THE
INVESTMENT
ASSOCIATION
INVESTMENT MATTERS

The Investment Association
Camomile Court, 23 Camomile Street,
London, EC3A 7LL

T +44 20 7831 0898
E enquiries@theia.org
W theinvestmentassociation.org
Twitter @InvAssoc

IA consultation response: European Commission Green Paper on Retail Financial Services

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ABOUT THE INVESTMENT ASSOCIATION

The Investment Association represents UK investment managers. We have over 200 members who manage more than £5.5 trillion for clients around the world. Our aim is to make investment better for clients so they achieve their financial goals, better for companies so they get the capital they need to grow, and better for the economy so that everyone prospers.

We cover every link in the investment chain:

- We work with investors, helping them to understand the industry and the options available to them. We know investing can seem daunting, so we work hard to make it clear and accessible.
- We work with investment managers, promoting high standards and the need to put clients first. Our work includes helping members to manage money efficiently and communicate effectively.
- We work with the companies we invest in, helping them to achieve better long-term results and, ultimately, greater returns for investors and the economy.
- We work with regulators and governments around the world. We've built close, trusting relationships with these bodies and play an active role in shaping the rules that govern the industry.

The Investment Association's purpose is to ensure that investment managers are in the best possible position to help people build resilience to financial adversity, achieve their financial objectives and maintain a decent standard of living as they get older. It is also to help investment managers maximise their contribution to economic growth through the efficient allocation of capital.

INTRODUCTION:

The Investment Association welcomes the opportunity to respond to the Green Paper on retail financial services. We believe it is timely for four reasons:

1. CMU and market-based finance. There is a clear link, as the Green Paper notes, between the CMU agenda and the successful operation of a cross-border financial services industry. As the role of market-based finance becomes more important, it is essential to ensure that financial services products and providers act as an effective link between those seeking to save and those looking to capital markets for company funding and investment in other projects, such as infrastructure. Only with a capital market intermediation structure that serves both savers and those looking for finance can CMU and the European single financial services market be pronounced a success.

An ancillary point here is the opportunity to make long-term investment more tangible for savers, putting the focus more firmly on the 'real' economy and the central importance of activities such as investment management and banking in funding businesses and activities that contribute to current and future growth. While initiatives such as the ELTIF are a welcome recognition of this role, there is an opportunity to embed this message more broadly and the industry is exploring ways to do this.

2. Changing patterns of saving. The notion of retail financial services is changing dramatically with demographic shifts and a transition towards greater individual provision for later life in the context of more constrained Government finances across much of Europe. This is particularly seen in pensions products where the growth of money purchase or defined contribution schemes seems likely to continue, and which effectively blurs the traditional retail and institutional investment management markets.

The Commission is right both to raise the prospect of greater cross-border personal pension provision (EPP) and, given point one above, to link it to CMU. In the United Kingdom, but also in other parts of Europe, there is growing evidence of households looking to residential property rather than more diversified provision for their long-term financial wellbeing. This is potentially dangerous from multiple perspectives: financial stability; productive investment in the wider economy; and appropriately diversified returns for savers. Again the Green Paper on retail financial services offers the opportunity to strengthen market diversity, even in areas such as fund management where a cross-border market already exists.

3. Accelerating pace of technological change. Digitalisation has been a feature of the landscape for some time and significant advances have already been made in online and app-based financial services provision. However, the pace of change has accelerated in recent years, such that the capabilities of technology to cope with much more complex data and decision sets have advanced. At the same time, societal attitudes have also shifted with the rising importance of peer experience as a measure of quality alongside traditional approaches such as formal advice from professionals. This has significant implications for patterns of tradition interaction in financial services – eg. branch-based advice versus online purchase based on what others may be choosing. In this context digital delivery is no panacea and carries its own risks. However, is it likely to be a central part of services provision in coming years. This is likely to lead to a broader debate across Europe about the nature of regulated financial advice and the role of

wider support mechanisms that facilitate product selection. This debate has already started in a number of countries, including the United Kingdom with the creation of the Financial Advice Market Review.

Technology also potentially offers the opportunity to facilitate access to products on both a national and cross-border basis via ‘Digital Passports’ which can verify the identity of savers and help to minimise what may sometimes be onerous requirements with respect to basic services such as opening bank or savings accounts. We note that different jurisdictions are at different stages of development in this regard and believe that exchange of best practice across EU member states may help to facilitate improvements within and between member states.

4. Distribution and the true cost of ownership. No piece of work on the retail financial services market can be complete without consideration of the role and relative cost of the core components in the value chain: product manufacture; distribution / advice. In looking at how competition may be stimulated, we believe that the European authorities should look carefully at the dynamics of distribution to ensure that, particularly where there are vertically-integrated delivery structures, consumers are offered both transparency of cost and effective choice. Differences in end-to-end fund management charges for similar funds across the European market suggest that there is much more work to do in this area. While MiFID focuses on the aggregation of cost, it will still be important for consumers to understand – and regulators to examine – the relative cost of different components within the value chain.

Cross-border fund management

The success of the UCITS framework can be seen both from a European cross-border perspective and in international context as a global brand. This success is based on several components:

1. A well-designed, EU legal framework that has been regularly updated since its inception in 1985 to reflect ongoing market developments and financial innovation.

2. An emphasis on consumer protection with strong oversight responsibilities via the depositary/custodian structure.

3. A fund passport allowing marketing – in principle - across all 27 EU Member States as soon as it has been authorised by the competent supervisory authority in the Member State where the UCITS is domiciled.

As a result of this, the choice of investment funds available to retail and institutional investors in each Member State is large and broadly diversified. However, there are a number of significant practical issues that prevent a more unified market, which we come back to in our response to question 2, notably:

• Direct obstacles to distribution, relating to a strong culture of vertical integration in significant parts ot the European financial services market;

• Indirect obstacles to cross-border distribution imposed by varying regulatory requirements in individual national jurisdictions, such as costs of registration for cross-border funds or complex templates for registration;

• Notwithstanding the advantages of being able to use multiple share classes to serve the European market, differences in the tax treatment of savings and investments across Europe also means that there are barriers to scale, as illustrated by barriers to fund mergers. In the near term, there may not be straightforward answers on tax harmonisation, and this may prove to be a problem for initiatives such as the EPP.

GENERAL QUESTIONS

1. *For which financial products could improved cross-border supply increase competition on national markets in terms of better choice and price?*

Given the relatively narrow range of financial services effectively available on a cross-border basis, there is wide scope for supply improvement, particularly in areas such as banking and insurance that have less-developed cross-border mechanisms than fund management . Long- term investment products are already successful across the EU (mainly UCITS but also AIFs) and key for the EU savings market. While there are other improvements that can be made in cross-border fund distribution (see our answer to Q2), an immediate question is how other parts of the financial services industry could draw on the success of UCITS.

First, on the product side some experiences from the UCITS regime could maybe serve as a role model to deliver successful cross-border financial services to retail clients. For example share classes are essential tools for cost-efficient fund management of collective investment. Share classes allow fund managers to respond to investors' varying needs relating to issues such as maximum/minimum investment amounts, types of fees and charges, denomination of currency, allocation of revenues etc. in a prompt and cost-efficient manner while maintaining a common management solution and offering the expertise of a particular fund manager to the whole fund. In particular, it is worth noting that creation of new share classes involves lower set-up costs compared to launching a new fund. Moreover, operating costs of large funds with different share classes are generally lower than for funds with lower levels of assets under management (e.g. in terms of transaction costs).

It is not advisable to discard these efficient methods without sufficient evidence for their misuse or any other kind of misconduct. Thus, while welcoming a common approach to the use of share classes by UCITS as envisaged by ESMA in its recent discussion paper, we caution against prohibiting the use of existing share classes, which clients choose to protect themselves from specific risks, such as currency risk, duration risk and equity market risk. Were ESMA to prohibit the hedging of such risks, this would damage the cross-border export of UCITS (including out of the EU).

Second, the method of delivery of (any) retail financial service through distributors is key. The EU could do more here to improve the customer experience. Challenges irrespective of financial product are:

- Ensuring delivery of whole of market (including of cross-border products)
- Efficient use of technology to improve existing distribution channels. Open architecture needs to be strengthened to develop this and allow access to the market for alternative models.

2. *What are the barriers which prevent firms from directly providing financial services cross-border and consumers from directly purchasing products cross-border?*

As rightly pointed out by the Commission in the consultation paper, language is a big barrier for retail customers accessing retail products across different Member States but the funds example shows that his can be overcome. Passporting and a harmonised product regime have made cross-border access to UCITS funds possible.

The existing legislation has some drawbacks however. In our view the following issues need fixing to secure the high levels of consumer protection and reputation of the UCITS regime (for more detail please refer to our response to the Commulative Impact Assessment of the Commission, submitted in January 2015: http://www.theinvestmentassociation.org/assets/files/consultations/2016/20160129-cmuciaresponseonlinesurvey.pdf):

- To bring self managed UCITS into better alignment with requirements for funds run by Management Companies for a higher level of consumer protection and more consistency across the single market.
- To improve access to economies of scale, the master feeder arrangements for UCITS need to be revived.
- For better tax outcomes for investors, the regime of fund merger needs to be modernised.

3. *Can any of these barriers be overcome in the future by digitalisation and innovation in the FinTech sector?*

In our view the most important impact of digitalisation for the retail market is the link between products and retail customers, ie. provision of access via the distribution / supply chain. When designed properly digital distribution instruments can deliver better information and choice of products to a greater number of customers more quickly than the current face to face advice model can. In combination with initiatives such as 'Digital Passports' (see answer to Q 22), there is an opportunity to significanctly enhance the consumer experience.

We do not believe however, that digitalisation is a silver bullet that can solve everything in terms of access to retail financial services. The evidence above is only a selection of theregulatory and commercial competition issues posing a problem to effective cross-border distribution.

4. *What can be done to ensure that digitalisation of financial services does not result in increased financial exclusion, in particular of those digitally illiterate?*

A key driver of financial exclusion is individual financial circumstances, particularly relating to issues of access to basic services such as bank accounts and credit that arise in more informal cash-based local economies. We believe that digitalisation presents ways to help bridge some of these divides, but clearly the financial services industry cannot neglect the more traditional needs of some clients, such as face-to-face.

On a general level, there is possibly a greater challenge, which is accessibility / inclusion as defined by the ability of individuals to understand and engageme with the products on offer. Product manufacturers and distributors as well as public education systems have to develop better methodologies to guide customers to help them satisfy their needs. This extends from the teaching of basic financial awareness in schools through to product information and consumer interfaces provided by the financial services industry. Once again, there is no silver bullet, but an obvious starting point for the investment management industry is the language it uses to describe the services it delivers and the ways in which it invests across different asset classes and markets. In the United Kingdom, the IA has been undertaking a project to look at this accessibility of language, with the ultimate ambition of supporting also consistency of usage across the industry.

Another area of obvious relevance is the range of products available. As described above, a growing need to access to high quality products should lead to competition and improvements for retail customers if the right underlying conditions, including regulatory structure, is in place.

5. *What should be our approach if the opportunities presented by the growth and spread of digital technologies give rise to new consumer protection risks?*

Consumer protection standards should be high, effective and coherent regardless of product offered/sold and distribution method used. From an investment and fund management perspective, neither cross-border nor digital distribution changes the fundamental importance of the consumer protection. As we note above, we believe that European regulation has helped to ensure a robust and internationally-respected model for investment funds. However, it is clear that both cross-border and digital distribution raise certain practical issues from a consumer protection perspective, notably: how to ensure that consumers access the right products; and how to obtain redress in circumstances where consumers feel that a product has not delivered.

Since the current regulatory regime has recently been renewed, we do not believe there is a need for further immediate change. Principles-based consumer protection rules were put in place via MiFID / IDD / Payment Services Directive MDD etc. Industry and Regulators are now implementating them and the next step will be observation of their impact and supervision of their success. If the regulations have been correctly designed, no further action will be needed for digital distribution of financial products. If, however, they limit innovation, a review of such regimes or parts thereof should be undertaken soon.

The MiFID II suitability regime might be such an example since it draws artificial lines between product categories irrespective of their actual characteristics and performance [complex/ non-complex] and limits ways in which customers can be informed / guided about what typically/generically could be done to help satisfying their needs.

6. *Do customers have access to safe, simple and understandable financial products throughout the European Union? If not, what could be done to allow this access?*

As mentioned above, for most products to be accessed by retail clients, distribution is key. Therefore, a regulatory environment that allows product providers efficient and non-discriminatory access to distribution channels throughout the Single Market will enable providers to deliver the best products to satisfy customers' needs.

As the investment fund model shows, when harmonised product regulation (UCITS) or in the case of PRIIPs distribution and point of sale disclosure requirements are in place, customer information about characteristics and risks of products will be available for all citizens, irrespective of where they are.

7. *Is the quality of enforcement of EU retail financial services legislation across the EU a problem for consumer trust and market integration?*

The quality is not a problem *per se*. Rather, the different implementation of EU rules in different countries is the problem. Whether regulators goldplate or aim to protect national champions/industry from cross-border competition, they limit cross-border activities. The IA accepts that different market structures and traditions in cases need different treatment but that should under no circumstances lead to limits on access to clients / opportunities to deliver best possible value to clients across borders.

For the funds industry one area of such concern is lack of sufficient open architecture and horizontally integrated manufacturing and distribution models. Access to the range of UCITS available throughout the EU is limited by nationally organised distribution systems with their individual limitations and biases.

In order to encourage consumers to engage with their needs and responsibilities, they need to trust the providers. To earn that trust, industry has to demonstrate that it can deliver quality products at competitive prices and outcomes in the interest of clients. At the same time Governments and regulators need to understand and articulate that customers should also deal with their needs responsibly. A customer might buy an unsuitable product without it being a case of professional misselling. Clear interpretation of rules and allocation of responsibility will help establish a level playing field generating trust and henceforth adequate provision of retail financial services.

8. *Is there other evidence to be considered or are there other developments that need to be taken into account in relation to cross-border competition and choice in retail financial services?*

[No IA Response.]

<u>Questions</u>

9. *What would be the most appropriate channel to raise consumer awareness about the different retail financial services and insurance products available throughout the Union?*

We believe that the role of Government institutions and regulators, whether at national or European level, is not to point citizens to particular financial products. Market participants are addressing this challenge and will continue to do so, adapting to the changing desires of their clients. However, public information, accessible ways and debates to help clients understand their needs and achieve their financial aims (eg. savings targets) are a must to build up financial resilience of the individual.One way of doing that is to continue standardisation of clear fair and not misleading information. In this regard, the UCITS KIID has been a significant success, allowing in particular much more consistent presentation of product charges. Such information should be accessible and not only paper-based. A key responsibility of legislators and regulators is to ensure that there is sufficient flexibility in this regard while avoiding any dilution of consumer protection mechanisms.

10. *What more can be done to facilitate cross-border distribution of financial products through intermediaries?*

- Existing channels need to be encouraged to consider distributing from a wider range of products (more open architecture – compare MiFID II requirements for independent advisers).

- More transparency about the costs of distribution which in turn will lead to better competition between intermediaries (MiFID II will bring some of that for instruments in scope of that directive)

- High(er) requirements for quality of intermediation services to improve experience and outcomes for customers, irrespective of type of channel: digital or analogue; distance or face to face sales.

11. *Is further action necessary to encourage comparability and / or facilitate switching to retail financial services from providers located either in the same or another Member State? If yes, what action and for which product segments?*

The PRIIPs Regulation expects emergence of comparison websites of all packaged retail insurance or investment products regardless of domiciliation Member State. This will bring a new level of competition of products to the benefit of the consumers - a model that could be exported to other financial service products.

Questions

12. *What more can be done at EU level to tackle the problem of excessive fees charged for cross-border payments (e.g. credit transfers) involving different currencies in the EU?*

    [No IA response]

13. *In addition to existing disclosure requirements[1], are there any further actions needed to ensure that consumers know what currency conversion fees they are being charged when they make cross-border transactions?*

[1] European Parliament legislative resolution of 8 October 2015 on the proposal for a directive of the European Parliament and of the Council on payment services in the internal market and amending Directives 2002/65/EC, 2013/36/EU and 2009/110/EC and repealing Directive 2007/64/EC (COM(2013)0547 – C7-0230/2013 – 2013/0264(COD)). See Articles 59 and 60(3)

For all (future) regulated disclosure requirements the IA urges the Commission to keep in mind that paper-based disclosures are not going to meet the needs of growing digital natives consumers.

Questions

14. *What can be done to limit unjustified discrimination on the grounds of residence in the retail financial sector including insurance?*

    [No IA response]

Questions

15. *What can be done at EU level to facilitate the portability of retail financial products – for example, life insurance and private health insurance?*

Most nationally designed savings products have a feature of tax incentivisation as part of their offering. In order to increase portability of such products, harmonisation of tax rules will be necessary. Please refer to our response to the Commission Commulative Impact Assessment for more detail of limitations to cross-border fund investment (UCITS) and portability.

Questions

16. *What can be done at the EU level to facilitate access for service providers to mandatory professional indemnity insurance and its cross-border recognition?*

    [No IA response]

Questions

17. *Is further EU-level action needed to improve the transparency and comparability of financial products (particularly by means of digital solutions) to strengthen consumer trust?*

See above Q 11.

Questions

18. *Should any measures be taken to increase consumer awareness of FIN-NET and its effectiveness in the context of the Alternative Dispute Resolution Directive's implementation?*

    [No IA response]

19. *Do consumers have adequate access to financial compensation in the case of mis-selling of retail financial products and insurance? If not, what could be done to ensure this is the case?*

Questions

20. *Is action needed to ensure that victims of car accidents are covered by guarantee funds from other Member States in case the insurance company becomes insolvent?*

    [No IA response]

<u>Questions</u>

21. *What further measures could be taken to enhance transparency about ancillary insurance products and to ensure that consumers can make well-informed decisions to purchase these products? With respect to the car rental sector, are specific measures needed with regard to add-on products?*

    [No IA response]

<u>Questions</u>

22. *What can be done at the EU level to support firms in creating and providing innovative digital financial services across Europe, with appropriate levels of security and consumer protection?*

As stated above: service provision via digital channels should not be limited by regulation unnecessarily. We strongly endorse so called Digital Passport initiatives, designed to simplify AML checks that exist both in physical and online application procedures.

<u>Questions</u>

23. *Is further action needed to improve the application of EU-level AML legislation, particularly to ensure that service providers can identify customers at a distance, whilst maintaining the standards of the current framework?*

    [No IA response]

24. *Is further action necessary to promote the uptake and use of e-ID and e-signatures in retail financial services, including as regards security standards?*

Yes – see need to develop a digital passport as discussed in response to question 22. In our view this is clearly a single market initiative the Commission should be launching in order to enhance (online) accessibility to cross-border financial services. Any standardised method to help providers fulfill their KYC oligation cross borders and languages will help uptake of cross-border retail products.

<u>Questions</u>

25. *In your opinion, what kind of data is necessary for credit-worthiness assessments?*

    [No IA response]

26. *Does the increased use of personal financial and non-financial data by firms (including traditionally non-financial firms) require further action to facilitate provision of services or ensure consumer protection?*

High levels of data protection rules need to be upheld. Consent and transparency are key to gain consumers' trust in cross-border and digitally distributed products.

27. *Should requirements about the form, content or accessibility of insurance claims histories be strengthened (for instance in relation to period covered or content) to ensure that firms are able to provide services cross-border?*

    [No IA response]

Questions

28. *Is further action required to support firms in providing post-contractual services in another Member State without a subsidiary or branch office?*

Digital distribution will not require less presence on the ground near the customer. To make delivery more efficient more effort should be put into improving facilities enabling distance sales of financial services such as the digital passport as referred to above. But also harmonised product and consumer protection standards are key to developing large scale cross-border markets for financial products.

Burdensome barriers such as the requirement for installing a paying agent in the country of residence of the retail investor of a UCITS (and AIFMD) needs to be abandoned (see cumulative impact assessment response for detail).

Questions

29. *Is further action necessary to encourage lenders to provide mortgage or loans cross-border?*

    [No IA response]

Questions

30. *Is action necessary at EU level to make practical assistance available from Member State governments or national competent authorities (e.g. through 'one-stop-shops') in order to facilitate cross-border sales of financial services, particularly for innovative firms or products?*

    [No IA response]

31. *What steps would be most helpful to make it easy for businesses to take advantage of the freedom of establishment or the freedom of provision of services for innovative products (such as streamlined cooperation between home and host supervisors)?*

    [No IA response]

Questions

32. *For which retail financial services products might standardisation or opt-in regimes be most effective in overcoming differences in the legislation of Member States?*

    [No IA response]

33. *Is further action necessary at EU level in relation to the 'location of risk' principle in insurance legislation and to clarify rules on 'general good' in the insurance sector?*

    [No IA response]