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COMMISSION STAFF WORKING DOCUMENT

ON THE FOLLOW UP IN RETAIL FINANCIAL SERVICES TO THE CONSUMER MARKETS SCOREBOARD

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EXECUTIVE SUMMARY

The Consumer Markets Scoreboard is the main market monitoring instrument for the consumer policy area. After the publication of the first Consumer Markets Scoreboard early in 2008, the Commission identified retail financial services as a sector where consumers are faced with a significant number of problems. Different retail financial services issues were singled out as areas where consumers experience difficulties. These were pre-contractual information, advice, the level and transparency of bank fees and bank accounts switching.

Pre-contractual information is one of the key instruments intending to facilitate consumer's decision-making when buying financial services. Yet, evidence shows that in many cases the information is incomprehensible, insufficient and presented in too many different ways making it difficult for consumers to compare different offers and to obtain the best deal. Adequate pre-contractual information for retail financial services can be summarised as not too much, but necessary and sufficient information, which is presented in a timely comprehensible manner. In order to achieve this, the Commission approach has been, for certain types of product, such as consumer and mortgage credit as well as UCITS, to promote the standardisation of pre-contractual information obligations through the adoption of carefully designed and tested formats. Where product features allow this, a well-drafted set of standardised information disclosures facilitates clearly the comparability of offers, and helps ensure that consumers understand and can use information to make more informed decisions such as switching providers. Therefore, for instance, the new Consumer Credit Directive provides for standardised, comparable information as a mandatory tool to inform consumers before concluding a credit agreement.

The problems of reliability of advice and the inbuilt conflict of interest faced by advisors due to remuneration systems that can bias them towards selling particular financial products are clearly matters which deserve further attention. There is growing evidence, that consumers often do not obtain suitable advice on financial services. The financial crisis further drew attention to deficiencies in the advice given to consumers at point of sale, leading people to purchase inappropriate products. Furthermore bank employees or intermediaries may often be faced with inherent conflicts of interest. One of the causes of such conflicts of interest may be

remuneration structures which are driven by the profit of the financial services provider rather than by the suitability of a product for the consumer. EU legislation, i.e. the Directive on markets in financial instruments, was adopted in this area and more recently the Commission published its Communication on Packaged Retail Investment Products. New research in the behavioural economic sciences suggests that the key behavioural biases affecting people's choices in retail financial services should be taken into account in the design of effective policies to provide consumers with real choice.

Bank accounts, in particular current accounts, are basic tools for consumers to carry out financial transactions. The analysis of bank fees revealed that the price structures of current accounts are often very opaque making it almost impossible for consumers to know how much they are paying and to compare different offers. This can ultimately result in consumers operating unfavourable current accounts. In addition, the market for current accounts is fragmented along national lines. Consumers in some Member States have to pay higher prices for current accounts than in other Member States. A single market in this area where price differences are easy to detect, e.g. through a standardised presentation of prices of current accounts, and where consumers could easily switch providers would enable consumers to shop for the best offer of current bank accounts. The Payment Services Directive, to be transposed by 1 November 2009, should lead to more information e.g. on the cost of a payment service.

The possibility to switch providers is essential for consumers to obtain the best deal. However, the Consumer Market Scoreboard 2009 showed that only 9% of consumers had switched their current bank account during the previous two years. The causes again relate among others to difficulties to compare offers on banking services and anticipated or experienced difficulties with the switching process. A first attempt to facilitate it for consumers to switch bank accounts has been made with the self-regulatory Common Principles for Bank Account Switching of the European banking industry. The Commission services will closely monitor and evaluate the implementation of this initiative.

1. INTRODUCTION: MONITORING THE MARKET

One of the main conclusions of the Commission's Communication on the Single Market Review[1] was that more attention needs to be paid to outcomes for citizens arising from

[1] COM (2007) 725 final of 20 November 2007.

European policies. Market monitoring signals a shift in European policy from an instrument-led approach to an evidence-based and outcome-oriented strategy that will ultimately create more effective regulation and markets which better deliver what citizens want. As a major element of the wider market monitoring initiative launched by the Commission as part of the Single Market Review, the Consumer Markets Scoreboard[2] is the main tool for analysing developments in the area of consumer policy. Consistent with the market monitoring methodology, the Scoreboard distinguishes between the screening and the analytical phases of monitoring. In the screening phase, markets which appear to be failing consumers are identified, using a limited number of indicators which capture the main characteristics. The following analytical phase requires additional, sector-specific data and aims to understand if and why the market in question is failing for consumers. Based on the indicators presented in the first Consumer Markets Scoreboard[3,] the retail financial sector merited further investigation as to its functioning from the point of view of consumers.

Three different retail financial services issues were singled out as areas where consumers experience difficulties. Firstly, it has been found that deficiencies in the field of pre-contractual information inhibit consumers from making the most appropriate decisions in relation to financial services, and thus they end up paying more for services or buy services they do not need or even want or which may be inappropriate for them. The financial crisis subsequently drew attention to deficiencies in the advice given to consumers at point of sale, leading people to purchase inappropriate products. Secondly, the Scoreboard found that some financial services are problematic because they are particularly opaque in structure and are not suited to helping consumers to compare different offers. This prompted the Commission to select bank fees and the question of their transparency for further analysis. Thirdly, customer mobility was assessed with a view to understanding why bank account switching levels remain low and how changes can be effected to counteract this. The low level of switching was seen to be caused by the difficulty with comparing offers, leading consumers to stay with their current service provider and ultimately paying more for their services. Finally, and in the context of the financial crisis, this paper describes the present situation for consumers as

2 The Consumer Markets Scoreboard: Monitoring consumer outcomes in the Single Market, 1st Edition 2008 and 2nd Edition 2009.

3 Press release on the Consumer Markets Scoreboard, 1st Edition 2008, http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/157&format=HTML&aged=0&language=EN&guiLanguage=en.

regards over-indebtedness and the resulting rising levels of foreclosures as well as access to financial services.

Besides the process foreseen in the Consumer Markets Scoreboard, the Commission uses other means to follow developments in financial markets such as the European Financial Integration report which is published annually. Furthermore, a snapshot of the European consumer credit market in areas affecting consumers such as interest rate levels and levels of outstanding credit is currently being compiled.[4] It will provide consumers with an overview of the European market and thereby encourage them to reap the advantages of the internal market in the form of more competitive cross-border offers. It will also allow policymakers to supervise the impact of the Consumer Credit Directive[5] which will be implemented by June 2010. This study, benchmarking key areas in relation to consumer credit, will be repeated and will also serve as a reference for testing some features, such as the thresholds and exemptions, which apply in the new Consumer Credit Directive.

The purpose of this document is to report on the problems consumers face in the three sectors singled out for further analysis, i.e. pre-contractual information and the related issue of advice, the transparency of bank fees and switching of bank accounts. The document also outlines a number of the Commission's key policy responses to these problems, including both existing regulatory requirements, and recently announced policy initiatives. It also places these sectors in the general context of indebtedness, foreclosures and access to financial services. This staff working document contributes further to the evidence-base underpinning the actions in the area of retail financial services that the Commission has announced in the Communication to the Spring European Council *Driving European Recovery* of 4 March 2009.[6]

2. CONSUMERS NEED TO KNOW WHAT THEY BUY

There are two main tools which enable consumers to choose the appropriate financial product for their needs: pre-contractual information and advice.

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4 See the Terms of Reference of the relevant study, http://ec.europa.eu/consumers/rights/docs/tor_ccd.pdf.

5 Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC, OJ L 133, 22 May 2008.

6 COM (2009) 114 final.

2.1. The first pillar: pre-contractual information

The purpose of pre-contractual information is to inform the consumer about the features of the product before he decides to buy it, such as the interest rate, expected return, risks and costs involved, and to enable him to compare competing products. However, often and sometimes even despite considerable pre-contractual information requirements for financial services providers, consumers still face significant difficulties when they want to choose a product based on the existing information. These difficulties are intensified because of consumers' vulnerabilities. Unclear pre-contractual information also plays a negative role in cross border commerce. A recent survey found that incomprehensible, insufficient and misleading information and information which is presented in too many different ways when comparing between different offerings are respectively the third, fourth, seventh and ninth most important barriers to cross-border shopping of financial services quoted by European consumers. Language problems and risk of fraud were cited as the two most important barriers to cross border shopping.[7]

In focus groups on pre-contractual information requirements in financial services[8] organised by the Commission services in all 27 Member States, consumers strongly criticised the complex language using difficult financial or legal jargon. The group members evinced considerable distrust towards financial services providers, based inter alia on opaque language which makes them believe that banks intend to hide unfavourable conditions. In order to address the needs of consumers, group members stated that the relevant language should be clear and understandable, avoiding complex and unappealing formats or the hiding of important details within small print.[9] While consumers emphasised their need for a complete set of information on all necessary aspects of a financial product, they stressed equally that they receive too much information. For instance in the UK, consumers found a consumer credit agreement which required 55 minutes to read is not suitable for information purposes. In general, anything of more than 1-2 pages would be perceived as too long and difficult to understand.[10] Research shows that policy solutions that aim at cutting down the amount of

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7 Special Eurobarometer 298, June 2008, QC23, p.127.

8 These focus groups dealt with specific financial services, namely consumer and mortgage credit and investment products with a focus on distance marketing of these products.

9 Optem, Report on pre-contractual information for financial services, January 2008, http://ec.europa.eu/consumers/rights/fin_serv_en.htm , pp. 20-22, 25-26, 29-30, 67-68.

10 UK Better Regulation Executive and the National Consumer Council, Final Report on maximising the positive impact of regulated information for consumers and markets ("Warning: Too much information can harm"), November 2007, http://www.berr.gov.uk/whatwedo/bre/reviewing-regulation/protecting-consumers/consumer-information/page44095.html, p. 7.

information in order to make it more understandable are, for certain products, not necessarily detrimental to the quality of the consumer's choices, and also save time spent on the decision-making process.[11]Nevertheless, the features of products may sometimes require more detailed information and limit the scope for simplification.

Going beyond the pure presentation of information consumers have also welcomed tools such as decision-trees that help them navigate through the process of making choices.[12]

Another important factor which determines how useful pre-contractual information is to consumers is its timing. The consumer's ability to act on certain information is reduced or even eliminated when information is provided only shortly before or at the time of the signature of the contract. This is particularly true for retail financial services products which are often complex and hence difficult for consumers to understand.[13] Timely information is also important to prevent consumers from making decisions under pressure, for example where they feel unable to leave the premises without purchasing or unable to ask for a second, independent opinion.[14]

Beyond written information, many consumers feel the need for a complementary source of information in the form of personal contacts to ask for explanations and to discuss the product on offer. As a consequence consumers tend not to rely on the information they receive from financial services providers, but often turn to friends and family for advice. This is particularly true for consumers who are inexperienced in financial products, but also for consumers in a cross-border situation.[15] Lack of personal contact, when purchasing at a distance has been quoted by consumers as an important obstacle to cross border shopping for financial services[16].

As a conclusion of these findings, adequate pre-contractual information for retail financial services which ensures that consumers are well informed about the features of the product and can compare with competing products can be summarised as concise, necessary and sufficient

11 Beshears, J., Choi, J.J., Laibson, D.I. and Madrian, B.C., How Does Simplified Disclosure Affect Individuals' Mutual Fund Choices?, April 2009. NBER Working Paper Series, Vol. w14859, 2009.Available at: http://ssrn.com/abstract=1376182, pp. 3, 12-13.

12 Cf. footnote 10.

13 Cf. footnote 9.

14 OFT, Assessing the effectiveness of potential remedies in consumer markets, 2008, http://oft.gov.uk/shared_oft/economic_research/oft994.pdf, pp. 81-86.

15 Cf. footnote 9.

16 Cf. footnote 7.

information. This information should be presented in a timely and comprehensible manner, as well as in a standardised form where product features allow this.

The basic implementation of this principle is represented by the Unfair Commercial Practices Directive (UCP Directive)[17] which covers all business-to-consumer transactions including retail financial services and implements the principle of fair marketing practices by providing basic standards for the information provided to consumers. It contains a minimum harmonisation clause in relation to financial services which allows Member States to maintain or adopt stricter and more detailed rules to protect consumers, where necessary, for example, with regard to information requirements. The Directive includes a black list of commercial practices banned upfront across the EU. The general provisions prohibit misleading information, i.e. not only false and untruthful information, but also deceptive information which is likely to affect the consumer's commercial decision, and omitting information, i.e. any element which would constitute an important part in the consumer's decision, as well as aggressive practices. For instance, information to consumers shall not be misleading as regards the benefits or results to be expected from the service and the risks. This information must be provided in a clear, intelligible, non-ambiguous and timely manner. For payment services, the Payment Services Directive (PSD) sets out that information must be given in easily understandable words and in a clear and comprehensible form.

In the context of retail investment services, the MiFID[18] requires that all information addressed by service providers to clients or potential clients is fair, clear and not misleading. More detailed requirements cover the information to be provided to clients about services, financial instruments, costs and charges, so that they are reasonably able to understand the nature and risks of the services and consequently to take decisions on an informed basis. This information may be provided in a standardised format. As regards the timely presentation of pre-contractual information, recent EU financial services legislation makes sure that the consumer is informed "in good time" before he concludes the contract.[19]

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17 Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market, OJ L 149, 11 June 2005, p. 22.

18 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, OJ L 145, 30 April 2004, p. 1.

19 Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers, OJ L 133, 22 May 2008, p. 66; Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services, OJ L 271, 9 October 2002, p. 16; Directive 2007/64/EC of the European Parliament

In order to achieve the aims of comparable and comprehensible product information, the Commission approach has been, for some products and services, in addition to the above requirements, to promote the standardisation of pre-contractual information obligations within carefully designed and tested formats. As evidenced by a series of surveys, a well-drafted set of standardised information facilitates clearly the comparability of competing offers, and help ensure that consumers understand and can use information e.g. for switching providers[20]. Indeed, the consumers participating in the focus groups organised by the Commission services overwhelmingly welcomed this concept.[21] In an Eurobarometer survey,[22] 79% of European citizens thought that it would be useful if all financial services providers used a standardised information sheet. Consumer organisations and representatives of the industry brought together in 2008 in a Commission workshop on pre-contractual information requirements for financial services discussed favourably standardised information formats. On the supplier's side, standardised forms could save time and money. However, a single standardised information sheet is not possible across all financial products and services, since there is a great variety in the types of product and service on offer, and consumers' information needs will therefore vary, requiring some tailoring of standardised disclosures.

A standardised format for pre-contractual information was first introduced in financial services in the European Standard Information Sheet (ESIS) forming part of the Code of Conduct for Home Loans signed in 2001 by industry and consumer associations. Consumer testing confirmed that, while consumers strongly prefer to receive the information in a standardised manner and have very favourable reactions to the ESIS, the information items currently included in the current version of the ESIS could be improved[23]. The Commission is therefore currently undertaking pan-European consumer testing to examine whether the different options for the presentation of individual information items are clearly understandable to consumers and to assess what overall package of information elements meets consumers' needs. The research and field-testing to be undertaken by the contractor has been divided into two phases. The first phase, which is completed, aimed at testing the

and of the Council of 13 November 2007 on payment services in the internal market, OJ L 319, 5 December 2007, p. 1; Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, OJ L 241, 2 September 2006, p. 26.

20 For more details on switching cf. the separate section 4 on switching.

21 Cf. footnote 9, pp. 45-46.

22 Cf. footnote 7, QC22, p. 123.

23 Cf. footnote 9, pp. 77-86.

effectiveness and usefulness of individual ESIS information items in helping consumers and to identify which individual information elements should be added to (or removed from) the current ESIS. As a result of this first phase, two variants of a revised ESIS have been produced. These contained the main elements (and the preferred descriptions of these elements) which consumers who were surveyed in the first phase, wanted to include in the ESIS. The second phase aims at identifying the most appropriate overall lay-out and presentation of the ESIS that best responds to consumers' needs and preferences. The results of the testing should be available by October 2009.

For consumer credit, the Standard European Consumer Credit Information was introduced in the new Consumer Credit Directive[24] as a mandatory tool to inform consumers before concluding a credit agreement. When drafting the standardised sheet particular attention was paid to easy-to-understand language and a clear structure, with the most important information items in the first two blocks of the sheet. The information items were tested with focus groups[25]. However, providing consumers with the standardised information sheet may not be sufficient if, in specific circumstances, they need more information. Therefore, if needed, creditors will have to explain the pre-contractual information, the essential characteristics of the product and the specific effects it may have on the consumer.

In the area of retail investments, the existing simplified prospectus for Undertakings for Collective Investment in Transferable Securities (UCITS) funds has been improved and replaced by requirements for a 'Key Investor Information' (KII) document[26]. The KII is intended to be a more clearly written, short document (limited in most cases, unlike the simplified prospectus, to 2 pages), containing all the information consumers need to make informed investment decisions. The new document is also intended to present the information in a common format which allows for the comparison of offers. The document should enable consumers to choose UCITS which are suited to their needs. To aid in the process of developing detailed implementing measures for the form and content of the document (which are currently being finalised), the European Commission, in cooperation with CESR, has just finished testing the new format with consumers.[27] As with the testing of the ESIS there were

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24 Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC, OJ L 133, 22 May 2008, p. 66.

25 Cf. footnote 9, pp. 31-45, 47-63.

26 Directive 2009/65/EC of 13 July 2009

27 UCITS Disclosure Testing Research Report by IFF Research and YouGov, June 2009, http://ec.europa.eu/internal_market/investment/docs/other_docs/research_report_en.pdf .

two test phases. In the first phase, individual options for the different core elements of a KII were tested, addressing such areas as the strategy of a fund, its objectives, risk and reward, performance and charges. As a result of the first phase, two overall models were developed and a variety of fully mocked-up examples were tested in a second phase. Consumers and intermediaries felt that the new KII could be an improvement of existing information available. The study confirmed that most consumers do not read long documents. Several participants stated that they have missed important elements of investment funds in the past due to the documents being too long and/or the information being hidden in small print. The risk/return profile was considered as the most important element for selecting a fund, closely followed by the objectives and the investment strategy. Consumers appreciated structured and standardised information, allowing for comparison of products and facilitating their understanding.

The Commission has also examined the quality and consistency of pre-contractual information requirements for packaged retail investment products (PRIPs). These products make up a major part of the retail investment market, covering such investment vehicles as collective investment schemes (including UCITS), insurance-based investment products such as unit-linked life insurance products, and retail structured products. The work has confirmed significant gaps and inconsistencies within the European legislative framework for PRIPs to the detriment of consumers, in particular in the areas of pre-contractual information and sales practices. For instance, pre-contractual information requirements vary depending on the legal form of a product, even though the economic substance of different products may be the same. Some products such as structured term deposits are currently not subject to any specific disclosure requirements at all. The Commission envisages responding to these disclosure problems by adopting a horizontal rather than sectoral approach to PRIPs, so that a consistent set of rules applies to all PRIPs originators, irrespective of the legal form the PRIPs might take.[28] The aim is to achieve as great a degree of harmonisation and standardisation of key retail disclosures as possible to allow for comparison between products, though with some tailoring of detailed rules to the specificities of the different PRIPs. The Commission has indicated that the KII will act as its benchmark in developing these retail disclosures for other PRIPs. A first orientation on the detailed measures will be published for stakeholder consultation by the end of 2009.

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[28] COM (2009) 204 final of 30 April 2009.

2.2. The second pillar: advice

The problems of reliability of advice[29] and the inbuilt conflict of interest faced by advisors due to remuneration systems that can bias them towards selling particular financial products are clearly matters which deserve further attention.

There is growing evidence that consumers often do not obtain suitable advice on financial services. In Germany, consumers terminate 50-80% of all long-term investments prematurely because of inadequate advice when buying the products. This leads to estimated damages for consumers of 20-30 billion Euros every year[30]. In one survey where 25 German bank advisors were approached in a mystery shopping exercise[31], 24 of these provided unsuitable advice. Recommending expensive and unsuitable mortgages is a typical example of selling practices resulting in consumer detriment due to the lack of appropriate financial advice[32.]

It has been observed that many consumers rely, without much reflection, on the advice of a familiar bank employee in their local bank branch or other known financial institution because they perceive him to be trustworthy and an expert in his profession.[33] Yet the current financial crisis has shown that those selling financial products or offering financial services have not always possessed or exhibited relevant degrees of professionalism in relation to the products they sell or the services they offer. Indeed, the suspicion is that many of those selling financial products do not have a sufficient understanding of these products to be able to effectively advise consumers on their advantages and risks. Therefore in-depth training on the advantages and disadvantages of the products on offer should form a key part of their profession.

Furthermore, bank employees or intermediaries may often face an inherent conflict between their interests and the interests of their clients, given remuneration structures which create so-called "commission biases". A study on the impact of these conflicts for direct marketing agents reveals that firms gradually become more lax in relation to the promotion and selling

29 The term advice used in this document includes recommendations to buy a product of independent third persons and selling practices of employees of financial services providers.

30 Study of Evers and Jung, Anforderungen an Finanzvermittler, September 2008, launched by the German Consumer Affairs Ministry, http://www.bmelv.de/cae/servlet/contentblob/379922/publicationFile/21929/StudieFinanzvermittler.pdf , p. 9 and 12.

31 Verbraucherzentrale Bundesverband, Pressemitteilung: "Banken-Test Vernichtendes Ergebnis für die Qualität der Bankberatung" http://www.vzbv.de/go/presse/1172/3/9/index.html

32 Europe Economics Study on Credit Intermediaries in the Internal Market, Final Report of 15 January 2009, p. 126 , http://ec.europa.eu/internal_market/finservices-retail/docs/credit/credit_intermediaries_report_en.pdf

33 Engelmann J.B., Capra C.M., Noussair C., Berns G.S. Expert Financial Advice Neurobiologically “Offloads” Financial Decision-Making under Risk., 2009, PLoS ONE 4(3): e4957.doi:10.1371/journal.pone.0004957; Moorpace Survey, 2008, p. 1.

of unsuitable products[34]. The results of a survey on (inter alia) retail investment products revealed that 72% of the investment professionals surveyed consider the fee structures rather than the suitability of investment products for customers as the main driver for sales. [35]

EU legislation covering investment services (MiFID[36]) requires financial services providers to act honestly, fairly and professionally in accordance with the best interests of their clients. In particular, when providing investment advice, investment firms are required to recommend to the client investment services or products that are suitable for him. When investment advice is not provided, investment firms still have to assess the appropriateness of the financial instrument with respect to the knowledge, experience and situation of the client. These requirements may conflict with the remuneration structures for employees of financial services providers or intermediaries, where transactions which are profitable for the service provider are rewarded. This is why, in the case of MiFID, specific provisions concerning the management of conflicts of interest and the payment of inducements have also been introduced[37].

With regard to sales of PRIPs, the Commission is committed to ensuring consistent and effective regulation for all sales of PRIPs, taking MiFID as a benchmark, so as to remove current variations in the standards applying to sales depending on the legal form of the product: selling practices should always be focused on the fair treatment of the consumer; when a consumer receives advice on an investment the advisor should undertake the steps necessary to ensure products sold correspond to the profile and needs of the consumer, and that the consumer understands the nature of the service being provided by the advisor.

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34 Inderst R., Ottaviani M., Misselling through Agents, 2008, p. 27, http://faculty.london.edu/mottaviani/misselling.pdf.

35 CFA Institute European Union Member Poll on Executive Compensation and Retail Investment Products, Summary Report, January 2009, Summary Report, p. 7.

36 Article 19 of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, OJ L 145, 30 April 2004, p. 1.

37 Articles 13 and 18 of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, OJ L 145, 30 April 2004, p. 1. Articles 21-23 and 26 of Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, OJ L 241, 2 September 2006, p. 26.

In this context, the recent Commission Recommendation of April 2009 on remuneration policies in the financial services sector[38] which focuses on the remuneration of significant risk-takers and its impacts on the firm's risk profile, highlights also that remuneration policy should be consistent *inter alia* with the principles relating to the protection of clients and investors in the course of services provided. In particular, when assessing individual performance, compliance with standards governing the relationship with clients and investors should be taken into account.

Apart from putting in place the rules on advice, conflicts of interest and inducements, proper enforcement of these rules is critical to ensuring they benefit consumers.

2.3. Benefits of behavioural economics for pre-contractual information and advice

Beyond the ongoing work on pre- contractual information and advice, the Commission services are also focusing on pre-contractual information from a broader perspective, taking into account new research in the behavioural economic sciences. Behavioural economics is a branch of economics which questions the conventional assumptions of economics (such as decision-making being based on rational considerations or people acting independently on the basis of full and relevant information) by subjecting them to the test of experiments and empirical observation. The results show that in many situations people depart from the behaviour predicted by classical economic assumptions. While not all biases result in consumer detriment, where that is the case remedies must be shaped accordingly if changes in consumer behaviour are to be expected. For example, a bad decision could be the result of choice overload and this might be addressed by re-framing the information available to consumers to make choice easier.[39]

For instance, overconfidence is one of the biases identified in behavioural economics. In many situations people are overconfident of their own abilities and this is especially important in the financial market. Consumers can underestimate the likelihood of incurring certain types of charges. As a result they do not pay sufficient attention to this information even if it can have a significant impact on their finances.[40] Anchoring is another issue revealed in economic literature which can be easily exploited by financial service providers. It refers to situations

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38 Commission Recommendation on Remuneration policies in the financial services sector, C (2009) 3159 of 30 April 2009, 3.2. and 5.4.

39 OECD, Roundtable on economics for consumer policy, Summary Report 2007, p. 12, http://www.oecd.org/dataoecd/5/38/39015963.pdf.

40 OFT, Study on Personal current accounts in the UK, 2008, p. 72, http://www.oft.gov.uk/shared_oft/reports/financial_products/OFT1005.pdf

when consumers use externally provided information or prices as a standard of comparison, despite the facts that this information has no rational basis and has not been verified.[41] As an example, insurance sellers may tell a customer that they "normally" charge a certain price for a product. Consumers will use this price as a basis of comparison, whereas it might not be representative of the type of product offered. Eventually consumers might sometimes even be misled by it.

There is often a strong inconsistency between the stated preferences of consumers and what they actually choose. Studies reveal that over-borrowing and under-saving is not the result of rational financial planning (at it is assumed by standard economics), but that self-control problems play a crucial role in determining such financial outcomes.[42] On the one hand, as an example, many consumers agree to automatically repay their credit card balances at the end of the month. However, when the automatic monthly reimbursement is less than 100%, consumers do not necessarily have the self discipline to reimburse the entire amount thereby increasing their debt pointlessly. On the other hand, consumers who would be motivated to act according to their self-discipline sometimes do not have this opportunity[43]. For example anecdotal evidence shows that some financial services providers simply do not allow an automatic reimbursement of the entire credit card balance.

People acknowledge that some financial decisions have a crucial importance for their future wellbeing but nevertheless procrastinate. For example financial services providers often leverage the consumers' inertia by maintaining low interest rates on default savings products so that only customers who act, benefit from a better interest rate.[44]

In order to be able to respond efficiently to the challenges linked to pre-contractual information and in particular advice the Commission services are seeking to better understand the behavioural drivers that are behind a consumer's choice of retail investment product. Therefore they plan to carry out a study to map the key behavioural biases affecting these choices. The final report of the study will contain a detailed econometric analysis of factors affecting consumers' choices in relation to retail investment products and of marketing

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41 Russo and Schoemaker, Decision traps: ten barriers to brilliant decision-making and how to overcome them, 1989.

42 Benton, Meier and Sprenger, Overborrowing and Undersaving: Lessons and Policy Implications from Research in Behavioral Economics, 2007, http://www.bos.frb.org/commdev/pcadp/2007/pcadp0704.pdf, pp. 9ff. and passim.

43 Ashraf, Karlan and Yin, Tying Odysseus to the mast: evidence from a commitment savings product in the Philippines - NAVA, 2006, http://ssrn.com/abstract=770387, passim.

44 Rabin & O'Donoghue, Procrastination in Preparing for Retirement, 1998, http://elsa.berkeley.edu/~rabin/retire.pdf, p.

strategies that influence consumers. It will also indicate the range of effective remedies that might help in providing consumers with real choices and thereby assist in making the market work for them.

One approach which could be assessed with the application of behavioural economics tools could be the introduction of optional, simplified standardised or certified products. The issue of simple, standardised products was examined in previous research[45] and mentioned in the Commission Green Paper on Retail Financial Services[46], feedback to which revealed a lack of support among financial services providers and some Member States to the introduction of standardised products whereas many consumer organisations saw potential in the idea.[47] While this reflection at EU level took place before the financial crisis, the crisis has shown that product complexity[48] presents a risk for some consumers, whose needs could, to a certain extent, be covered by a core set of simple, standardised products. According to preliminary Eurobarometer data more than half of the respondents think that all but one of nine types of financial products need to be simplified.[49] This is also discussed in other jurisdictions in the context of the crisis.[50]

3. BANK FEES NEED TO BE TRANSPARENT

Bank accounts, in particular current accounts, have become an integral part of life for most people. It is very difficult for most consumers to manage their financial affairs without a bank account. While in 2003, 80% of EU15 citizens had a current account with a payment card or chequebook[51], in 2008, 87% of European consumers (EU 27) had a current account. This is a higher percentage than those who have telephone services (both mobile and fixed-line) or a gas supply[52].

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45 Charles River Associates for the European Commission, *An assessment of the extent of an identified need for simplified, standard financial services products*, 2003 http://www.crai.com/uploadedFiles/RELATING_MATERIALS/Publications/files/cra-simplified-products-main-report.pdf.

46 Green Paper on Retail Financial Services in the Single Market, COM (2007) 226 final, p. 19, http://ec.europa.eu/internal_market/finservices-retail/policy_en.htm.

47 Summary of the written contributions received on the Green Paper on Retail Financial services in the Single Market, 18. September 2007, p. 14/15, http://ec.europa.eu/internal_market/finservices-retail/docs/policy/gp_report-2007_09_18_en.pdf.

48 For instance, option adjustable rate mortgages.

49 Draft Flash Eurobarometer 282, August 2009. For pensions, the figure is even as high as 71%.

50 US Department of the Treasury, Recommendations for a Financial Regulatory Reform, June 2009, p. 66.

51 Special Euro barometer 230, August 2003, Q3, pp 15-16.

52 Flash Euro barometer 243, July 2008, pp. 87, 97, 113.

However, 29% of EU consumers have difficulties in comparing offers in relation to these same current accounts[53] and so they are not in a position to choose the best account for their needs.[54] A recent study monitoring the pricing of electronic bank payment tools[55] such as direct debits and credit transfers confirmed the difficulties in determining the cost of these services due to the opaque tariff structure of bank accounts. Even for the experts undertaking the research it was difficult to untangle the pricing structures offered by the financial services providers on their websites. In 69% of all cases, clarification had to be sought in a follow-up check with the provider in question.

A 2008 study by the UK Office of Fair Trading[56] found that consumers basically do not know what they were paying in bank charges, either before or after they were incurred. Over three-quarters of consumers did not know the credit interest rate of their current account. Two thirds of consumers did not know what their bank charged for an unarranged overdraft.[57] Overall, the report found that the personal current account market was set up in a way which placed consumers at a disadvantage compared with their provider. While the findings from that study cannot easily be generalised across all EU Member States because the UK has particular characteristics in how banking revenue is generated[58], they nevertheless confirm the trend showing that consumers cannot clearly see what they are paying, and that they often pay more than they had intended in bank fees.

In order to shed more light on the prices of current accounts, the Commission services launched a study which compares price levels across the EU Member States and which also examines their transparency.[59] The study analysed a sample of 224 banks which cover 81% of the retail banking market in terms of customer deposits and which are representative of the diverse banks in the EU. The comparison of prices is based on usage profiles which reflect the intensity of current account usage. Transparency is one of the issues identified by this exercise

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53 Flash Euro barometer 243, July 2008, Q2_A, p. 20.

54 According to preliminary Eurobarometer data for accounts in general it is even 37% of the respondents; Draft Flash Eurobarometer 282, August 2009.

55 Consumer Policy Evaluation Consortium, Preparing the Monitoring of the Impact of the Single Euro Payment Area (SEPA) on Consumers, Final Report, August 2008, http://ec.europa.eu/consumers/rights/docs/SEPA_monitoring_study.pdf.

56 Cf. footnote 40.

57 Cf. footnote 40, p. 72.

58 While in the rest of the EU banks gain profit more on the basis of fees for services, UK business models are often built on profits generated from penalties.

59 Van Dijk Management Consultants, Study on the Data collection for prices of current accounts provided to consumers, http://ec.europa.eu/consumers/strategy/facts_en.htm#Retail .

as problematic. The parameters used during the data collection[60] to assess the transparency of the information on the tariffs included the availability of the tariffs on the banks' web sites, their visibility and their clarity.

In line with the previous study, this information proved difficult to find online: 66% of the banks surveyed required additional contact for clarifying the information. Around 10% of the banks had little or no price information available on their website and 33% of the banks had incomplete price information in their tariffs. A striking finding of the study was that requests for further information from banks were "*in most cases difficult and required recurring contacts*". [61] When asking banks for tariff lists by e-mail, they usually referred to the customer service phone number and there agreed to give oral information, but refused or were reluctant to send the tariffs list electronically or by fax.

The identified lack of transparency in the banks' information on their tariffs make it almost impossible for consumers to systematically compare all the offers presented in the market in order to identify the one that is best for them This ultimately can result in consumers losing money when operating an unfavourable current account. By contrast, standardised information presentation on prices for mortgages and consumer credit products facilitates the comparison of different offers and consumers are in a position to choose the best offer.

The transparency problems identified for current account fees can also play a role when it comes to earning interest on accounts because thresholds and other conditions for obtaining interest might not be clearly indicated. This can lead consumers to forgoing some of the interest they could have received if they had sufficient knowledge of the different products on offer. The opposite situation of consumers becoming unintentionally overdrawn can also be a result of opaque tariff structures. Evidence shows that consumers pay little attention to key elements of the pricing structure of current accounts. For instance, only five per cent of UK consumers surveyed considered overdraft fees important when choosing a personal current account[62].

Another issue which emerges from the current accounts study is the highly fragmented nature of the market along national lines.[63] Price divergence for bank accounts at the EU level is

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[60] The data collection was based on a mystery shopping exercise which replicated the experience of normal consumers.

[61] Cf. footnote 59, p. 33.

[62] Cf. footnote 40.

[63] Cf. footnote 59, p. 5.

higher than the variation of prices of other services across the EU[64]. The divergence of prices of current accounts is also higher from one Member State to the other than domestically.[65] This means that consumers in some Member States have to pay considerably higher prices for current accounts than in other Member States. As an example, the prices of the more intensive users' accounts[66] range from a high of €831 in Italy to a low of €28 in Bulgaria. The analysis of European profiles reveals that, regardless of the intensity of the usage, there are countries which are consistently at the higher end of the price distribution, notably Italy and Spain. Also, the average prices for Austria, France and Latvia are higher than three quarters of the countries included in the analysis.

The fragmentation of the market along national lines can also be illustrated in the variety of business models resulting in different levels of average simplicity and transparency in banking fees. At one extreme are countries with more complex and less transparent fees such as Italy, France, Hungary, Greece and Spain. Complexity is somewhat correlated with lack of transparency and for some countries there may be a link to high fees. For example there are higher than average debit card charges in France, credit transfer fees in Greece or overdraft fees in the UK, all countries with less transparency. Austria, France, Italy and Spain all score poorly on transparency and are among the most expensive countries for banking services. At the other extreme, the Netherlands, where banks rely mostly on fixed annual fees, are more transparent and at the low end of banking costs.[67]

Data show that consumers pay more for their current accounts in countries where they have difficulties comparing offers from various banks and where tariffs are complex and lack transparency. This conclusion is based on the significant correlation which exists between prices of current account profiles and the percentage of consumers who say that they find it difficult to compare offers from current account providers.[68] The finding is reinforced by the significant correlation which exists between the prices of current account profiles and an indicator of simplicity and transparency revealed by the study on prices of current accounts.

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64 The coefficient of variation of bank account price levels across the EU is higher than the coefficient of variation of prices of other services across the EU - up to 0.7 (depending on the profile) for current accounts compared to 0.4 for several European services (average presented in the 2nd Consumer Markets Scoreboard).

65 The coefficient of variation of bank account price levels is higher at the EU level (up to 0.7) than the average of the national levels (up to 0.4).

66 The term used in the study for this profile is "active domestic profile".

67 Cf. footnote 59, p. 23.

68 Draft Flash Eurobarometer 282, August 2009.

The fragmentation of the current accounts offers along national lines shows that the single market does not yet exist in this area. A single European market where price differences are easy to detect, e.g. through a standardised presentation of prices of current accounts, and where consumers could easily switch to a lower priced current account would enable them to save money and increase competitive pressure. This would result in a range of prices related to the competitiveness of the providers, but not to their location in specific national markets. Further efforts are needed in order to achieve a single market where consumers are able to shop for the best offer of current bank accounts at EU level.

A fundamental legislative measure in place addressing payment services is the Payment Services Directive (PSD)[69] which is due to be transposed in the Member States by 1 November 2009. Title III of the PSD[70] aims to lay down rules on the transparency of conditions and information requirements for payment services. The PSD will lead to more transparent information (e.g. on the cost of a payment service) and the elimination of hidden costs (e.g. value dating). Customers should be able to compare prices more easily and shop around within the EU.

The Directive provides for harmonised requirements in order to ensure that necessary and sufficient information is given to the customer. Together with the general information concerning the payment service, the provider is obliged to inform the clients about all the relevant details of the payment for every single transaction in particular charges, interest and exchange rates[71]. When changes in charges and conditions are proposed by payment institutions, specific rules allow consumers to close the account free of charge if they disagree with these changes after they have been notified of these changes two months in advance. In general, the closure of any account is free of charge if the account has been open for more than one year.

The PSD also provides the legal foundation to make the Single Euro Payments Area (SEPA)[72] possible. SEPA will mean that customers will be able to use their bank account anywhere in the 31 SEPA countries[73] just like at home.

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69 Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market, OJ L 319, 5 December 2007, p. 1.
70 Articles 41(1), 42(2), 44(2) and (3), 47(1), 48(1), 80-83.
71 Articles 41(1), 42(2), 44(2) and (3), 47(1), 48(1).
72 For more information see: http://ec.europa.eu/internal_market/payments/sepa/index_en.htm
73 EU, EEA and Switzerland.

In the 'joint statement clarifying certain principles underlying a future SEPA direct debit (SDD) business model' recently published by the European Commission and the European Central Bank[74] the two institutions noted that in order to promote economic efficiency, payment services should be priced transparently. Currently, direct debit services are perceived by consumers as free-of-charge in many Member States as they are integrated in a package. The Commission Services will closely monitor the evolution of consumer pricing in this respect.

The UCP Directive[75] is a horizontal Directive and therefore also applicable to bank fees. For example, the calculation of the price should be provided in a clear, intelligible, unambiguous and timely manner, otherwise prices will be considered misleading and thus in breach of the Directive. The trader should not omit, wholly or partially, information which is necessary for a transactional decision. Equally it is also misleading and a breach of the Directive to provide false information or to deceive consumers even if the information is factually correct. 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. Further, 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. In general, under the Directive, any invitation to purchase a financial service shall include the final price that the consumer will pay (inclusive of all interest and charges). If it is not possible to give a final price (for instance due to varying interests rates), the manner of calculation should be clearly indicated so that the consumer can work it out.

The Directive on unfair terms in consumer contracts[76] also provides for some protection against unclear standard contract terms in relation to interest rates or overdraft charges. This Directive obliges a financial services provider to draft its terms and conditions in plain and intelligible language. Standard terms and conditions (including those setting interests rates or overdraft charges), which do not comply with this transparency requirement can be

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[74] http://ec.europa.eu/competition/sectors/financial_services/sepa_direct_debit.pdf .

[75] Cf. footnote 17. The Directive covers all business-to-consumer transactions including retail financial services, unless more specific legislation is applicable.

[76] Council Directive 1993/13/EEC of 5 April 1993 on unfair terms in consumer contracts, OJ L 95, 21 April 1993, p. 29. The Directive is horizontal and covers all business-to-consumer transactions including retail financial services, unless more specific legislation is applicable. The Proposal for a Directive of the European Parliament and of the Council on consumer rights of 8 October 2008, COM (2008) 614 final, aims at revising among others this Directive.

challenged if they are imbalanced to the detriment of the consumer. Terms which are found by a national court or administrative body to be unfair under the Directive are not binding on consumers. Furthermore, according to the Directive[77], a bank or any other financial institution should inform the consumer at the earliest opportunity about a change of the rate of interest due to the consumer. In this case the bank should give the consumer the possibility to terminate the contract immediately. Standard terms and conditions which do not comply with those requirements could be considered unfair.

National courts and enforcement authorities are responsible for intervening against unfair commercial practices and unfair contract terms and applying effective, proportionate and dissuasive sanctions. For example, in Greece a €10 million fine was recently imposed on 17 banks for infringing consumer protection legislation rules by overcharging the use of credit cards[78]. Moreover, a €1 million fine was imposed on a specific bank because of misleading information about financial products, in breach of the Greek legislation transposing the UCP Directive.[79]

As regards the UCP Directive, the Commission will report on its application by 12 June 2011, in particular also on financial services. The problem of enforcing fairness applies both at national and at cross-border level.

The Commission's recent Consumer Enforcement Communication[80] strives to bring down barriers to cross-border trade within the EU by strengthening enforcement mechanisms so that consumers may shop confidently in the knowledge that their rights will be equally protected whether buying at home or abroad. The Consumer Protection Cooperation Regulation (CPC)[81] offers the possibility to promote a concerted enforcement action between the responsible national enforcement authorities to ensure the application of the UCP Directive to

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77 Article 3 (3) of the Directive and paragraph 2b of the Annex to the Directive.

78 Fine imposed by the Ministry of Development, Directorate General for consumer protection. For the relevant press release, see http://www.efpolis.gr/filesbase/866_sitefile-10019.pdf

79 Ministry of Development, Directorate General for Consumers, Directorate for Consumer Protection, Unit B, "Fining imposed (articles 9γ, 9δ and 9ε of law 2251/1994, as amended and is in effect) to the company CITIBANK PLC, Official Number Z2-7802, Athens 2009 (Υπουργείο Αναπτυξης,, Γενικη Γραμματεία Καταναλωτή, Διεύθυνση Προστασίας Καταναλωτή, Τμήμα Β, «Επιβολή προστίμου (άρθρα 9γ, 9δ και 9ε του ν. 2251/1994, όπως τροποποιήθηκε και ισχύει) στην εταιρεία με την επωνυμία CITIBANK PLC», Αριθ. Πρωτ.: Z2 –7802, Αθήνα 2009).

80 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the enforcement of the consumer Acquis, COM (2009) 330 final, http://ec.europa.eu/consumers/enforcement/consumer_enforcement_package_en.htm .

81 Regulation (EC) No 2006/2004 of the European Parliament and of the Council of 27 October 2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws. Text with EEA relevance. OJ L 364, 9.12.2004, p. 1–11.

non-transparent and therefore unfair bank fees. Member States are invited to conduct a screening of the national bank fees situation. The national enforcement authorities who decide to carry out such screening at national level could then share the information gathered with the authorities in the other Member States. The CPC Committee could possibly be the forum for such an exchange of information and best practices. Moreover, any possible cases having a cross border implication which are detected during the screening may be dealt with through the CPC cooperation procedures.

4. SWITCHING BANK ACCOUNTS IMPROVES CONSUMERS' COSTS AND CONDITIONS

An essential feature of a market economy is that it allows consumers to be able to choose the best deal for their services. This means that consumers must be able to switch providers if they so wish. Consumers generally wish their bank account to be convenient, cost-efficient and that the terms and conditions, including fees, should be transparent and competitive. When bank accounts do not satisfy consumers' needs, it should be easy for them to move to another provider.

Therefore, from the perspective of bank account transparency, cost-efficiency and convenience, bank account switching merits a closer look. Switching a provider can result in improvements in costs and conditions, but also benefits can accrue to a consumer in search of better conditions if the actual process of switching can be improved. When switching is not facilitated, or when the process of moving a consumer's current account from an old to a new bank is inefficient, it can result in consumers bearing a large financial burden for instance because of late payment penalties. It would also impact negatively on competition to the ultimate detriment of consumers' welfare.

Switching is not only beneficial for those who obtain better service and lower prices by changing their supplier; switching is also beneficial to the relevant market. The Consumer Markets Scoreboard has revealed data which shows that there is a strong correlation between higher switching rates and smaller price increases.[82] This means that straightforward switching has a positive transformative effect on consumer markets.

The findings from the Consumer Market Scoreboard 2009[83] showed that while car insurance policy holders had the highest switching rates, at 25%, only 9% of consumers had switched

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82 The Consumer Markets Scoreboard: Monitoring consumer outcomes in the Single Market 2nd Edition 2009, p. 54.

83 Cf. footnote 82, p. 6.

their current bank account during the previous two years. An indication that this is a low figure comes from another survey[84] which shows that 90% of consumers which had a problem with retail banking had made complaints about it. One explanation for the apparent disparity between the level of complaints and the level of switching is that bank account costs are not always transparent, and so offers cannot be compared, and that it is not always easy or safe to switch.

An Eurobarometer of 2008 dedicated to switching[85] also presented findings on the causes of the low switching levels in retail banking – from consumer inertia to switching costs and lack of information. From an enquiry which covered eleven services, it was found that when it came to comparing offers, around half of those surveyed found it very easy or fairly easy to compare offers, however, comparison difficulties were most widely reported in the consumer banking services sector. Here, 37% considered comparing offers fairly or very difficult. The greatest difficulty in comparing offers (around 40% finding it difficult or very difficult) arose in the savings/investment and the mortgage categories. While switching levels were relatively low in all services categories, being most popular among the young and highly-educated groups, the majority found it easy to switch. Again, the ease of switching was not mirrored in the banking sector, where a level of 43% of respondents interested in switching anticipated or experienced difficulties. However, most people also found that when they did switch, the new service was cheaper than the old. Overwhelmingly, the main conditions cited which would facilitate a decision to switch were cost, the provision of standardised comparable information and the provision of a dedicated website giving an overview of the conditions of various offers.

The Commission's efforts to promote standardised, comparable information, where product features allow this, will be helpful in reducing obstacles to switching. At the same time, the Commission services co-finance in seven Member States (Czech Republic, Poland, Hungary, Slovakia, Slovenia, Bulgaria and Romania) the creation of a comparison website. This website will, in countries where such websites are not yet created by the market itself, enable consumers to make comparisons of financial products.

Steps have already been taken to make it easier for consumers to switch bank accounts at national level. Upon the invitation by the Commission, in December 2008, the European

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84 IPSOS consumer satisfaction survey, May 2007, data collected in 2006.

85 Flash Euro barometer 243, July 2008, p. 13.

banking industry came forward with self-regulatory Common Principles for Bank Account Switching. [86] This instrument, to be implemented in all Member States by November 2009, is intended to mitigate switching obstacles. The banks will provide consumers with a switching guide explaining what steps need to be taken. Both old and new bank will also assist the consumer throughout the switching process. For example, they will cooperate in transmitting information about the consumer's recurrent payments, respectively terminate the recurrent payments on the old account and reinstall them on the new account and inform the third parties about the consumer's new account details. The Common Principles foresee deadlines for the old and the new bank to take various steps in assisting the consumer. Based on the experience in countries where switching is already in place, it is expected that new banks will not impose fees on their new customers as an incentive to swap provider. The new bank would assist consumers to move their old account, thus overcoming the obstacles which previously inhibited consumers from undertaking this on their own.

Self-regulatory measures can be an alternative to legislation if the measure in question not only establishes expected standards but also includes monitoring and complaint handling mechanisms.[87] In order to ensure appropriate enforcement of this initiative for the benefit of the consumer, the Commission services will oversee this exercise in self-regulation by closely monitoring and evaluating the implementation. For this purpose, the Commission services will launch a monitoring exercise in 2010, possibly in the form of mystery shopping. This will be accompanied by a special Eurobarometer switching survey. The experience from this self-regulatory instrument combined with a monitoring exercise will show whether and to what extent this effort by banks has borne fruit and provide lessons for future initiatives.

As announced in the Staff Working Paper on retail financial services accompanying the Single Market Review[88] a study on tying and other potentially unfair practices in the financial sector has been launched with the purpose of developing a comprehensive analysis of the impact of these practices, including amongst other things customer mobility, price transparency and levels, switching costs and risk management. While product tying[89] may be beneficial for consumers by offering them possibilities to purchase two products together

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86 European Banking Industry Committee, Common Principles for Bank Account Switching, December 2008, http://www.eubic.org/Position%20papers/2008.12.01%20Common%20Principles.pdf.

87 Cf. fn. 80, Section 2 (13).

88 SEC(2007) 1520

89 Tying occurs when two or more products are sold together in a package and at least one of these products is not sold separately, Report on retail banking sector inquiry, SEC(2007) 106, European Commission, January 2007, p. 49.

more cheaply, it may also bind consumers to a particular provider, with a negative effect on price transparency and comparability among providers. For consumers who have purchased tied products at one bank, switching costs are raised as the process of switching to a new service provider may become more costly and burdensome. Taking into account the results of the study, the Commission will consider whether EU action in the field might be necessary.

In addition to the initiatives described above, there are also some legislative standards in place at EU level. According to the PSD, as already mentioned, the closure of accounts open for more than one year must be free of charge. If consumers are faced with providers' standard contract terms, which include unjustifiably cumbersome procedures for switching (e.g. unreasonably long periods for the consumer to cancel a contract), such contract terms may be in breach of the Directive on Unfair Contract Terms. Furthermore, the UCP Directive prohibits aggressive practices, taking into account in particular any onerous or disproportionate non-contractual barriers imposed by the provider where consumers wish to terminate a contract in order to switch to another service or another provider.

5. DEALING WITH DEBT

Indebtedness is an issue that the majority of European households face and which is likely to intensify due to the financial crisis. However, the Commission services are not yet in a position to assess fully the current levels of indebtedness and the effect of the crisis. Some of the available data relates to all 27 Member States, while other available data focuses on the Euro area. In addition, most of the data date back to the pre-crisis period, while only a few stem from the first quarter of 2009.

Over the past decade in many Member States household borrowing has grown considerably, reaching very high levels both in relation to income and in absolute terms. The ratio of total household debt to disposable income in the Euro area rose by more than 50% since the early '90s, reaching 86% at the end of 2004[90]. In 2007, the loans to the household sector for the EU27 amounted to €7 trillion. Mortgages made up the bulk of the outstanding loans to households, representing about 70% of all credit granted to households[91]. Household participation in the mortgage market is very heterogeneous across the Euro area countries. Italy shows the lowest percentage of households with mortgages (12%), followed by Greece (17%). In Germany, Spain, France and Portugal, the share is between 25% and 30%, while in

90 ECB Working Paper Series no. 570/January 2006, p. 8.

91 ECRI, Consumer Credit in Europe (1995-2007), Statistical Package 2008, October 2008, p. 2.

Ireland and the Netherlands it is between 35% and 40%[92]. Consumer credit in the EU27 accounted for around 16% and other credit for about 14%. In a few countries consumer loans or other loans are significant and, taken together, are approximately equivalent to (Austria) or outweigh (Cyprus and Slovenia)[93] housing debt .

The outstanding consumer credit to the household sector, i.e. loans granted to households for personal use in the consumption of goods and services, in the EU27 accounted for almost one trillion euros in 2007 (almost €930 billions in 2006, almost €884 billions in 2005 and almost €660 billions in 2000[94]). These figures demonstrate a steady annual growth in the levels of indebtedness across the EU. However, the debt levels differ widely across the EU countries. On the one hand, while the EU27 average in 2007 was € 1,971 per capita, the UK had by far the highest amount of outstanding consumer credit per capita with €4,969 (annual GDP per capita being €33,270), followed by Ireland with €4,258 (annual GDP per capita of €43,720), Cyprus with €3,996 (annual GDP per capita of €19,859) and Denmark with €3,414 (annual GDP of €41,779)[95]. On the other hand, the EU 12 Member States present lower levels of indebtedness. Slovakia (€229), Latvia (€314), Bulgaria (€477) and from the EU15 Belgium (€1,334) rank among the countries with the least indebted population (with an annual GDP per capita of €10,133, €8,797, €3,784 and €31,048 respectively).

A few comparisons can be drawn between pre-crisis and more recent data. Loans to households (including consumer credit, loans for house purchase and other credit) in the Euro area accounted for €4.8 billion in 2007 increasing to about € 4.9 billion in the first quarter of 2009[96]. As to the subjective perception of this situation, recent data demonstrate that almost 60% of Europeans already personally feel the consequences of the crisis in their life. Pessimism regarding the consequences of the crisis at a personal level is highest in Greece (88%), Hungary (88%) and Estonia (82%) and lowest in Denmark (22%), Sweden (24%) and Finland (27%). More than half of Europeans (56%) expect that the repercussions of the economic and financial crisis for them personally will be important in the next five years. That can be observed predominantly in Greece (89%), Hungary (86%) and Lithuania (77%), while less in Denmark (15%), in Finland (27%) and the Netherlands (28%)[97].

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92 European Central Bank, Housing Finance in the Euro area, 2009, p.13
93 Cf. footnote 91, p. 12.
94 Cf. footnote 91, p. 20.
95 Cf. footnote 91, p. 5, p.22&41.
96 http://sdw.ecb.europa.eu/reports.do?node=100000143
97 Eurobarometer 71.1, Europeans and the Economic Crisis, 2009, QD1.4.

The available figures demonstrate that European debts are growing. However, it is still early to describe the full picture of the current situation. According to information from Member States, governments are also seeking to avoid the consequences of the financial crisis on individuals and families. They are taking measures to protect mortgage holders against repossessions (e.g. renegotiation of mortgages for the unemployed), to address over-indebtedness, or to create incentives for banks to give access to credit to individuals, including people on low income[98].

Any assessment of indebtedness levels should also refer to over-indebtedness, which is the phenomenon more likely to increase during the financial crisis, as people will, now more than ever, face higher debts than they are able to repay. The situation of over-indebtedness can generally be described as disequilibrium in a household budget due to expenditure increases or due to income decreases. Over-indebtedness can arise from sudden shocks to expenditure or income flows or it might accumulate over time. So far there has been a lack of a common operational definition of over-indebtedness, as well as a lack of concrete, comparable data across the EU Member States. However, a recent study on over-indebtedness has shown that 38% of respondents totally agreed or tended to agree that they were having difficulties to a certain extent with paying their bills[99]. The reasons given for over-indebtedness include loss of income and low income, but also poor money management, over-spending and other social reasons. It is important to note that this situation can arise for any household in any income bracket, but some may be more at risk than others. The most vulnerable groups were found to be young people, unemployed or low income people, those with children or lone parents and people with ill health. However, the current crisis has shown that it is not only low-income people who risk being over-indebted.

The effects of these large amounts of debt can be demonstrated by poverty and exclusion figures. In 2007, a Eurobarometer on poverty and exclusion showed that 53% of EU citizens have difficulties keeping up with their bills and credit commitments while 5% have real financial problems, falling behind with their bills and credit commitments. In addition, on the

[98] Joint assessment by the Social Protection Committee and the European Commission of the social impact of the economic crisis and of policy responses, Document number SPC/2009/5/9 final, May 2009.

[99] European Commission, Directorate-General for Employment, Social Affairs and Equal Opportunities Towards a common operational definition of over-indebtedness, 2008, p. 10.

social and psychological level, over-indebtedness can have severe consequences for the affected individuals[100].

To better evaluate the issues of indebtedness and over-indebtedness, the Commission services have started collecting more data. For example, an Eurobarometer survey will collect data concerning peoples' perceptions on their financial security over the years, on their ability to keep up with their bills and on how often they fall behind with certain credit types, e.g. mortgages or consumer loans. The availability of comparable data should lead to a common operational definition of over-indebtedness, as suggested in the 2008 study[101].

Also, in the follow-up to the global financial and economic crisis, the Commission announced its intention to come forward with measures on responsible lending and borrowing.[102] First steps included a public consultation which was followed by a public hearing on 3 September 2009.

6. EXAMINING THE PROBLEM OF FORELOSURES

As already mentioned, available statistics on the composition of outstanding loans to the household sector reveal that almost 70% of a household's loan obligations are made up of mortgage credit. Given the serious consequences of foreclosure, i.e. the possible resultant loss of his home which is an average consumer's largest lifetime investment, and the particular financial difficulties for households in the current financial crisis, the Commission services are currently seeking information from Member States on the number of foreclosures and default rates on mortgage loans in the Member States over the last 12 months. For the moment, this data shows for many Member States an increase in the number of foreclosures. Other data also seems to indicate that default rates on loans have worsened over the last year in many Member States as well sometimes increasing even by four times[103].

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100 Cf. footnote 99, p. 5.

101 Cf. footnote 99, pp.58-86. This study also assessed over-indebtedness policies in Member States, in their preventative and curative dimensions.

102 Communication to the Spring European Council "Driving European Recovery" of 4 March 2009, COM (2009) 114, http://ec.europa.eu/commission_barroso/president/index_en.htm

103 In the UK, mortgage repossessions should raise a peak in 2010, with 80 000 effective repossessions, as in 1990, against 20 000 in 2006 (Social Situation Observatory, seminar on "Housing, social inclusion and the economy", Brussels, 21 April 2009, http://www.socialsituation.eu/WebApp/Events.aspx).

Against this background, the Commission services are examining ways to ensure that foreclosure procedures are avoided wherever possible, to prevent citizens from losing their homes. A report setting out best practices in this area will be published by the end of 2009[104].

7. ENSURING ACCESS TO FINANCIAL SERVICES

It is recognised that having a bank account is a necessity for the vast majority of consumers in order to participate meaningfully in the modern economy. In 2008, the Commission published a study on "Financial Services provision and prevention of social inclusion"[105] which underlined that financial and social exclusion increasingly interconnected[106]. The results of the study were presented and discussed at a large scale conference "Financial inclusion: Improving access to basic financial services", where representatives from the financial sector, consumer groups, public authorities and NGOs participated.

According to a Eurobarometer study, at the end of 2003, 10% of adults aged 18 and over in the EU 15 countries and 47 % of adults in the EU10 had no bank account at all whereas 6% to 8% respectively have only very limited access to financial services[107].

The proportion of individuals who were completely unbanked (neither deposit nor transaction account) ranged from 2% in the Netherlands to 62% in Latvia. In general it was higher in the EU10 countries than in the EU15[108].

Those most likely to be financially excluded are people living on low incomes, those who are unemployed, lone parents caring for children full-time and people who are unable to work through sickness or disability. In the EU12, retired people also have high levels of financial exclusion. Financial exclusion is influenced by the difficulties in finding out the costs of using banking services, by lack of knowledge about financial services, and through not receiving any marketing materials. All of this reinforces a belief that financial services are "not for people like me"[109]. Financial exclusion is linked to people's knowledge of and exposure to

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104 COM (2009)114 final, Volume 2: Annexes of 4 March 2009, p. 5.

105 http://ec.europa.eu/employment_social/spsi/events_en.htm#financial_exclusion

106 European Commission, Directorate-General for Employment, Social Affairs and Equal Opportunities Financial services provision and prevention of financial exclusion, March 2008, http://ec.europa.eu/employment_social/spsi/docs/social_inclusion/2008/financial_exclusion_study_en.pdf

107 These results may be different from those obtained from another Eurobarometer in 2008. According to the 2008 Eurobarometer, 87% of EU citizens have a current account. Possible reasons for potential differences may be the difference in the time and scope of these Euro barometers.

108 Cf. footnote 106, p.21.

109 Cf. footnote 106, p. 33

financial services and it remains statistically significant, having a large effect even when other factors such as income and work status are controlled[110].

The aim would be to ensure that consumers can access basic financial services and to allow them to choose a financial product suitable to their needs[111]. To that end, the Commission Recommendation on the active inclusion of people excluded from the labour market also emphasised the importance of financial inclusion[112]. The Commission services launched a consultation on "Financial Inclusion: Ensuring access to a basic bank account"[113] in February 2009, and received about one hundred responses. The aim of the consultation paper was to collect views from all stakeholders on how financial inclusion can be improved and, more specifically, to ensure that by a certain date every EU citizen or resident has access to a basic bank account. After analysing the responses, the Commission services will conduct a cost-benefit analysis of any potential future policy options. In an attempt to improve the information available, the Commission is collecting some data regarding the quantitative and qualitative use of bank services, which can prove useful for the initiatives aiming to ensure adequate access to financial services[114].

To better address the problem of financial exclusion it is useful to identify the factors which alienate consumers of financial services. For example, pre-contractual and contractual information in a clear language and in a standardised, comparable format is there to help consumers finding out the costs of financial products and shop around for the product that best covers their needs at the lowest possible cost. Furthermore, the Commission initiatives on financial education[115] aim at empowering consumers' understanding of financial services and make them confident when making a purchase. For example, the Commission's online education tool, *Dolceta*[116], will, among others, provide both adults and pupils with basic but necessary information about financial services. A module on financial services, giving general knowledge of financial services topics and enabling the consumer to learn to perform several types of financial services activities, is already in place. In March 2010, a new module on

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110 Cf. footnote 106, p.38.

111 Cf. also European Commission Communication, A Single market for the 21st century Europe, COM(2007) 725 final,2007.

112 Commission Recommendation on the active inclusion of people excluded from the labour market of 3 October 2008, C(2008) 5737.

113 http://ec.europa.eu/internal_market/consultations/2009/financial_inclusion_en.htm

114 The Commission has launched an Eurobarometer on poverty and social exclusion to collect this data. Results will be published before the end of 2009.

115 Communication from the Commission: Financial Education, http://ec.europa.eu/internal_market/finservices-retail/docs/capability/communication_en.pdf.

116 www.dolceta.eu

teacher training in financial literacy will be launched, for which the Commission services have committed around €1million. It will provide teachers in primary and secondary education with ready-to-use materials, where various financial subjects will be explained, in order to encourage them to incorporate financial topics on a voluntary basis into the general curriculum. Furthermore, the Commission services are promoting consumer financial education with various stakeholders, in particular national governments, through a group of experts with practical experience in the area, a database of relevant schemes in the EU and offering patronage to selected events.