

RETAIL FINANCIAL SERVICES IN THE SINGLE MARKET

The UK response to the EC Green Paper

Introduction

1. The United Kingdom (“the UK”) submits this paper as an initial response to the Commission’s Green Paper on Retail Financial Services in the Single Market (COM(2007) 226 final). It has been prepared by HM Treasury, the Office of Fair Trading and the Financial Services Authority.
2. The UK is content for this response to be placed on the Commission’s website.

General comments

Background

3. The financial services sector plays a unique role in any economy, whether at the national, European or global level. It has three linked functions:
 - to enable savers, borrowers and investors to make provision for future needs by providing intermediation and securing the transmission of funds along the “investment chain”;
 - to help businesses, organisations and individuals manage risk by providing insurance products, derivatives, collective investment schemes (UCITS) and other means of portfolio diversification;
 - to enable businesses, organisations and individuals to store, access and move wealth by providing bank accounts and payment systems.

These functions give the financial services sector both strategic importance in the internal market as a whole and make the sector an important part of the internal market in its own right.

4. The UK fully supports the development of the internal market in all areas and considers that this important objective can best be furthered, in relation to financial services as in relation to other sectors, by following a coherent and principled approach to the development and formulation of internal market policies. These policies need to be:
 - a) clear about purpose - focused on promoting jobs, growth and prosperity, through the creation of a dynamic and competitive internal market (with greater competition, lower prices, and more opportunities for business);
 - b) focused on priorities – part of a systematic approach with policy priorities set according to sound analysis of where the economic benefits to consumers and businesses are greatest;
 - c) taken forward at the right level - based on cooperation and the principle of subsidiarity, so that EU-level action is taken to remove barriers to trade and boost consumer confidence only where problems cannot be sufficiently tackled by individual member states;
 - d) chosen from a modern and flexible framework – with policy makers embracing a wider range of policy tools, including more pro-active use of competition policy and non-regulatory mechanisms that are easier to adapt to new areas of consumer detriment.

5. Considerable progress has already been made in bringing forward the internal market in financial services. Building on the fundamental principles in the Treaty – the free movement of goods, services, labour and capital and the freedom of establishment - a comprehensive legislative framework (the “internal market directives”) has been established to approximate the laws and practices of member states so that the internal market can operate in practice. The internal market directives also include minimum prudential standards for authorised financial services providers, a high degree of harmonisation of conduct of business rules and provision for supervisory co-operation. These directives have served Europe well both in wider economic terms and in

delivering some significant gains for participants in wholesale financial markets - a process that is ongoing through the implementation of the Financial Services Action Plan.

6. In the UK's view, the primary way to make the internal market work for the consumer must be to ensure the implementation and enforcement of the existing measures, supported if appropriate with action by EU and national competition or regulatory authorities to address specific issues in specific markets. In relation to the legislative framework, the questions that need to be addressed are:
 - has the legislative framework allowed the internal market in retail financial services to develop as fully as is practicable;
 - if not, what are the blockages to the legislative framework operating effectively in relation to retail financial services;
 - what action might be taken by the Commission or member states to address these blockages, including where appropriate, whether there should be further evolution of the legislative framework.
7. Future action will need to take account of technological developments and the level of development in national markets. Any proposals will need to be underpinned by a realistic analysis of costs and benefits.
8. The UK therefore welcomes the Commission's clear commitment to better regulation in the Green Paper and the emphasis on the need to base policies on solid economic evidence and to subject policy proposals to thorough impact assessments. The advantages of this approach have been demonstrated in the case of Solvency II where there was extensive formal and informal contact with a wide range of stakeholders and full use of better regulation tools during the development of the Commission's proposal. This allowed the Commission to produce a high quality impact assessment and made a material difference to the quality of the proposed Directive. The preparation of the Code of Conduct on Clearing and Settlement has also

demonstrated the advantages of a non-regulatory approach. As the Commissioner for Internal Market and Services recently noted - we are “considerably further advanced today than we would have been had we gone down the route of introducing a directive. We also have a much more flexible arrangement that can be adapted as experience and circumstance dictates”¹. These successes from following a ‘better regulation approach’ can be contrasted with the case of the Consumer Credit Directive (CCD) where a better regulation approach was not taken and no impact assessment was brought forward in support of the proposals. A study of the Directive's economic impact commissioned by the European Parliament’s Committee on Internal Market and Consumer Protection suggested that the CCD on its own would not achieve a internal market and that alternative approaches may have been more beneficial². As the European Parliament study notes: "A large majority of national banking associations does not expect an increase in consumer confidence as a consequence of the proposed CCD, neither regarding consumer credit agreements concluded nationally or cross-border. A majority of national consumer organisations responding to the survey even have a negative view in this respect"³.

Wholesale and retail markets

9. EU-level policy makers and institutions have recently focused primarily on the integration of wholesale financial services markets and the establishing of modern prudential standards. Retail financial services markets are different from wholesale financial services markets. There will always tend to be a number of “historical” and “cultural” differences (e.g. language, longstanding legal restrictions on product design, interaction with national tax and social welfare systems, different patterns of spending, saving and borrowing) which mean that retail

¹ Speech to the European Parliament's Open ECON Coordinators Meeting, Strasbourg, 10 July 2007.

² Civic consulting study requested by European Parliament's committee on Internal Market and Consumer Protection under contract IP/A/IMCO/FWC/2005-58/LOT4/SC1 entitled “Broad Economic Analysis of the Impact of the Proposed Directive on Consumer Credit”, April 2007, p37.

³ *Ibid.* p39.

consumers will tend to prefer to operate nationally (or even locally) rather than cross-border. These differences cannot simply be “regulated” away nor can they be readily overcome through cross-border price competition by non-domestic providers. It is necessary to recognise that the vast majority of the 500 million EU citizens purchase, and are likely to continue to purchase, financial services products in their domestic markets.

10. However, it should not be assumed that there is clear separation of retail and wholesale financial markets. Business customers of financial institutions can range in size from micro-businesses whose needs for financial services products will be almost indistinguishable from the needs of ordinary retail consumers, to major multinational corporations. Small and medium-sized enterprises may well have a range of needs for financial products some clearly retail, others clearly wholesale in character. In addition, there will be high net worth individuals whose needs for financial services may on occasions be better met in wholesale than in retail markets.
11. Integration is already happening in retail financial services at both the European and wider international levels. There are essentially three models:
 - mergers and acquisitions – many EU financial institutions already have subsidiaries in other countries (both inside and outside the EU) and there are subsidiaries of non-EU financial institutions in member states. This is, and is likely to remain, the main way in which integration takes place;
 - alliances between financial institutions in different countries to market products, use brand names etc;
 - cross-border selling of financial products.
12. For most European consumers, buying financial services cross-border will almost always be an alternative to domestic provision. The shape of

that domestic provision will be very different between national markets. But cross-border purchases will rarely be a necessity forced on consumers by the absence of any domestic provider (including foreign owned domestic providers). As the number of consumers “shopping” cross-border for financial services products will be small in relation to a total market of 500 million people, it would be disproportionate to direct internal market policy solely towards the aim of expanding that market rather than aiming at promoting consumer welfare in the round. Policy on the internal market in retail financial services should therefore continue to be based on improving consumer welfare in local and cross-border markets. Unlike in the case of the internal market in consumer goods and services across the EU, it follows that the amount of cross-border consumer shopping should not be seen as the key measure of the success of the internal market in retail financial services. A more sophisticated approach is required.

13. However, it is necessary also to recognise that there are already consumers for whom cross-border transactions are both natural and necessary. Travellers, those who live near national borders and people with family or friends in other countries may need to make cross-border payments, use payment cards, or deal with financial institutions from their domestic markets, while in other countries. The EU has recently taken a major step forward in supporting the internal market in payment service-related activities with the Payment Services Directive (PSD) which is scheduled to be implemented by November 2009. The PSD will create the legal framework underpinning the industry-led SEPA project, which is ongoing work.

Objectives and tools

14. The primary objectives for any strategy for retail financial services must be to reduce the degree of market failure on the supply side and to secure increasing value for consumers over time, through improvements

in the sales process, financial advice, product quality and/or lower prices, by securing greater useful choice for consumers between providers and by assisting consumers to become informed and confident players in retail financial services markets.

15. The European Commission is right to emphasise in their interim report on the Single Market⁴ that a new set of tools is required to optimise the internal market and complement the existing *acquis*. The UK agrees that a policy designed to increase cross-border consumer activity or harmonise national systems as an end in itself would not be the right way to proceed. The better approach would be to focus on removing barriers to firms delivering products and services through the various internal market tools already available. This will mean making effective use of a range of tools such as:

a) sharing best practice - for example:

- in developing approaches to promoting financial literacy and consumer capability,
- in using the European Competition Network (ECN) to provide a forum for sharing best practice,
- by encouraging greater co-operation between national ombudsman schemes and ADR mechanisms through FIN-NET, and
- in developing codes to facilitate bank account switching;

b) making better use of national competition and consumer law enforcement and policy - for example:

- in tackling agreements or practices substantially affect competition within an individual member state,
- in tackling anti-competitive product tying arrangements in national markets, and
- in ensuring that there are no anti-competitive restrictions on access to consumer credit data;

⁴ COM(2007)60. Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions on a Single Market for Citizens – Interim report to the 2007 Spring European Council.

- c) ensuring effective implementation and enforcement of existing internal market directives – the UK expects that the Commission will devote considerable resources to this activity now that the negotiation phase of the FSAP has largely ended;
- d) rigorously reviewing existing ‘general good’ and similar provisions at national level to ensure that they are not anti-competitive and benefit consumers rather than protect existing domestic providers;
- e) ensuring that the benefits from greater competition, technological progress and the completion of the internal market in wholesale financial services can be passed on in retail financial services markets – for example, the benefits in terms of access to market infrastructure in other member states for providers arising from the modernised institutional framework established under MiFID;
- f) encouraging market-led solutions, co-regulation and industry codes of conduct - for example by supporting industry-led initiatives to develop mortgage funding arrangements;
- g) making more use of EC level competition law enforcement where there is evidence of anti-competitive practices across member states – for example, by following up the DG Competition enquiries into competition in the financial services area in relation to:
 - anti-competitive co-operation between banks, and
 - payment card networks and interchange fees;
- h) facilitating the development of pan-European products - for example, building on the success of UCITS to explore whether optional “28th regime” products could be made available in other areas; and
- i) reviewing the existing *acquis* to ensure that it is not acting as a barrier to cross-border activity - for example the work that CEIOPS is undertaking in examining whether the Insurance Mediation Directive is meeting its internal market and consumer protection objectives or the Commission’s review of the Distance Marketing Directive.

16. In view of the current differences between national regimes, widespread attempts to create a single, harmonised regulatory regime are very unlikely to yield benefits that outweigh the costs. However, by applying the tools outlined above, the UK considers that effective steps can be taken to ensure that the benefits of the internal market can be translated into meaningful improvements in consumer welfare in Europe.

Answers to specific questions in the Green Paper.

- (1) *Do you agree with the objectives and priorities set out in this paper?*

The UK agrees that the primary objective must be increasing consumer welfare and welcomes the Commission's commitment to examining the evidence and identifying the barriers to consumers shopping cross-border. However, there are natural reasons (culture, language etc) why consumers will continue to opt for familiar products distributed locally. As a consequence, EC-level intervention in retail markets should be much less than in wholesale markets. Applying better regulation principles will reduce the risk that any initiatives are shown in retrospect to have made little positive difference or added significant costs, and will help target any new action on areas of genuine need where there is a real prospect of success.

- (2) *Are there issues that are not covered in this Green Paper, which are important for the integration of retail financial markets and to which the Commission's attention should be drawn? For example, are consumers in their everyday life confronted with requirements or limitations from either financial services providers or other stakeholders (employers, social security, administrations, businesses, etc.) which restrict their ability to use cross border financial services (such as an obligation to have a bank account or insurance policy in one specific country, etc.).*

The UK believes that that main focus should be the completion of initiatives already under way e.g. Solvency II, MiFID implementation, SEPA and UCITS etc.

Lack of effective competition in local markets probably remains a key source of consumer detriment in the EU as a whole and significant welfare gains might therefore be achieved by national and EU competition authorities working together to remove barriers to entry, anti-competitive practices, and other obstacles to effective competition. Action will also be needed to promote consumer understanding and competence.

One issue that is not discussed in detail is implementation and enforcement. The Commission may wish to look again at the *acquis* and whether improvements can be made at member state level to fulfil objectives which have already been agreed.

- (3) *The Commission has undertaken several initiatives to improve consultation with consumers and to secure their input into its policy making. Should further steps be taken and, if so, what steps?*

The UK supports the use of consultation both, when measures are developed, and when cost-benefit analyses or regulatory impact assessments are prepared. The UK supports the Commission's

attempts to involve consumers in policy creation (e.g. in the area of mortgages, through the Mortgage Forum Group and in relation to the review of the Simplified Prospectus, where the Commission has emphasised to CESR the importance of consulting with consumer groups). Obtaining meaningful feedback from the users of retail financial services will always have to play a vital role to play in the formulation of policy in this area.

- (4) *Is consumer choice unnecessarily limited by restrictions on the providers and channels through which they access retail financial services? What are, in your experience, these restrictions?*

The UK understands that in some member states mortgage lending is an activity restricted to licensed banks (credit institutions). Other member states (including the UK) permit mortgage lending by a wider range of firms such as wholesale market-funded and non-bank lenders. The UK experience is that such lenders have contributed to consumer access and choice and the work of the Commission's Mortgage Funding Expert Group has highlighted the benefits of enabling such lenders to be active in all markets.

In other areas of financial services distribution various models operate around Europe, with a universal banking model in some member states and a more decentralised adviser framework in others. The UK authorities believe that provided the various models conform to *acquis* provisions, any applicable national regulations and competition law, there is no one distribution model that is inherently better suited than others to the diverse commercial conditions that exist around Europe.

- (5) *Despite efforts, in particular the creation of FIN-NET, the handling of cross-border consumer complaints in the field of financial services still remains problematic. The Commission would welcome input as to the ways to improve the current situation. For example, should Member States be obliged to ensure that alternative dispute resolution (ADR) schemes are in place? Should providers be obliged to adhere to an ADR scheme? Should they be contractually obliged to offer ADR mechanisms to their clients?*

The UK fully supports greater co-operation between national ombudsman schemes through FIN-NET and believes that FIN-NET has a role to play in facilitating the development of a more integrated market in retail financial services by giving consumers greater confidence to purchase products on a cross-border basis.

The Consumer Protection Co-operation Regulation (Regulation (EC) No 2006/2004) already supports the use of FIN-NET and other cross-border supervisory contacts and the UK does not consider that there is a case for further EC-level legislation in relation to ADR schemes. ADR schemes need to be tailored to national circumstances to meet the needs of consumers and the providers who primarily operate in the home

market, and to be compatible with local law and practice in consumer protection and other areas.

Non-legislative action to support the ombudsman network and ensure FIN-NET works effectively should therefore be encouraged. Further work to promote minimum standards and greater commonality in approach for national ADR mechanisms, and to promote greater cross-border access to compensation schemes could also be valuable in the longer term. Member states should be encouraged to ensure that their out-of-court redress arrangements become members of FIN-NET, where they are not already members.

- (6) *The creation of the Single Euro Payments Area (SEPA) offers challenges and opportunities for businesses and consumers alike. What do stakeholders think of SEPA's impact on consumers? Should consumers be more involved in the governance and the preparation of SEPA?*

The UK understands that the Commission is undertaking work to monitor the overall development of SEPA as well as its economic and competition impacts. Although SEPA concerns Euro payments, this work being undertaken by the Commission is very important to the UK, in view of its objectives for open access, competition, efficiency and innovation in payment systems. In particular, appropriate governance arrangements and transparency to end-users may play an important role in supporting pro-competitive SEPA services.

- (7) *With view to the launch of its study on credit intermediaries, later this year, the Commission would like to know whether stakeholders believe the current legislative framework to be sufficient and if consumers face any particular problems in dealing with credit intermediaries, particularly on a cross-border basis.*

Intermediaries already play a key role in the UK mortgage market, with around two thirds of mortgage business being conducted through intermediary channels. The reasons for differences in the level of intermediary activity in national markets are not clear and the Commission study may shed useful light on this issue. However, the case for establishing a new legal framework for mortgage intermediaries at the EC level has not been made.

- (8) *The Commission believes that it has an important role to play in developing a competitive, open and effective market for long-term savings, retirement and pension schemes that meet consumers' needs. Do stakeholders agree and how could the Commission contribute? Could an optional legal EU-wide regime ("28th regime") for savings and/or 3rd pillar pension products be envisaged?*

The UK supports the development of a competitive, open and effective market for long-term savings, retirement and pension products and considers that the implementation of the recommendations of the FSC

working group on the role of financial markets in the provision of retirement income could deliver real benefits.

Furthermore, the Commission's planned work to develop UCITS further, together with retail oriented policies in the Asset Management White Paper, represents an important step towards increasing the European market for long term savings products.

However, developing "28th regime" products may be complex. It is necessary to distinguish between the underlying financial product itself (i.e. an annuity or units in a collective investment scheme) and the "wrapper" (e.g. a pension arrangement or life assurance policy) in which it is sold to consumers. In some member states (including the UK), support for long-term savings by consumers is provided in different ways through national direct tax systems, while institutional arrangements for occupational (supplementary) pension schemes vary considerably between member states, as does the share of occupational pension schemes and universal state pension schemes in providing retirement income. The development of a competitive, open and effective market in long-term savings, retirement and pension products could be assisted by ensuring that there are no artificial or anti-competitive barriers to the inclusion of underlying financial products from other member states in an individual consumer's wrapper.

- (9) *Do you think that there could be benefits for both banks and consumers, if banks would have the opportunity to offer an optional simplified standardised product, which would have a good level of consumer protection, would be easy to understand, and could be offered across borders without the need to be modified to fit local rules?*

In principle, making simplified standardised products available could bring benefits for both providers and consumers. However, the provision of such products must be optional for providers and it will be important that providers remain able to compete using products tailored to meet the needs of their customers.

- (10) *The Commission believes that more could be done to improve consumers' financial literacy and capability. Possible measures include developing guidelines or promoting best practices. The Commission would welcome input on how this policy should be further developed at the European level.*

The UK agrees with the Commission that financial literacy, or capability, is increasingly important, as consumers play a greater role in managing their financial affairs. At the same time, the range, complexity and sophistication of financial services available to the consumer also continues to increase. As the Commission notes, financial education is a matter for Member States. The UK Government recently set out its long term approach to financial capability, including aspirations to ensure that children have access to financial education, adults have greater access

to generic financial advice and public services play a role, where appropriate, in supporting financial capability. This work complements the Financial Services Authority's National Strategy on financial capability and supports the UK Government's objective of promoting greater financial inclusion. The Commission could further support Member States by promoting best practice and innovation in these areas.

- (11) *Do you think that, as they stand, the provisions on consumer information contained in financial services directives are adequate and consistent with one another? Were it not the case, how could the Commission ensure that information requirements are set at the right level, ensuring proper information but without creating any overload? Do you think that informing consumers is sufficient or that advice should also be provided? If yes, should that be compulsory or on request?*

There may be advantages in codifying and simplifying information requirements to ensure greater consistency in the financial services directives⁵.

Distribution mechanisms for financial services products vary significantly around Europe, and so any disclosure rules must take into account the differing delivery channels for the disclosure. Furthermore information requirements should be future-proof and technology neutral. This is important so that sales channels such as text message or email are not adversely affected.

Any proposed information requirements would need to be carefully tested with consumers and subject to full cost-benefit analysis before being introduced.

- (12) *Measures to improve lenders' access to credit data will be discussed in the context of the forthcoming White Paper on Mortgage Credit. The Commission believes that more could be done to promote the accessibility of credit data, in particular on a cross-border basis. Who should be able to access consumer credit data? How could the cross-border transferability of consumer credit data be improved, ensuring in particular that mobile credit data follows increasingly mobile consumers? Could a memorandum of understanding, ensuring smooth data circulation between credit bureaus, be a workable solution?*

The UK believes that access to credit data is vital if firms are to compete in unfamiliar markets and price their products correctly. Therefore the UK considers that there should be access for credit professionals on non-

⁵ For example, the Insurance Mediation Directive, the Distance Marketing Directive and the E-commerce Directive have differences in their consumer information requirements. This poses consistency issues for providers and intermediaries when disclosing on products covered by the Directives at the same time e.g. initial disclosure for retail intermediaries.

discriminatory terms – similar, for example, to the principles of reciprocity adopted by credit reference agencies and their users in the UK . It is important also that such access should not be restricted to credit providers that are licensed banks or credit institutions but should include all professional credit providers regardless of whether they are authorised under national laws implementing the financial services *acquis*.

On other issues likely to be dealt with in the Commission's forthcoming White Paper on Mortgage Credit, the UK supports the central principle endorsed in the Mortgage Funding Expert Group report (December 2006) that lenders should be free to choose the most appropriate funding methods. It may also be worthwhile to support industry-led initiatives to develop mortgage funding arrangements where appropriate, for example to promote best practice to improve the consistency and transparency of reporting standards.

There is also scope for the Commission to promote market-led initiatives to facilitate lenders access to foreign markets including developing trusted, common valuation standards, raising confidence in repossession procedures and encouraging the development of electronic access to land registries.

Any work on mortgage markets – which are very different from consumer credit markets – needs to be taken forward in line with better regulation principles. The UK considers that a case for a Directive on mortgage credit has not been made.

- (13) *Fragmentation of retail insurance markets, for example in the field of motor insurance, does not allow consumers to reap full benefits of EU integration in this area. Do you think that more should be done at EU level to address this fragmentation?*

The UK is supportive of the current work that CEIOPS is undertaking in examining whether the Insurance Mediation Directive is meeting its internal market and consumer protection objectives, and urges the Commission to undertake a revision of the Directive in 2008-09. The UK believes that the scope of the Directive should be actively considered as part of this work, along with a proper assessment of the costs the Directive imposes on firms, and an assessment of its impact on cross-border business. Furthermore the UK is supportive of the Commission's review of the Distance Marketing of financial services Directive. It is important that this review is undertaken with close reference to the work on the Insurance Mediation Directive so that financial service providers are not subject to inconsistent requirements, for example on information provision.

National differences in such things as insurance law, 'general good' provisions, liability for damages and consumer protection law, tax

requirements, underwriting experience and claims handling requirements mean that there will always be practical limits on the willingness of insurance companies to undertake cross-border business. Nevertheless, there are instances where cross-border business is done when a business case can be made. For example, UK firms are active in Spain, Germany and Italy and Irish firms are active in the UK, Belgium and the Netherlands.

Certain retail insurance markets (e.g. motor insurance) also appear to be competitive at national levels. This may reduce the incentive for consumers to purchase products cross-border.

The UK does not therefore see a particular need for legislation to bring about greater harmonisation of retail insurance markets. However, action to target specific identifiable market failures where this could be supported by proper analysis and an appropriate assessment of the costs and benefits of intervention could be justifiable.

- (14) *Customer mobility and competition are closely associated. The Commission would welcome input as to how customer mobility could be enhanced. In particular, in the field of bank accounts, and as a follow-up to the Expert Group's work, would stakeholders see merits in, for example, having EU wide account switching arrangements? Will SEPA have an impact on customer mobility?*

It is a valid goal to make it easier to switch bank accounts for European consumers but, realistically, most consumers may prefer to maintain bank accounts and relationships with banks in the country where they live.

Like other Member States, the UK has considered this problem and implemented an approach designed to reduce disincentives to switch, thus driving greater competition in this market. There may well be a case for sharing best practice in this area and for the Commission to support and encourage action by national competition authorities to make switching easier in national markets.

The UK notes the report of the Commission's expert group on customer mobility. If overall performance is to be raised, this might be achieved through the development of a model code on a non-legislative basis which could be adapted in individual Member States to meet local circumstances. More specifically, the costs of measures to facilitate account number portability across the EU may outweigh the projected benefits. That would be the case in the UK where account details (e.g. direct debits) are transferred but not the account number. Transferring account numbers would require the development of new payment systems not just upgrades to existing systems, for a very limited benefit.