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"Restoring Consumer Trust in Retail Financial Services"

ESBG Conference "Retail Banking in Europe – the way forward, lessons from the crisis and priorities for the future"

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Ladies and gentlemen,

It is with great pleasure that I join you this afternoon at this most interesting conference on Retail Banking in Europe. A lot has been said today about the future of retail banking. We have heard about business models, the restructuring of the sector and the supervisory model that needs to be built for the banks.

My main message today is that the future of retail banking, like that of any retail service today, cannot be written without the consumer dimension being firmly placed at the heart of the debate.

We are quick to forget that this crisis originated and took roots in the sale at retail level of inadequate loans to consumers. These risky loans were sliced and repackaged into complex financial products that were also sold back, directly or indirectly, to consumers as saving and investment products. The sheer magnitude of the risk passed on to consumers at both ends of the market suddenly became apparent last year - and it was breathtaking.

Besides the significant financial pain imposed on many households, the result has been the massive loss of consumer trust and a withdrawal from financial markets. Retail financial markets will not thrive and achieve their full potential if they cannot get back this trust.

This crisis did not build on void. For many years, the retail financial sector has been drawing some attention for its retail commercial practices, which did not seem to be favourable to consumers.

In 2007, the European Commission published a retail banking sector inquiry that highlighted the prevalence of opaque fees, the level of which were hard to explain, the practice of tying financial products in a single contract to the customer, and the imposition of switching costs. The EFTA surveillance authority had a report on the sector that same year highlighting the same issues.

But regulators at the time, as also illustrated in the European Central Bank retail banking inquiry of 2006, were principally focusing on the fragmentation of markets along national lines and on the need to promote integration and competition.

Let me tell you this. You cannot get a vibrant integrated competitive retail market if you don't get the consumers right. I am referring to the basic principles of consumer information, consumer awareness and consumer choice. Ultimately, regulators don't integrate markets, consumers do. But only if they can and only if they feel the market is worth it. And the financial market had never been a market easy to navigate for consumers.

The Consumer Market Scoreboard last year pointed to financial services as a market that needed further scrutiny from the point of view of delivering to consumers. Consumers seemed to have difficulty comparing banking offers and switching banks.

Today's publication of our Staff Working Paper and Bank Fees study is the culmination of an in-depth analysis of evidence we have gathered on the issues that were singled out for attention. This set of work exposes the problems caused by inadequate pre-contractual information, inadequate advice, and the opaque bank fees which are unintelligible to consumers. It also stresses the problems encountered by consumers who want to switch bank accounts.

Our findings have shown us that many retail financial contracts are overly complex and, even worse, are not transparent. This makes it difficult and costly for consumers to deal with them. I a nutshell, retail financial contracts and commercial practices often violate the basic principles of a good consumer markets.

What are these principles?

First of all, fair marketing that does not mislead or pressure consumers. Second, complete and relevant information about the service they are buying and about its true cost. Third, fair commercial practices that do not impose excessive constraints or abusive charges. Fourth, the ability to exercise real choice: to walk out of a bad deal or to change for a better deal. Finally, I believe that consumers must not be exposed to catastrophic risk in retail markets. In the same way we make sure consumers don't get electrocuted in the market of appliances, we must not tolerate excessive and unnecessary exposure to the risk of total bankruptcy or the loss of a home.

In the face of increasing complexity in financial products, financial education has a role to play in helping consumers – it will equip consumers to better assess the claims made for financial products. However, financial education is insufficient on its own – there is only so much we can realistically expect of people and the financial industry seems to have no limits in terms of complexity and sophistication. Financial service providers must bear responsibility for producing information people can realistically use and understand.

Let me discuss first pre-contractual information in financial services. Our analysis tells us that consumers benefit from insufficiently clear information prior to signing up to a transaction, leaving them to pay more for products and less able to make an appropriate choice.

This barrier to choice also promotes market fragmentation. Unsurprisingly, incomprehensible, insufficient and misleading information, and information that is presented in too many different ways, were found in a survey to be important inhibitors of cross-border shopping in financial services.

Information should be concise, contain all the necessary facts that are sufficient for an informed decision and it should be presented in a timely and comprehensible manner. Where product features allow, it should also be presented in a standardised form.

Indeed we found that almost 80% of Europeans think that it would be useful if all financial services providers used a standardised information sheet for comparable products. Our focus groups in all Member States also provided overwhelming support for standardised formats of pre-contractual information for financial services.

We have already made progress on the provision of standardised and comparable information. The new Consumer Credit Directive employs a standard sheet for pre-contractual information which can be easily compared from one bank to another so that consumers can choose the best deal.

In investments too, a standardised format is set to be deployed as part of the new Key Investor Information Document accompanying the revised UCITS [Undertakings for Collective Investments in Transferable Securities] Directive.

Testing is also ongoing to improve the mortgage pre-contractual information sheet, the so-called ESIS, turning it into an easy-to-read, comparable format in which to present information.

But this is not enough.

We cannot be complacent about the risk incurred by consumers for failing to read or understand the implications of the information in the small print. Across Europe, people are losing their homes for having failed to grasp the importance of some understated information buried in tiny font.

We must extend standardised, comparable pre-contractual information to all relevant areas of banking, credit and investment. I would say we must go further and also explore the opportunity for simple default standard products to be offered to those consumers who wish to stay away from complexity and risk.

Information is important to consumers but financial advice is no less crucial as consumers are easily influenced by advisors who are perceived to be experts.

The field of behavioural economics provides us with important insights into consumer behaviour. It shows that personal advice is the main driver for consumers' decisions to buy a specific financial product and that many consumers rely, almost unthinkingly, on the recommendation of a familiar bank employee or on the advice of a broker because they perceive them to be an expert in their profession or a neutral source.

In principle, advisers should act honestly and fairly. They should provide advice that is appropriate to the consumers. They should have thorough knowledge of the products and match them to the needs of the consumer.

Yet, the reality is too often quite different. We have growing evidence that consumers often do not receive suitable advice on financial services.

In Germany, researchers posing as consumers approached 25 German bank advisors and received unsuitable advice in 24 out of the 25 cases. In Ireland, complaints about advice on financial services doubled in 2008 compared to 2007 and almost 65% of them were resolved in favour of the consumer.

The financial crisis has exposed cases of expensive and unsuitable mortgages sold to consumers. Consumers did not understand or were not told the full contract terms governing the interest rates, and seemingly attractive deals sometimes turned into payments they could not meet. In parts of the EU, many consumers were advised to take out loans in foreign currency with a gross underestimation of the currency risk.

The fact is that many people trust their financial advisors the way they trust their doctors. And, sadly, they should not.

Why? Because bank employees and intermediaries are not always experts in relation to the products they sell. Because there is also an inherent conflict of interest arising from how they are paid. If a bank employee earns the highest bonus for selling those products that are very profitable for the bank, one should not be surprised that the advisors ultimately tends to sell the products which are the most lucrative for them.

Three quarters of the respondents in a recent survey of investment professionals considered fee structures to be the main driver for sales, rather than the needs of the consumer.

Up to now, the issue of advice has been treated in a fragmented way and only for some types of products. The next Commission needs an all-encompassing approach that develops an overarching framework dealing with advice standards to be respected by all retail financial advisers and to be enforced by all relevant regulators.

The third issue I want to address is the general opacity in bank fees. Even the contractors of our bank fee study, who had expert staff, needed recurring explanatory contacts with the financial institutions in over two-thirds of cases in order to get to grips with the real cost of a banking account.

Around 10% of the banks had little or no price information available on their website and one-third of them had incomplete price information in their tariff list.

This is unacceptable.

Bank fees must be transparent consumers. After all, we are talking about the cost of a product which is used by almost 90% of consumers, a usage rate second only to electricity.

The opacity of returns and fees cost consumers money. Consumers forego interest on accounts when thresholds and other conditions for obtaining interest are not clearly indicated. Consumers also pay very high fees they could have avoided had they understood and been familiar with the tariff structures.

Last year's study by the Office of Fair Trading in the UK found that the majority of consumers did not know what they were paying for bank account overdrafts or what they were receiving in interest, mostly because the associated conditions were hidden or were too complex to fathom.

Unsurprisingly, our study also finds that the retail banking market is fragmented along national lines, implying that, at least for bank accounts, the internal market does not yet exist. The average banking price for a similarly defined heavy user of banking services ranged from a high of €831 per year in Italy to a low of €28 in Bulgaria.

Regardless of the intensity of usage of banking services, there are countries which are consistently at the higher end of the price distribution, notably Italy and Spain. Austria, France and Latvia also fall into the high price group.

The dispersion in prices is matched by the variety of business models across the EU. Banking fees have different degrees of simplicity and transparency in different countries. Spain, Italy, France, Greece and Hungary have both more complex and less transparent fees than other EU Member States. There seems to be a link between complexity, opacity and higher bank charges. France debit charges that are significantly higher than average, Greece has higher than average credit transfer fees and the UK, a very bad performer on transparency, has very high overdraft fees. Italy and Spain, as I mentioned before, are overall bad performers. At the other extreme, the Netherlands, where banks rely on fixed and transparent annual fees, exhibit some of the lowest total banking costs.

The Payment Services Directive which must be implemented in all Member States on 1st November will increase consumer information on pricing by providing more information on the cost of a payment service, such as a direct debit or credit transfer. But the sheer complexity of the fees structures show that this is not enough.

We must consider the need to actively enforce consumer protection legislation and notably the Unfair Commercial Practices Directive, which is also applicable to bank fees. This Directive provides that information should not be misleading and acts of omission are sanctioned.

Information on the prices of services provided by banks must be provided in a clear, intelligible, unambiguous and timely manner not to be in breach of the Directive. Notably, the trader should not omit, wholly or partially, information which is necessary for a transactional decision.

So, for example, where the advertised interest rate of 0% is really 0% for a few months only and thereafter becomes 5%, the omission of this latter piece of information is in breach of the Directive and considered unfair to consumers.

Furthermore, where the price or credit structure is so complicated and unintelligible that the average consumer targeted by the advertisement could not work out the price, this constitutes a breach of the Directive.

We want to ensure that the Unfair Commercial Practices Directive is fully enforced. A good example is a recent case of credit card overcharging which led to a ten million euro fine for 17 Greek banks. Although the authorities responsible for enforcing fair practices and fair contract terms are national authorities, the Commission is also active in supporting cross-border enforcement. The Consumer Protection Co-operation Regulation offers the possibility for concerted enforcement by Member States to ensure that consumer rules are respected. It links national public enforcement authorities in an EU-wide Enforcement Network which can put an end to cross-border breaches of consumer protection laws.

The Communication on enforcement issued earlier this year paves the way for a strengthening of enforcement mechanisms across the EU.

It will be no surprise that in face of such opacity of retail banking costs, consumer switching rates are low. This situation is detrimental to consumers since we have found that there is a strong correlation between low switching rates and price increases.[1]

Our findings reveal that almost a third of consumers surveyed are not able to compare current account offers and cannot choose the account that suits them best. Lack of comparability is not limited to bank accounts. In our surveys, the greatest difficulty people had in comparing offers occurred in savings and investments where as many as 40% of consumers found it difficult or very difficult to compare offers.

The banking industry has now developed a set of Common Principles to facilitate switching. This is due to be implemented in all Member States by 1st November. It represents a first step, which we will follow up with monitoring and evaluation to check on its progress.

As this is a self-regulatory exercise, the involvement of the main stakeholders, i.e. consumers, in gauging its effectiveness will be important.

Consumer trust in financial services is currently at an all-time low. The roots of this confidence crisis are to be found in the pervasive neglect of basic consumer policy principles in retail banking. If we want to set our retail financial markets on the path of healthy growth and particularly if we want to integrate our markets, we must provide European consumers with a market in which they can safely and confidently operate. Information, fair commercial practices and fair disclosure, transparent prices and costs as well as easy switching must be unavoidable elements of the solution to the current situation. Concretely, what is the way ahead?

The European Commission must work to extend its work on standardizing pre-contractual information to cover all relevant financial products.

The Commission must establish a reliable framework that helps disentangle perverse incentives in financial advice with respect to all types of products, be it mortgages or any type of individual investments.

The European Commission must actively promote the enforcement of consumer legislation, and notably the enforcement of the Unfair Commercial Practices Directive, with respect to the marketing and pricing information of banking and retail financial products.

Finally, the European Commission must monitor the implementation of the self regulatory Common Principles to facilitate switching.

[1] Consumer Market Scoreboard (insert ref)

The best, the most innovative, and the most competitive retail markets are those driven by consumers. Europe is yet to unlock this potential in retail financial markets. They say with crisis come the opportunities. In the interest of our citizens and in the interest of our economies, this is an opportunity we should now grab.

Thank you very much.