

Consumer protection workshop

Executive summary:

There is at present a patchwork of national consumer protection regimes for consumer credit in particular that creates specific legal conditions for operating in each European market.

This situation is considered by most multinational or global players to hinder their ability to sell similar products across Europe and therefore to obtain economies of scale and is rarely justified by very specific consumer needs.

The current attempts to harmonise European legislation related to consumer protection can be considered as steps in the right direction but have not been sufficient yet to develop an integrated market, as they still allow for major divergences between legislations.

Targeted full harmonisation (ie full harmonisation of the main dispositions that are necessary to guarantee an adequate level of consumer protection adapted to the average needs of EU consumers while enabling the industry to develop synergies and cross-border business) appears to be an adequate solution for many industry players and observers in particular for consumer credit, mortgages and savings. However the scope of topics selected for harmonisation and the degree of precision required for harmonising dispositions on these topics needs to be determined on a case-by-case basis.

Further harmonisation of EU consumer protection laws would benefit consumers in several ways:

- Industry players would be able to increase synergies leading to potential economies of scale and price reductions
- Foreign players would be able to access new markets completing the range of local products and increasing competition which could put pressure on prices.

As an example, industry players consider that the modified version of the consumer credit directive goes in the right direction of focused harmonisation identifying 7 main themes to be harmonized:

- Advertising
- Pre-contractual information
- Contractual information
- Definition and calculation of interest rates
- Right of withdrawal
- Linked credits
- Early repayment

Full harmonisation would require the directive to be more precise on certain topics and to modify a certain number of dispositions of the present proposal on these 7 themes taking into account the constraints and needs of financial institutions and distributors

and the interests of consumers. The common proposals of the market were published in May 2005 by EBIC.

Once these additional precisions have been specified, Member States should not be allowed to introduce specific domestic consumer protection requirements regarding these themes as they would hinder the potential for financial institutions to develop industrial synergies.

Main questions to be addressed during the workshop:

Can differences in consumer protection laws be explained by different customer needs across EU countries ? for example for consumer credit or investment products

What are the respective responsibilities of consumers and industry players in the purchase of a financial service ? for example a consumer credit ?

What are the key points to focus harmonization on to guarantee an appropriate level of consumer protection and to enable the industry to develop sufficient synergies ?

How to implement efficiently targeted full harmonization to the benefit of consumers and industry players ? for example for consumer credit

- How to make sure the directive covers the key points for consumer protection and for the industry to develop the necessary synergies ?
- How to make sure there are no local adaptations on key points to be harmonized ?

In what circumstances and on what consumer protection issues can mutual recognition be appropriate ?

Can customer education be an adequate alternative or addition to consumer protection law in certain cases ?

To what extent can industry-driven codes of conduct be a useful alternative or addition to consumer protection law ?

Financial services are everyday life services for which a certain degree of caution is necessary. This is why consumer protection laws have been developed in each Member State over time

Certain characteristics of retail financial services explain why consumer protection is a strong issue for these products:

- The “products” and services are intangible, and their features, quality and performance can be complex or difficult to understand for consumers.
- Consumers buy certain of these products relatively rarely, thus making it difficult to learn from experience (ex: mortgages, long term savings...).
- The effect or benefit of the 'product may not be apparent for many years in certain cases (e.g. a life assurance policy or pension) and is not easily predictable.
- Consumers should be prevented from going into over-indebtedness.

Detailed consumer protection legal dispositions have been developed in most EU countries to give consumers protection from the issues mentioned above in particular. These cover both credit and savings products. In addition most countries have, or are adopting, detailed pensions regulation, which also contains measures designed to protect consumers.

This leads to a patchwork of consumer protection regimes that creates specific legal conditions for operating in each European market

Consumer protection regimes have been developed largely in isolation by each member state. Over time they have evolved in different directions with variable levels of detail or constraints, although pursuing the same overall objective. The result is a market fragmented on national lines. Because of these different regimes, providers are usually unable to offer the same products in more than one Member State.

This is true for most financial services products: consumer credit, mortgages, savings products, pension funds...

This fragmented situation does not appear to be justified by specific consumer needs or preferences

Such differences would make sense if they were justified by a wide variation in consumer needs and behaviours among EU countries.

However, certain industry observers believe there is no compelling evidence that consumers within the EU differ widely in their needs or preferences regarding protection and believe that major differences in consumer protection regulations and the main dispositions they contain are not justified.

They explain these disparities mainly by historical evolutions or legal jurisprudence (successive court rulings that have introduced specific dispositions) or by local regulatory tradition that do not always relate therefore to tangible consumer needs.

This situation is considered by most multinational or pan-European players to hinder their ability to sell similar products across Europe and therefore to obtain economies of scale while increasing competition in local markets

We consider there is cross-border selling in two main situations:

1. When a customer purchases a product in a foreign country (activity driven by demand)
2. When a market player enters into a new market by establishing local branches / subsidiaries or via agents / brokers (activity driven by supply).

In the first situation, although most industry players consider that the size of cross-border retail financial services markets is limited in the short term (1) a certain number of cross-border niche markets are nevertheless developing and need to be taken into consideration for example in the consumer credit, mortgages or savings markets. This can lead local banks or financial institutions to organize specific services and products to serve their foreign clients.

In the second situation mentioned above there are many examples of companies that have been successful in developing their business across Europe especially in consumer credit, mortgages and savings products. Despite the legal hurdles foreign companies have been able to propose new products that complete the existing local product range and to increase competition in the local market therefore potentially enabling prices to go down for consumers.

However in most cases companies at present are obliged to adapt their products, processes and information provided to the specific local customer protection rules and therefore tend to develop and market specific products adapted to the local laws. Consequently, they only benefit from a limited level of synergy: possible synergies are often limited at present to the usage of a common IT infrastructure (or part of it) and to the sharing of certain corporate functions, but there is potential for further synergies that could lead to greater economies of scale and reduced prices for consumers.

This leads certain industry players to consider that at present there are little specific advantages of developing a new activity in EU member states apart from the European passport and the use of the Euro, compared to developing business in another international market.

Industry observers consider that cross-border synergies are limited at present in the European financial services industry and that this penalises the EU growth rate by as far as 0,5 to 0,7% of the PIB (figure quoted in Les Echos 18 January 2006).

(1) Financial services remain in general a proximity business requiring advice and personal contact and only a very limited fraction of European consumers would be ready at present to shop around Europe via internet to find the best offers).

There are certain well-known exceptions in the mortgages market in particular:

- people who acquire a house in a foreign country and get a mortgage in that country (around 15 million households in Northern and Central EU countries are expected to buy a secondary house in Southern European countries in the coming 10 years according to figures put forward by the UCI (Revue Banque Mai 2005)
- people who live near the border and who working in the nearby foreign country get a mortgage in the country where they work ("frontaliers")

The current attempts to harmonise European legislation related to consumer protection can be considered as steps in the right direction but have not been sufficient yet to develop an integrated market

The issue of harmonizing consumer protection is naturally at the forefront of EU initiatives:

- Articles 95 and 153 of the Treaty sets out the requirement for a high degree of consumer protection as a necessary feature of a genuine EU-wide internal market.
- There are a number of specific EU Directives on aspects of financial services (Consumer Credit, Distance Selling, Unfair Commercial practices...). Many of these Directives focus on providing consumer protection through regulating the competence and financial strength of the providers. Others, such as the Consumer Credit Directive, aim at making it easier for consumers to make well-informed choices.

The need for a common approach was recognised by the European Commission in its proposals of May 2002 for enhancing consumer protection policy.

The May 2002 paper gives three primary objectives:

- A high common level of consumer protection - explicitly bringing into line (through a combination of directives, standards and promotion of “best practice”) different regimes and minimising Member States’ ability to adopt a different approach.
- Effective enforcement of consumer protection rules - building consumer confidence by demonstrating that suppliers (and Member States) are being obliged to adhere to robust rules.
- Involvement of consumer organisations in EU policies - demonstrating that the voice of the consumer is being heeded.

The Directive concerning unfair business-to-consumer commercial practices in the internal market, which the European Commission adopted on 18 June 2003 and reviewed on May 2005, is also a step in the right direction:

- The Directive clarifies consumers’ rights regarding unfair commercial practices.
- It also sets out consistent rules across the EU in this area to prohibit unfair commercial practices.

Despite these initiatives many observers consider that the progress made so far to harmonise consumer protection regulations at the EU level is insufficient due in particular to the complexity and heterogeneity of existing dispositions at the domestic level. and to the heterogeneity of local transpositions for previous initiatives.

Further harmonisation of EU consumer protection laws would benefit consumers in 2 main ways: reduced prices and greater choice of products

Industry players would be able to increase synergies leading to potential economies of scale and price reductions if potential cost reductions are at least partly passed on to consumers (potential cost reductions for financial institutions in servicing, distribution, origination and funding costs).

In addition foreign players would be able to access new markets more easily enabling them to:

- Close possible product gaps in the local markets: this could mean products more closely aligned with borrowers' needs for existing borrowers as well as access to credit for some segments insufficiently served at present
- Increase competition which could put pressure on prices.

Targeted full harmonisation appears to be an adequate solution for many industry players and observers to foster more harmonization

Most industry players consider that harmonizing the whole extent of existing dispositions of EU consumer protection laws leads to a high level of complexity as illustrated by the first proposal for a "consumer credit" directive. This approach is very complex because it involves finding solutions to harmonise all existing dispositions and can lead to aggregating the strictest national dispositions which would be detrimental to the industry while not necessary fulfilling the needs of the average consumers.

At the other end of the scope, a stand alone mutual recognition without any targeted harmonisation is considered inadequate in many cases because it can lead to the co-existence of products developed under many different legal regimes within a given country and can lead to potential distortions of competition between banks depending on the country in which they are established.

The option favoured by the industry and put forward in the proposals made by the EFR in 2005 (in particular for 3 industry sectors: consumer credit, mortgages and investment products or savings) is targeted full harmonisation. Its objective is full harmonisation of the main dispositions that are necessary to:

- Guarantee an adequate and reasonable level of consumer protection adapted to the average needs of EU consumers with a particular attention paid to the priority dispositions that are in the interest of the consumer
- While enabling the industry to develop synergies and economies of scale at the EU level on the areas that are key for their economics.

However the scope of topics selected for harmonisation and the degree of precision required for harmonising dispositions on these topics needs to be determined on a case-by-case basis (depending in particular on the product / service considered) to avoid creating unnecessary complexity.

This solution enables financial institutions to offer their products under the same key legal requirements in all Member States (enabling them to develop economies of scale) and prevents consumers from being confronted with different legal regimes for the same product without losing protection.

The EFR recommended in 2005 a focused harmonisation of the key issues and mutual recognition for other issues. (1)

(1) It is worth noting that targeted full harmonisation since it is focused on key common issues cannot solve all the problems and that the fields not covered by harmonised dispositions can still be covered by national legislation combined with mutual recognition if necessary.

5 key principles were proposed to go towards a common and “reasonable” consumer protection regime:

- Consumers should receive the appropriate information that would enable them to make an informed decision. This means in practice:
 - o An emphasis on quality of information not quantity
 - o The consumer should not be overburdened with information
- Customers should be given time or opportunity to reflect, either before committing themselves
- Customers should be granted a withdrawal right
- Customers should be able to receive advice tailored to their personal circumstances, but only as an option if they want it. Consumers have an obligation to themselves to ensure they have sought and obtained appropriate advice before signing up to any financial commitment.
- Regulators should ensure there is a cheap and easy scheme for consumers to obtain redress where they have been sold wrong or inappropriate products or have been improperly advised.

As an example, industry players consider that the modified version of the consumer credit directive goes in the right direction of focused harmonisation but that certain improvements are necessary

The industry considers that the following objectives should be pursued through the Directive:

- Consumers should benefit from an equivalent level of protection on the key points of a credit operation whether they buy a credit from a local financial institution or from an institution from another EU country. This would favour the confidence of consumers in products offered by foreign providers.
- Financial institutions should be able to implement a maximum level of synergies to bring their costs down which will enable them to provide their consumers with more favourable conditions. They should be able to have a common approach for the development of products, the overall management of products and the processing of the credits in particular. Commercial and middle office processes (sales, credit decisions, setting up of the credit and follow-up of unpaid monthly payments) should be the only activities to remain at the local level although central shared IT systems can be used to support these activities.
- Lenders should also benefit from a reduction in credit and risk management costs that could accrue from diversification and scale as they develop cross-market asset portfolios and from lower funding costs due to a more liquid capital market.

The Commission’s revised proposal for a EU consumer credit law of October 2005 is considered by the industry as a progress compared with the initial proposal of 2002 as it is clearly focused on the key issues for consumer protection.

This leads to focus harmonisation on 7 main themes for which no domestic room for manoeuvre or interpretation should be left during the national implementation of the directive to enable industry players to benefit from sufficient synergy potential while

defining a homogeneous level of consumer protection adapted to the average needs of EU consumers.

(Consequently article 21 § 2 of the proposal of modified directive should be modified):

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- Pre-contractual information
- Contractual information
- Definition and calculation of interest rates
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- Linked credits
- Early repayment

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Once these additional precisions have been specified, Member States should not be allowed to introduce specific domestic consumer protection requirements regarding these topics.

Eurofi contacts:

Marc Truchet, ICME Associate Partner:
Didier Cahen, Secretary General of Eurofi

marc.truchet@icme-group.com
cahen.didier@wanadoo.fr

Appendix 1:

Examples of issues that need to be further specified in the consumer credit directive proposal on the main themes identified above.

More detailed proposals of the industry can be found in the document published in May 2006 by EBIC:

- Advertising: compulsory information (figures particularly) put forward in advertising should be specified and kept reasonable
- Right of withdrawal:
 - o The directive should define whether it is possible or not to provide the funds lent during the withdrawal period
 - o The delay of withdrawal should be fixed according to common market practices taking into account the constraints of financial institutions, distributors and the interests of consumers. EBIC proposes to reduce the present proposed delay of 14 days to 7 days and for credit agreements signed at the point of sale a further reduction to 3 days is proposed upon agreement with the customer
- Linked credits:
 - o The link between the credit contract and the sales contract should be defined more clearly and objectively
- Early repayment: the directive should determine:
 - o The reasonable reduction of the total cost of the credit to which the borrower is entitled
 - o The amount or the calculation method of the indemnity due