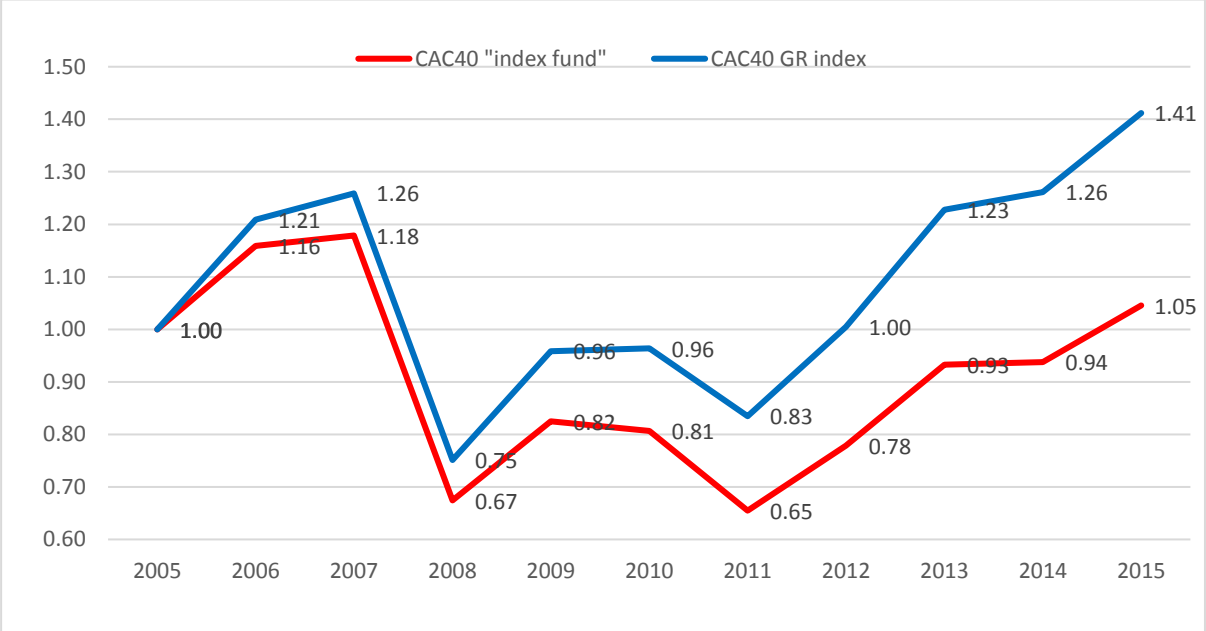
Figure X: Past performance disclosure in the KIID: CAC 40 "Index" fund and its benchmark



Source: fund KIID, 2016.

[39] Please see Annex 2 in our Press Release on our Closet Indexing Study

Figure Y: Same CAC 40 Index fund and its benchmark correct past performances in compounded returns



Source: Fund KIID, Euronext (index) © Better Finance, 2016.

- Grossly false marketing information and inconsistency with KIID: "*you benefit from ultra-low fees*" (in reality seven times higher than the equivalent index ETF fund: 1,71% versus 0,25%), and incorrect benchmark performance disclosure up to 2012.
- Widespread violations of MiFID provisions on "fair" and "not misleading information", especially the ones requiring that information be intelligible for the average target clients. As documented by the OECD, a large majority of EU citizens do not know how to compute simple compound interest or returns: disclosed returns should be compounded.
- Widespread violations of the MiFID provisions requiring to present the potential benefits in a balanced way but also "any relevant risks" related to the product (we have never actually seen any fund marketing document fulfilling this latter requirement) and the MiFID provisions against disguising and obscuring important items and warnings: no warnings on the very high level of fees, on the outright and repeated failure not to even get close to the stated investment objective since inception, the impossibility to achieve this also in the future due to the level of fees, and on the massive destruction of value (after inflation) over the years;
- Violations of the provisions on inducements of MiFID, especially those requiring the disclosure of the existence and of the amount of inducements: nowhere to be found on the online distributor's website.

Detriment remediation status: Despite repeated complaints to the NCA by Better Finance, these violations of MiFID and UCITS KIID rules continue largely unabated. The impact is very difficult to evaluate (if only because of the lack of disclosure of

compounded returns) and very costly to prove for fund investors. So far, none has complained, except for Better Finance.

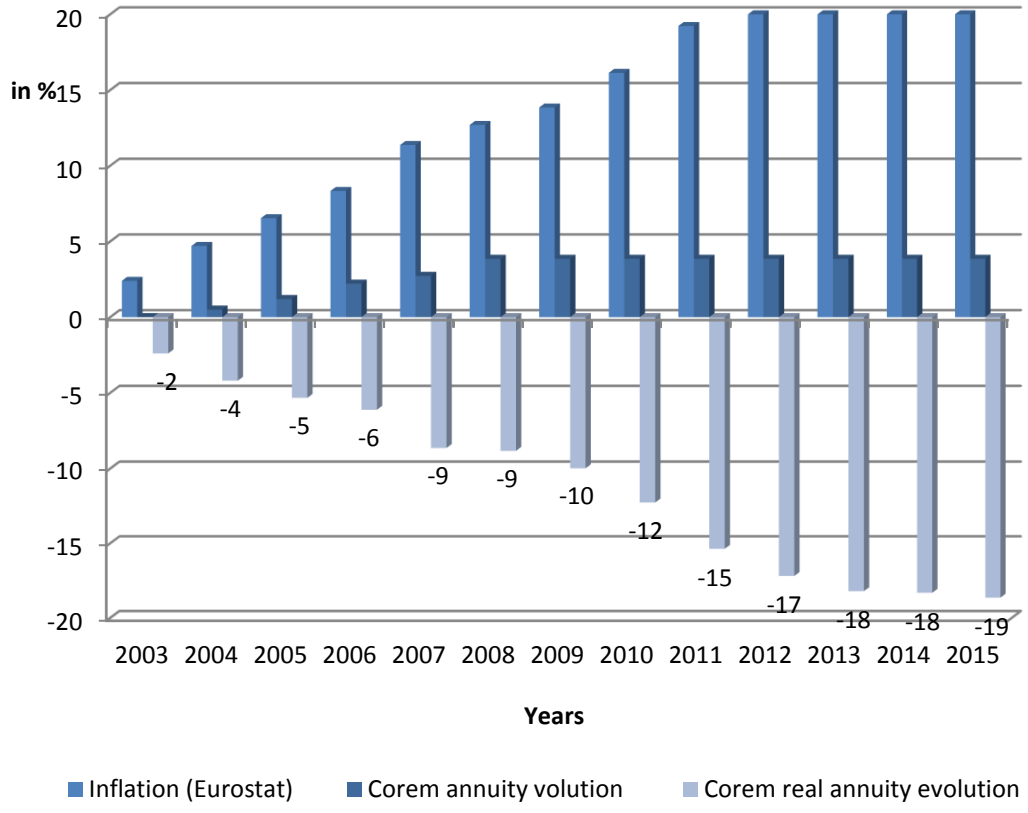
- Personal pensions:

→**COREM** (formerly "CREF", French insurance-regulated pension savings)[40]

450 000 pension savers were abused by this pension scheme, which – until 2002 - was illegally run mostly as a pay-as-you go scheme. Still today:

- No disclosure or very poor disclosure of the coverage ratio and of the reserve gaps (€ 2,9 billion at the end of 2014), no prominent warnings about these severe weaknesses, and, on the contrary, misleading advertisements about the solidity and performance of the pension product
- No disclosure of past evolution of annuities (see graph below) and no warnings on the repeated failure to match the cost of living evolution (resulting in very important losses for savers, often hidden by the complexity of the product and opacity of reporting)

Corem annuities real value, compounded evolution in %



Source: ARCAF 2016

[40] For more information: Better Finance research report on the real return on long-term and pension savings in Europe, 2016 Edition, pp. 166-167

Detriment remediation status: The Public Supervisor (the French State) has been convicted and ordered to indemnify 20 % of the prejudice to the plaintiffs but refuses to indemnify all the other victims, or even to inform them about their rights to damages. The Mutual running the scheme up to 2002 was also convicted and ordered to indemnify the pension savers, but then went into bankruptcy. Court cases are pending against the successor mutual. Several former executives have also been sentenced individually. But the unfair and misleading information (see above) remain published.

- Insurance-regulated occupational pension funds[41]: Belgian insurance-based corporate pension plan

- No disclosure of total costs and fees
- No warnings on the repeated failure to get any closer to the stated investment objectives (resulting in losses for savers, often hidden by the complexity of the product and opacity of reporting).

Real case of a Belgian occupational pension insurance	
2000-2016* performance vs. capital markets benchmark	
Capital markets (benchmark index) performance**	
Nominal performance	100%
Real performance (before tax)	44%
Pension insurance performance (same benchmark)**	
Nominal performance	33%
Real performance (before tax)	-4%

**To 30/06/2016*

*** 50 % Equity / 50 % bonds (MSCI World equity index and JPM Euro Govt Bond Index[42]) invested on 31/12/1999*

Sources: Better Finance, provider

Detriment remediation status: No complaint to our knowledge. This is once more a case for which it is extremely difficult for the individual saver to even realise the detriment incurred due to the lack of or unclear and misleading information provided.

- Life insurance:
  - No disclosure of total costs and fees (in particular in the case of unit-linked contracts)
  - Misleading promises like "treble your capital in 8 years"
  - Unit-linked (equity) contracts sold to very old people
  - No disclosure of past performances

Better Finance can provide more detailed evidence on these cases upon request.

[41] For more information: Better Finance research report on the real return on long-term and pension savings in Europe, 2016 Edition, pp. 77-78

[42] « Information has been obtained from sources believed to be reliable but J.P. Morgan does not warrant its completeness or accuracy. The Index is used with permission. The Index may not be copied, used, or distributed without J.P. Morgan's prior written approval. Copyright 2015, J.P. Morgan Chase & Co. All rights reserved. » (J.P. Morgan)

- Bank structured products:
  - Misleading promises like "double your capital in 8 years"
  - Not understandable return formulas

Better Finance can provide more detailed evidence on these cases upon request.

- Mortgage credit:

The problem of mortgage loans in Spain ("Clausulas Suelo") refers to the introduction of a minimum interest rate (a floor) in variable interest mortgage loans. This problem affected more than 1.4 million people just in Spain. Usually, this variable rate was linked to the EURIBOR, which is the rate of interest at which large European Banks lend each other Euros. However, this variable rate was subject to a frequently rather high lower limit (floor) so when the EURIBOR decreased significantly in recent years, the mortgage borrowers had to keep on paying a high minimum interest rate above the current market one.

In addition, clients were not well informed about the clause and its consequences. In most of the cases, the information that the client received was considered abusive and illegal. In this respect, ADICAE (see above: the Bankia case) sued more than a hundred banks (around 40 after the banking restructuring). The Supreme Court of Spain declared this floor clause null and abusive in May 2013. Three years later, on the 21st of December 2016, the European Court of Justice ruled, in an un appealable decision, against the limitation of the retroactivity of the nullity of the clause on the mortgage loans, so that banks and savings banks are obliged to return all the money illegally collected by the floor clauses since the signing of the mortgage for the acquisition of housing.

Detriment remediation status: Following the ECJ ruling on this matter, the Spanish government issued a Decree in order to facilitate the resolution of the procedures through Alternative Dispute Resolutions (ADR). ADICAE, which has been gathering consumers' complaints since the beginning, is now pressing for the Spanish government to create a monitoring commission in order to promote a more transparent process; and the banks to eliminate the floor clause (because some of them keep on applying it) and to return the "fair" amount to their clients.

- Foreign Exchange:

The Foreign Exchange (a.k.a. Forex, FX or Currency Market) is the market on which practically every nation's currencies are exchanged. It is by far the world's largest market, with a value of daily operations around five trillion US dollars (more than all other financial markets combined). It has grown so much in the past years that currently the total daily value of all operations in international trade of goods and services only represent a small percentage of the value of the Forex trades. As a result, this market is rather independent from real economy transactions.

Investigations of US and UK national financial supervisory authorities revealed that traders in London, Tokyo and New York manipulated exchange rates from 1 January 2003 to 1 December 2013. The banks involved in this Forex scandal are Bank of America, Barclays Bank, Citigroup, JP Morgan, Royal Bank of Scotland, UBS, Credit

Suisse and Goldman Sachs, BNP Paribas, Deutsche Bank, HSBC, Morgan Stanley, and The Bank of New York Mellon.

The most loss-making products which affected retail investors were the following:

- Forward Customized contracts between two parties to buy or sell an asset at a specified price on a future date;
- Spot Trading, meaning the purchase or sale of a foreign currency, financial instrument or commodity for immediate delivery;
- and Cross Border Financing, which refers to any financing arrangement that crosses national borders and includes cross border loans, letters of credit, bankers accept ancestor cross border leasing contracts.

The damages can aggregate to an amount of up to 0.5% of the transaction volume.

Detriment remediation status: from the outset Better Finance has been informing EU consumers about this case of mis-selling of financial products and supports the Dutch Stichting Forex Claim, which is gathering users' complaints.

The procedure was started by inviting the perpetrators to settlement negotiations exploring the possibility of an extra-judicial agreement. If no agreement is possible, the Foundation will bring legal action in the form of a Dutch class action at a competent court. In the event that litigation is successful, the defendants may still settle the case. Such settlements can be declared binding by the Amsterdam court.

4. Public enforcement and supervision: improvable

This paper does not analyse the European alternative dispute resolution (ADR) systems, like the national and EU ombudsmen.

As for the European Parliaments' ECON Committee, it decided to look into how the issue of mis-selling of financial instruments could be incorporated into the ECON Committee work programme and requested Better Finance to provide its take on the issue.

In short, Better Finance responded that "*the mis-selling of saving and investment products is a major issue of enforcement and supervision as several key EU regulatory provisions regarding retail investor and saver protection are not properly enforced*".

The European Parliament is now considering holding a public hearing in June 2017 on the issue of mis-selling and inviting stakeholders to contribute to the debate.

4.1. EU Commission

The European Commission is not directly in charge of enforcement in the field of retail financial services. According to its general code of good administrative behaviour[43], the Commission should nevertheless answer within 15 days to any letter from a citizen, a group of citizens, companies, etc. However, our experience is that the EC often takes

[43] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32011D0929(01)&from=EN

more than 15 days or does not reply at all (i.e. Better Finance's complaint on closet indexing funds).

4.2. The European Supervisory Authorities (ESAs)

> *"While the ESAs have started to shift attention and resources to analyse risks to consumers and investors … work in this area must be accelerated"*
>
> (European Commission – Consultation on the operations of the ESAs – March 2017)

Compared to their predecessor "Committees" (CESR, CEBS and CEIOPS) up to 2010, the ESAs bring a major improvement to the protection of financial services users in the EU, with regulatory and supervisory powers, including "enhancing customer protection" (albeit sixth and last), as part of their legal objectives (article 1.5). All three ESAs have been devoting resources and efforts to customer protection.

However, in our response to the EC's consultation on the review of the European System of Financial Supervision[44], we stressed that several legal provisions of the ESAs aimed at protecting retail investors and financial services users were not used or even sometimes not complied with in our view. In this respect, the ESAs have not used their powers to prohibit or restrict certain financial activities that harm financial users. To our knowledge, they have also not used their powers to deal with any breach of EU Law in the area of user protection. Moreover, the ESAs have not always maintained a balance between representatives from the industry and retail user representatives in their "Stakeholder Groups", to the detriment of the latter. Nor have they fulfilled the legal requirement of an "adequate" compensation for not-for-profit user-side expert members (€ 18.75 per hour gross and number of hours capped).

To our knowledge and experience[45], ESMA has never deployed its power to investigate breaches of EU Law (article 17 of the ESAs Regulations) in the area of consumer protection, even after a request to investigate such a breach from the Stakeholder Group (SMSG) itself. The same goes for EBA and for EIOPA with regard to consumer protection.

Beyond their regulatory powers, the ESAs can also issue guidelines to strengthen customer protection, like ESMA did for example in 2012 by requiring that 100% of the profit derived from lending a UCITS fund's portfolio securities to be given back to the fund. But it apparently took ESMA more than three years instead of the required two months to collect the agreements of the NCAs on these guidelines[46], and Better Finance believes that they are not consistently enforced to this day.

Furthermore, in several occasions the three ESAs failed to comply with article 9.1 of the ESAs Regulations requiring them to collect, analyse and report on consumer trends

[44] http://betterfinance.eu/fileadmin/user_upload/documents/Position_Papers/Financial_Supervision/en/PP-ESFS_Review_30072013.pdf

[45] Better Finance has been and is the most involved user-side NGO with the ESAs' work with up to 20 expert members in the ESAs stakeholder groups, vice chairing three of them (EBA, ESMA and EIOPA Insurance) and having chaired the first ESMA one.

[46] « *Within 2 months of the issuance of a guideline or recommendation, each competent authority shall confirm whether it complies or intends to comply with that guideline or recommendation. In the event that a competent authority does not comply or does not intend to comply, it shall inform the Authority, stating its reasons.* » (Article 16,3 of the ESMA Regulation 1095/2010).

in matters relating to the performance, the costs and the fees of the consumer investment products under their supervision:

"*The Authority shall take a leading role in promoting transparency, simplicity and fairness in the market for consumer financial products or services across the internal market, including by:*

(a) Collecting, analysing and reporting on consumer trends".

One can only effectively supervise what one can and does measure. Full compliance with article 9.1 would give the ESAs much more knowledge, intelligence and understanding of suspicious issues in these key areas (performances and fees) in terms of mis-selling behaviour. More generally, compliance with these provisions would help the ESAs to focus more on consumer protection, as they have been up to now more focused on systemic risks and prudential issues, as recently pointed out by the European Commission (see quote above).

This problem has been pointed out by the EC in its CMU Action Plan (September 2015): "*To further promote transparency in retail products, the Commission will ask the European Supervisory Authorities (ESAs) to work on the transparency of long term retail and pension products and an analysis of the actual net performance and fees, as set out in Article 9 of the ESA Regulations*".

A good example of this is the case of closet indexing - closet index funds[47] are funds that claim to be actively managed (with managers therefore charging rather high fees for it) but that instead tend to replicate the fund's benchmark before fees (and often underperforming it after fees). See our summary of this mis-selling case above on page 14.

Better Finance eventually discovered that more than 40% of the suspicious funds ("potential closet indexers" according to ESMA's metrics) do not comply with EU Law on Key Investor Information Documents (KIID), by failing to disclose the performance of their benchmark alongside that of their fund, preventing investors from knowing whether they meet their investment objectives or not. This, in our view, demonstrates a serious failure of public law enforcement in financial services.

In turn, these issues stem from more general concerns with the design of the ESAs themselves:

- Firstly, the inadequate governance of the ESAs: they are completely governed by the institutions that they are supposed to supervise, as the National Competent Authorities (NCAs) entirely compose the supervisory boards of the ESAs.
- Secondly, the possible conflicts of objectives between the financial stability of provider institutions on the one hand ("prudential" supervision), and consumer protection on the other.
- Thirdly, the inappropriate fragmentation of supervision between banking, insurance, pensions, securities and financial markets, which generates fragmented and inconsistent consumer protection levels (despite the action of "Joint Committee" of

[47] http://betterfinance.eu/media/press-releases/press-release-details/article/better-finance-replicates-and-discloses-esma-findings-on-closet-indexing/

the ESAs). For example, unit-linked insurance contracts fall within the scope of EIOPA, but their main components (investment funds) fall within the scope of ESMA. Retail financial intermediaries typically sell "substitutable" financial products that are not supervised by the same ESA, and therefore have to follow different rules, different guidelines and refer to different supervisors depending on the type of retail investment product they sell.

- Lastly, the ESAs should have the necessary resources to perform their tasks with regard to customer protection, which is not currently the case, as pointed out by EBA when it decided to stop providing statistical information in its annual "Consumer Trends" report in 2017.

5. Better Finance proposals to improve the enforcement of conduct of financial business rules

While progress has been achieved since 2010 on the enforcement of conduct of financial business rules, there is still a lot of room for improvement in both public and private enforcement.

Private enforcement could offer more practical solutions to reduce financial user detriment. But investor and retail financial services issues are often too complex and too technical and legal advice too costly for individuals to effectively obtain individual redress through court or through alternative dispute resolution (ADR) mechanisms, such as ombudsmen. Collective redress (if well designed) would be an effective solution that will facilitate and make legal remediation of damages incurred by EU citizens as financial services users cheaper.

5.1. Public Enforcement

- ESAs scope

Better Finance sees value in entrusting the ESAs with competencies vis-a-vis financial data providers, and not only with regard to those providing capital market trade data, but also those providing data on savings products such as investment funds. Currently the ESAs do not have the proper tools to easily and efficiently collect the data necessary to fulfil their role. The ESAs should be empowered with ensuring that the provision of such data is competitive, independent and easily accessible to individual savers and investors.

Extending the ESAs competencies to financial reporting standards and to "post-trade" issues such as securities ownership identification, securities lending and cross-border voting of shares inside the EU, would also be sensible, given the very important impact of these activities on investor protection, on shareholders' rights, on corporate governance and more generally on sustainable and responsible investments and finance.

We also recommend for the European Parliament to ask the EC and the ESAs to report on the enforcement of the regulations requiring fair, clear and not misleading information, and those requiring to disclose the existence and the amount of inducements prior to the sale of any investment product, since these provisions are too often poorly enforced at Member State level (see above, section 3).

- Governance of the ESAs and effective supervision

Our organisation has repeatedly pointed out the flaw in the ESAs' governance. We believe that there are significant aspects to be improved in this area that would ultimately lead to a great improvement of the enforcement of EU Law.

As mentioned before, the ESAs have inherent contradictions impacting their governance and impartiality. The board of supervisors of the ESAs is solely composed of national Member State supervisors (in fact much more supervisors than regulators). Thus, it is politically very difficult for the ESAs to increase the effectiveness of their supervisory activities since the institutions that they have to control are their board members. A crucial example of this is the investigation of potential breaches of EU Law or of non-implementation of EU Law (article 17 of the ESAs Regulations) by one or several of their board members. This has never happened as far as investor and consumer protection is concerned as mentioned in the previous section.

Better Finance once more asks the EU to consider changing the governance of the ESAs (as asked for by Better Finance and many other stakeholders during the Review of the European System of Financial Supervision; see footnote 26). Of course, we are aware this requires a change of EU regulations, but it is within the scope of the current EC's Public Consultation on the operations of the ESAs[48]. Therefore, Better Finance reiterates the proposal it made in 2013 for the Review of the ESFS (the ESMA Stakeholder Group did the same): to introduce independent members in the supervisory board of the ESAs, like it has been done for the ECB. Likewise, the supervisory board of the ESAs should be more open to national regulators (not only supervisors) to better achieve a single rulebook at EU level.

Having been the most involved user-side NGO in the ESAs Stakeholder Groups (see footnote 47) Better Finance is also looking to improve these advisory tools. The ESAs Stakeholder Groups should also be more balanced between the industry side and the retail user side, as required by EU Law (article 37 of the ESAs Regulations). This is not only an issue of numbers even if Better Finance had to complain to the EU Ombudsman to have this rule enforced in some cases in the past. Currently, there is still a membership balance issue in the EIOPA Occupational Pensions Stakeholder Group where retail user representatives are only three out of a total membership of thirty.

But a balanced representation also implies an "adequate" compensation for the not-for-profit user side members - as mandated by the ESAs Regulations – and "adequate" secretarial support for them, since they are not even remotely as well-resourced as the industry members and have to deal with very specific and technical issues, especially when they take additional responsibilities and tasks such as chairing or vice-chairing the Stakeholder Groups. Special attention should also be given by the ESAs to publish papers with executive summaries in plain English and in the major languages of the

[48] http://ec.europa.eu/info/finance-consultations-2017-esas-operations_en

Union. Otherwise it is very difficult for retail user expert representatives to collect the feedback of their constituencies on the ESAs consultations. This is an issue of democracy, no less.

- For a "Twin Peak" approach

Better Finance has been advocating a "Twin Peak" approach to EU financial supervision, separating (as it has been done in the US and in the UK for example) prudential supervision from conduct of business and client protection supervision. For example:

  - Prudential supervision merging prudential competencies from EBA and EIOPA, and also from ESMA, although this ESA has far less competencies in this area. Direct supervision competencies should remain with ESMA (such as credit rating agencies)
  - Financial conduct for all financial products to fall under ESMA competencies (which would have to change its name)

This is the best way to end the conflict of objectives between the prudential ones – which have always taken precedence since the 2008 financial crisis – and the conduct of business and consumer protection ones, which come sixth and last in the current Regulations governing the ESAs. Section 3 above illustrates such conflicts where the public supervisor decides to save a failed financial institution at the expense of its customers. Contrary to the dominant vision, it is not only taxpayers that footed the bill for failed financial institutions, but also, and often far more so, non-insider investors and customers. And BRRD only reinforces this damaging trend.

- Ending the "Silo approach"

Continuing with a supervision fragmented by type of financial provider is not appropriate in our view. This "Silo approach" – typical of the EU institutions - creates an inconsistent level of consumer protection at the point of sale, depending on the financial product and depending on the types of financial provider and distributor. This separation ignores the reality of retail financial markets in Europe where most investment products are "substitutable" at the point of sale, and the same retail distributor may propose alternatively securities, funds, life insurance, banking products or pension ones, sometimes insurance-based, sometimes not. The saver can also often compare these options with those offered by his employer, like corporate DC pension products. Already several national supervisors have faced this reality (UK, Netherlands, Belgium, etc.) and supervise all financial products offered at the retail level.

In other words, we see no compelling rationale for not having a single public supervisor for all financial products sold to EU citizens.

- Product intervention

The ESAs have never used their product intervention powers to protect consumers. This is certainly in part due to the same governance issue that refrained them from using their powers with regard to breaches of EU Law (see above), but also due the current limitations of the ESAs rules. The ESAs should be able to ban or even temporarily prohibit the distribution of toxic or dangerous financial products (Article

9.5 of the Regulation)[49]. Better Finance proposed a definition of toxic savings products to the EU Authorities: products that are very likely going to destroy the real value of the savings of the client. Minimising product toxicity is a key objective for drug, food and health supervisors but not yet for financial ones. It is even absent from the new MIFID and IDD rules for product governance. Moreover, article 9 refers only to financial risks and stability issues[50] as a basis for any product intervention, not to consumer protection motives. In this respect, we believe that article 9.5 should be amended to provide the ESAs with real power to ban or put on hold the selling of financial products that are toxic or not suited for retail clients in particular.

A good step[51] will be taken from 3 January 2018, when *"ESMA and NCAs will have the power to temporarily prohibit or restrict investment firm's marketing, distribution or sale of:*

- units or shares in UCITS and Alternative Investment Funds (AIFs); and

- financial instruments with certain specified features.

ESMA and NCAs will also have the powers to prohibit MIFID financial activities or practices which pose risks to investors, market integrity, and financial stability in the EU".

In a longer term, there is a clear need to harmonize EU financial consumer protection rules whatever the legal nature of the retail investment product: shares, bonds, investment funds (currently covered by MiFID/MiFIR), life insurance products (IDD), pension funds (IORP), and bank savings. The three latter categories are less protective of consumer rights despite the fact that they represent more than three quarters of the financial savings of EU households. Better Finance stressed this need in the call for evidence on the EU regulatory framework for financial services.

- Better empowerment of the ESAs to track and sanction large market abuses

The ESAs should develop tracking tools and be allowed to impose financial sanctions proportional to the magnitude of the abuses. The Market Abuse Regulation and Directive should be reviewed soon, in particular in order to assess their effectiveness in terms of administrative sanctions by Member States. A more successful fight against market abuse is critical to restore investor confidence and for the integrity and usefulness of capital markets.

[49] "Article 40 - MiFIR - ESMA's temporary intervention powers:
1. In accordance with Article 9(5) of Regulation (EU) No 1095/2010, ESMA may, where the conditions in paragraphs 2 and 3 are fulfilled, temporarily prohibit or restrict in the Union:
(a) the marketing, distribution or sale of certain financial instruments or financial instruments with certain specified features; or
(b) a type of financial activity or practice".

[50] "The Authority may temporarily prohibit or restrict certain financial activities that threaten the orderly functioning and integrity of financial markets or stability of the whole or part of the financial system"

[51] https://www.esma.europa.eu/press-news/esma-news/esma-calls-consistent-application-mifir-product-intervention-powers

5.2. Private enforcement: for an EU wide collective redress scheme

As we pointed out in our response to the EC's consultation on Building a CMU[52], we are strongly supportive of the development of a Pan-European collective redress mechanism, modelled on best practices in Europe, in particular the Dutch collective settlement procedure/collective action. Our experience demonstrates that individuals as financial users are not equipped to assess their detriment, and even less equipped to obtain redress in court on their own: it is very often too technical and too costly for them. Also, as illustrated in section 3, court cases can take many years to close. In addition, contrary to consumer goods such as drugs and cars, most financial products are not pre-tested by Public Authorities. Therefore abuses should be even more effectively identified and sanctioned, and the victims properly indemnified. This is a must to restore consumer confidence in financial services, and for those to stop being ranked as the worst consumer market of the whole EU.

Finally, as we stressed in our CMU briefing paper[53], even regulators have recognized the challenge to identify and sanction large market abuses. This fact has certainly deterred individual investors from participating more in capital markets. It remains to be seen how the new MAD/MAR regulations on market abuse will be implemented and enforced in the EU. Market abuse redress is better enforced in the US than in Europe: several high profile financial executives have been prosecuted and sentenced to years in jail in the US, and collective actions have also allowed many US investors and users to obtain indemnifications for market abuses. The EU still seems very far behind despite significant investments and efforts by certain national supervisors (market abuse tracking tools developed in recent years by the FSA/FCA in the UK in particular).

52 http://betterfinance.eu/fileadmin/user_upload/documents/Position_Papers/Financial_Markets_Infrastructure/en/Better_Finance_Response_to_EC_Consultation_CMU_13052015.pdf

53 http://betterfinance.eu/fileadmin/user_upload/documents/Position_Papers/Financial_Markets_Infrastructure/en/CMU_Briefing_Paper_-_For_Print.pdf

Annex 1: Rules on information and conflicts of interest

- **Directive (EU) 2016/97 Insurance Distribution**

➔ Article 17 - General principle

1. *"Member States shall ensure that, when carrying out insurance distribution, insurance distributors always act honestly, fairly and professionally in accordance with the best interests of their customers".*
2. *"Without prejudice to Directive 2005/29/EC of the European Parliament and of the Council (14), Member States shall ensure that all information related to the subject of this Directive, including marketing communications, addressed by the insurance distributor to customers or potential customers shall be fair, clear and not misleading. Marketing communications shall always be clearly identifiable as such".*

➔ Article 19 - Conflicts of interest and transparency

1. *"Member States shall ensure that in good time before the conclusion of an insurance contract, an insurance intermediary provides the customer with at least the following information":*
    a. *"whether it has a holding, direct or indirect, representing 10 % or more of the voting rights or of the capital in a given insurance undertaking";*
    b. *"whether a given insurance undertaking or parent undertaking of a given insurance undertaking has a holding, direct or indirect, representing 10 % or more of the voting rights or of the capital in the insurance intermediary";*

➔ Article 20 - Advice, and standards for sales where no advice is given: this article provides for a Product Information Document (PID)

➔ Article 27 - Prevention of conflicts of interest: *"an insurance intermediary or an insurance undertaking carrying on the distribution of insurance-based investment products shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest"*

➔ Article 28 - Conflicts of interest:

1. *"Member States shall ensure that insurance intermediaries and insurance undertakings take all appropriate steps to identify conflicts of interest between themselves, including their managers and employees, or any person directly or indirectly linked to them by control, and their customers or between one customer and another, which arise in the course of carrying out any insurance distribution activities."*

- **Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (IORP 1) (3 June 2003):**

  ➔ Article 11 "Information to be given to the members and beneficiaries"

  ➔ Article 13 "Information to be provided to the competent authorities"

  ➔ Article 18 "Investment rules"

  1. *"Member States shall require institutions located in their territories to invest in accordance with the "prudent person" rule and in particular in accordance with the following rules:*

     the assets shall be invested in the best interests of members and beneficiaries. In the case of a potential conflict of interest, the institution, or the entity which manages its portfolio, shall ensure that the investment is made in the sole interest of members and beneficiaries (…)"

- **Directive (EU) 2016/2341 on the activities and supervision of institutions for occupational retirement provision (IORPs) (14/12/2016):**

  ➔ Recital 2: *"In the internal market, institutions for occupational retirement provision (IORPs) should have the possibility to operate in other Member States while ensuring a high level of protection and security for members and beneficiaries of occupational pension schemes".*

  ➔ Article 8 - Legal separation between sponsoring undertakings and IORPs

  "Member States shall ensure that there is a legal separation between a sponsoring undertaking and an IORP registered or authorized in their territories in order that the assets of the IORP are safeguarded in the interests of members and beneficiaries in the event of bankruptcy of the sponsoring undertaking".

  ➔ Article 19 - Investment rules

  1. *"Member States shall require IORPs registered or authorized in their territories to invest in accordance with the 'prudent person' rule and in particular in accordance with the following rules:*

     a. *The assets shall be invested in the best long-term interests of members and beneficiaries as a whole. In the case of a potential conflict of interest, an IORP, or the entity which manages its portfolio, shall ensure that the investment is made in the sole interest of members and beneficiaries";*

TITLE IV - INFORMATION TO BE GIVEN TO PROSPECTIVE MEMBERS, MEMBERS AND BENEFICIARIES

  ➔ Article 36 - Principles

  1. *"Taking into account the nature of the pension scheme established, Member States shall ensure that every IORP registered or authorized in their territories provides to:*

     a. *Prospective members: at least the information set out in Article 41;*

     b. *Members: at least the information set out in Articles 37 to 40, 42 and 44; and*

c. *Beneficiaries: at least the information set out in Articles 37, 43 and 44".*

2. *"The information referred to in paragraph 1 shall be:*

   a. *Regularly updated;*

   b. *Written in a clear manner, using clear, succinct and comprehensible language, avoiding the use of jargon and avoiding technical terms where everyday words can be used instead;*

   c. *Not misleading and consistency shall be ensured in the vocabulary and content;*

   d. *Presented in a way that is easy to read;*

   e. *Available in an official language of the Member State whose social and labour law relevant to the field of occupational pension schemes is applicable to the pension scheme concerned; and*

   f. *Made available to prospective members, members and beneficiaries free of charge through electronic means, including on a durable medium or by means of a website, or on paper".*

➔ Article 37 - General information on the pension scheme

1. *"Member States shall, in respect of every IORP registered or authorised in their territories, ensure that members and beneficiaries are sufficiently informed about the respective pension scheme operated by the IORP, in particular concerning:*

   b. *The rights and obligations of the parties involved in the pension scheme;*

   c. *Information on the investment profile;*

   d. *The nature of financial risks borne by the members and beneficiaries;*

   e. *The conditions regarding full or partial guarantees under the pension scheme or of a given level of benefits or, where no guarantee is provided under the pension scheme, a statement to that effect;*

   f. *The mechanisms protecting accrued entitlements or the benefit reduction mechanisms, if any;*

   g. *Where members bear investment risk or can take investment decisions, information on the past performance of investments related to the pension scheme for a minimum of five years, or for all the years that the scheme has been operating where this is less than five years;*

   h. *The structure of costs borne by members and beneficiaries, for schemes which do not provide for a given level of benefits";*

3. *"Members and beneficiaries or their representatives shall receive within a reasonable time, any relevant information regarding changes to the pension scheme rules. In addition, IORPs shall make available to them an explanation of the impact on members and beneficiaries of significant changes to technical provisions".*

4. *"IORPs shall make available the general information on the pension scheme set out in this Article".*

CHAPTER 2 - PENSION BENEFIT STATEMENT AND SUPPLEMENTARY INFORMATION

➔ Article 38 - General provisions

1. *"Member States shall require IORPs to draw up a concise document containing key information for each member taking into consideration the specific nature of national pension systems and of relevant national social, labour and tax law ('Pension Benefit Statement'). The title of the document shall contain the words 'Pension Benefit Statement'".*

➔ Article 41 - Information to be given to prospective members

1. *"Member States shall require IORPs to ensure that prospective members who are not automatically enrolled in a pension scheme are informed, before they join that pension scheme, about:*
    a. *Any relevant options available to them including investment options;*
    b. *The relevant features of the pension scheme including the kind of benefits;*
    c. *Information on whether and how environmental, climate, social and corporate governance factors are considered in the investment approach; and*
    d. *Where further information is available".*
2. *"Where members bear investment risk or can take investment decisions, prospective members shall be provided with information on the past performance of investments related to the pension scheme for a minimum of five years, or for all the years that the scheme has been operating where this is less than five years and information on the structure of costs borne by members and beneficiaries".*

➔ Article 45 - Main objective of prudential supervision

1. *"The main objective of prudential supervision is to protect the rights of members and beneficiaries and to ensure the stability and soundness of the IORPs".*

COMPARATIVE TABLE – EU REGULATIONS – INFORMATION AND CONFLICTS OF INTEREST

See below:

	MiFID I (2004/39/EC)	MiFID II 2014/65/EU	IDD 2016/97/EU	IORP II 2016/2341/EU
	Article 19(2) & article 27.2 Commission Directive 2006/73/EC	**Article 24 & article 44.2 Commission Delegated Regulation (EU) 2017/565**	**Article 17**	**Articles 24, 36 and 37**
Information	Information addressed to clients, including marketing communications, **should be fair, clear and not misleading**: *" the information (...) shall not emphasise any potential benefits of an investment service or financial instument* ***without also giving a fair and prominent indication of any relevant risks."*** *" the information (...) presented in a way* ***that is likely to be understood by, the average member of the group*** *to whom it is directed, or by whom it is likely to be received"* *"the information (...) shall not disguise, diminish or obscure important items, statements or warnings"*	*"All information, including marketing communications, addressed by the investment firm to clients or potential clients shall* ***be fair, clear and not misleading****."* *"The information referred to in paragraphs 4 and 9 shall be provided in a comprehensible form* ***in such a manner that clients or potential clients are reasonably able to understand the nature and risks of the investment service*** *and of the specific type of financial instrument that is being offered "* The Delegated Regulation provides that " *this regulation clarifies that such information would also include an exaplanation of the risks arising from insolvency and related events, such as bail in".*	*"insurance distributors always* ***act honestly, fairly and professionally"*** *"Member States shall ensure that all information related to the subject of this Directive, including marketing communications, addressed by the insurance distributor to customers or potential customers* ***shall be fair, clear and not misleading."***	*ar.24 "IORPs shall enable the holders of key functions to undertake their duties effectively in* ***an objective, fair and independent manner. (...) "*** *ar.36* *"2. The information referred to in paragraph 1 shall be:* *(b) written in a clear manner, using clear, succinct and comprehensible language, avoiding the use of jargon and avoiding technical terms where everyday words can be used instead;* *(c)* ***not misleading, and consistency shall be ensured in the vocabulary and content;*** *(d) presented in a way that is easy to read; (...)"* *ar.37 "1. Member States shall, in respect of every IORP registered or authorised in their territories, ensure that members and beneficiaries are sufficiently informed about the respective pension scheme operated by the IORP, in particular concerning:* *(c)* ***information on the investment profile;*** *(d) the nature* ***of financial risks borne by the members and beneficiaries****;* *(g) where members bear investment risk or can take investment decisions,* ***information on the past performance of investments related to the pension scheme for a minimum of five years, or for all the years that the scheme has been operating where this is less than five years;*** *(h) the structure of costs borne by members and beneficiaries, for schemes which do not provide for a given level of benefits;(...)"*
	Recital 39 MiFID I implementing Directive 2006/73/EC	**Recital 56, articles 23 & 24 MiFID II**	**articles 19 & 27**	**Article 19**
Conflicts of interest/ Inducement	***"concerning inducement*** *(...) the receipt by an investment firm of a commission in connection with investment advice or general recommandations, in circumstance where the advice or recommandations are not biased as a result of the receipt of commission,* ***should be considered as designed to enhance the quality of the investment advice to the client"***	*rec. 56"require investment firms to take all appropriate steps* ***to identify and to prevent or manage conflicts of interest between themselves,*** *including their managers, employees and tied agents, or any person directly or indirectly linked to them by control and their clients or between one client and another that arise in the course of providing any investment and ancillary services, or combinations thereof, including those caused by* ***the receipt of inducements from third parties or by the investment firm's own remuneration and other incentive structures."*** *ar.23: 1. Member States shall require investment firms to take all appropriate steps to identify and to prevent or manage conflicts of interest between themselves, including their managers, employees and tied agents, or any person directly or indirectly linked to them by control and their clients or between one client and another that arise in the course of providing any investment and ancillary services, or combinations thereof,* ***including those caused by the receipt of inducements from third parties or by the investment firm's own remuneration and other incentive structures.*** *ar.24: (a) when investment advice is provided, the investment firm must, in good time before it provides investment advice, inform the client:* *(i) whether or not the advice is provided on* ***an independent basis****;* *(...)*	*ar.19 "intermediaries and insurance* ***undertakings take all appropriate steps to identify conflicts of interest*** *between themselves, including their managers and employees, or any person directly or indirectly linked to them by control, and their customers or between one customer and another, that arise in the course of carrying out any insurance distribution activities."* *ar.27 " an insurance intermediary or an insurance undertaking carrying on the distribution of insurance-based investment products shall maintain and operate effective organisational and administrative arrangements with a view to taking all* ***reasonable steps designed to prevent conflicts of interest"***	*"the assets shall be invested in the best long-term interests of members and beneficiaries as a whole. In the case of a potential conflict of interest, an IORP, or the entity which manages its portfolio, shall* ***ensure that the investment is made in the sole interest of members and beneficiaries"***

NOTES

The European Federation of Investors and Financial Services Users
76, rue du Lombard, 1000 Brussels - Belgium
Tel. (+32) 02 514 37 77 - Fax. (+32) 02 514 36 66
E-mail: info@betterfinance.eu - http://www.betterfinance.eu

European Commission

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