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

Better Finance response to a consultation from MEP Sven Giegold on the mis-selling of financial products

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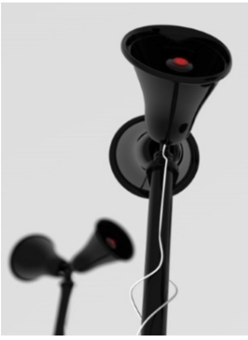
Better Finance, the European Federation of Investors and Financial Services Users, is the public interest non-governmental organisation advocating and defending the interests of European citizens as financial services users at European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances. It is the one and only European-level organisation solely dedicated to the representation of individual investors, savers and other financial services users.



Better Finance was founded on the believe that the financial system exists to serve the real economy. For this reason it focusses on restoring confidence in financial markets and promoting an open, transparent, efficient and sustainable real economy served by financial institutions that have the public interest in mind.

Better Finance acts as an independent financial expertise and advocacy centre to the direct benefit of European financial services users. Since the Better Finance constituency includes individual and small shareholders, fund and retail investors, savers, pension fund participants, life insurance policy holders, borrowers, and other stakeholders who are independent from the financial industry, it has the best interests of all European citizens at heart.

Better Finance engages in campaigns to provide relevant information and better protection for end-users, promote market integrity and transparency for retail investors and non-industry stakeholders and establish better governance of financial supervision for all European citizens.

In 2009, for the first time, all types of financial services users such as individual shareholders, fund investors, insurance policy holders, bank savers, pension funds participants, borrowers and others, joined forces to create Better Finance. Today Better Finance counts nearly 50, independent, national and international member and sub-member organisations, mainly from EU Member States but also other countries such as Iceland, Norway, Russia, Turkey, Lebanon and Cameroon.

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CONSULTATION

Better Finance of course shares the view of MEP Sven Giegold that financial markets must serve consumers and end-users, and welcomes the European Parliament's ECON Committee focus on the mis-selling of financial products.

Better Finance experiences 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, especially key MiFID ones:

- on "*fair, clear and not misleading information*" (article 27 of MiFID I implementation Directive 2006/73/EC),
- on conflicts of interests and "*inducements*" (article 26 of MiFID I implementation Directive).

Also, more than 75% of retail financial savings are less protected by EU Law against mis-selling, as they are not covered by the MiFID provisions, but by other less protective EU regulations (IDD, IORP, etc.).

1. Comments on the background ECON document ("Annex 9") provided

- **Relevant EU Law**

Better Finance wishes to point out that about 76 % of retail investment products are outside of the scope of MiFID/MiFIR, as those cover exclusively securities (shares, bonds, etc.) and investment funds.

More than 40 % of retail investments are in bank products, and more than 35% in life insurance and pension products.

Therefore, at a minimum, we believe one should add IDD and IORP II as relevant law for mis-selling retail investment products.

These latter ones do not provide by far the same level of user protection, particularly in the area of disclosures, misleading information and of conflicts of interests.

Regarding shares and bonds, we believe MAD/MAR and the Prospectus Directive/Regulation are also relevant pieces of EU Law.

- **Procedures within the Commission**

"*The Commission is bound to reply within 15 days to any letter that it receives, whether coming from a citizen, a group of citizens, companies, etc*"

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This is not our experience: the EC responds later than 15 days or does not respond at all.

Examples: our complaint on closet indexing funds, our complaint against the ESAs for not complying with provisions of article 9 of the ESAs Regulations.

Complainants do not receive replies from NCAs in France for example: only an acknowledgement of receipt, but no reply at all on the substance.

"*ESMA also has powers to pursue breaches of Union law but, apparently, these powers are rarely deployed*"

To our knowledge and experience (BF experts have been members of the ESMA Stakeholder Group since its creation, and chaired it form 2011 to 2013), ESMA has never deployed these powers in the area of consumer protection, even after a request to investigate such a breach from the SMSG itself. The same goes for EBA and for EIOPA in the area of consumer protection.

- **Relevant ESMA activities**

As pointed out above, ESMA is competent for only about 24 % of retail investment products. Therefore BF believes the EP should also look at the relevant activities if any of EBA and of EIOPA, which are competent for most retail investment products, not ESMA.

Also, as the two other ESAs, ESMA has repeatedly failed to comply with article 9.1 of the ESAs Regulations requiring them to collect, analyse and report on consumer trends in the area of the performance, the costs and the fees of the consumer investment products under their supervision. One can 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 for mis-selling behaviours (performances and fees). More generally, compliance to these provisions would help the ESAs to focus more on consumer protection, as they are currently much more focused on systemic risks and prudential issues.

This failure has been at least implicitly 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".*

Following the emergence of "Closet indexing" (falsely active funds: charging high "active management" fees for a performance that is very close or below their benchmarks) issues in Scandinavian countries, BF has asked ESMA to investigate

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this potentially huge mis-selling case on a Pan-European basis in October 2014. ESMA agreed to do it and disclosed some of the results of its investigation in February 2016. However, ESMA refused to disclose the names of the up to 15% of active equity funds it found to be highly suspicious with regard to closet indexing. BF then asked the EC which declared itself incompetent. To date (October 2016 – i.e. already two years after the BF request for investigation) to our knowledge no EU NCA has disclosed any fund names nor has sanctioned any fund manager. The only NCA to have done both (disclose and sanction) is the Norwegian one.

- **Possible way forward**

For reasons mentioned above BF believes ECON coordinators should also ask EIOPA (not only EC, ESMA and EBA) to regularly present its activities in the area of mis-selling.

Inquire the ESAs about their compliance with article 9.1 (collect, analyse and report on consumer trends, in particular on the performances and fees of consumer products) and 17 (breaches of EU Law regarding client protection) of the ESAs Regulations.

Specifically ask the EC and the ESAS to report on the enforcement of the regulations requiring fair, clear and not misleading information, and those resuiring to disclose the existence and the amount of inducements prior to the sale of any investment product. As these provisions are too often poorly enforced at Member State level (see below, section 2).

Consider changing the governance of the ESAs (as asked for by BF and many other stakeholders during the Review of the European System of Financial Supervision) to ensure the independence of the ESMA Board from the NCAs and therefore enable the ESAs to make actual use of the breach of EU law powers (for example by appointing some independent board members, like it is already the case for the ECB). Of course we are aware this requires a change of EU regulations.

Longer term, there is a clear need to harmonize EU financial consumer protection rules whatever the legal nature of the retail invesment product: shares, bonds, investment funds (currently covered by MiFID/MiFIR), life insurance products (IDD), pension funds (IORP), and bank savings and investment products, the three latter cateories being much 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, but it would seem from early indications that the EC is not taking it into account.

Better Finance also advocates for 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.

2. Areas of financial services specifically affected by violation of EU Law through mis-selling

BF strongest expertise is in savings, investments, life insurance and pension products. The following comments therefore pertain to this scope of financial products.

BF found evidence of mis-selling cases for the following product categories:

<u>Commercial banks' shares, preferred shares and bonds</u>

- Misleading information on risks
- Conflicts of interest

<u>Investment funds</u>

- Closet indexing (see section 1 above – ESMA activities)
- False and misleading KIID disclosures (case of four complaints in 5 years to the NCA on the same product without adequate remediation and no sanction)
- Grossly false marketing information and inconsistent with KIID (same case)
- Widespread violations of MiFID provisions against "misleading information", especially the ones requiring that they are intelligible for the average target clients and that they present in a balanced way the potential benefits but also the risks of the product; we have never actually seen any fund marketing document fulfilling these requirements (same case).
- Widespread violations of the provisions against disguising and obscuring important items and warnings (same case)
- Widespread violations of the provisions on inducements of MiFID, especially that requiring the disclosure of the existence and of the amount of the inducements (same case)

<u>Life insurance</u>

- no disclosure of total costs and fees
- misleading promises like "treble your capital in 8 years"
- Unit-linked (equity) contracts sold to very old people

<u>Bank structured products</u>

- misleading promises like "double your capital in 8 years"
- not understandable return formulas

<u>Personal pensions</u>

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- no disclosure or very poor disclosure of the coverage ratio and of the reserve gaps
- no disclosure of total costs and fees
- no warnings on the repeated failure to meet stated objectives (resulting in very important losses for savers, often hidden by the complexity of the product and opacity of reporting)
- no disclosure of recent performances

Insurance-regulated occupational pension funds

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

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

Annex: Article 27.2 of MiFID I Implementation Directive 2006/73/EC

Conditions with which **information** must comply in order to be **fair, clear and not misleading**

2. 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.

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

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