

## **Finance Watch response to the European Commission's Public consultation on the operations of the European Supervisory Authorities**

16 May 2017

*The Commission sought views among other things, on the operations of the ESAs and on their ability to protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system for the benefit of the Union economy and its citizens.*

*Link to consultation page: [https://ec.europa.eu/info/finance-consultations-2017-esas-operations\\_en](https://ec.europa.eu/info/finance-consultations-2017-esas-operations_en)*

*Finance Watch is grateful for the inputs of our member organisation BEUC in answering some of the questions in this consultation.*

### **Q5- To what extent are the ESAs tasks and powers in relation to guidelines and recommendations sufficiently well formulated to ensure their proper application? If there are weaknesses, how could those be addressed? Please elaborate and provide examples**

Art.16 of the ESAs regulations empowers ESAs to issue guidelines and recommendations “with a view to establishing consistent, efficient and effective supervisory practices within the ESFS, and to ensuring the common, uniform and consistent application of Union law.”

We support a broad interpretation of that Article giving priority to consistency and uniformity, in order to give ESA guidelines and recommendations more legal certainty. For example, ESAs should consider their decisions as binding on themselves.

That said, we also stress the need for the work of the ESAs to be guided by the objective of sustaining financial stability and providing appropriate consumer protection.

### **Q6- What is your assessment of the current tasks and powers relating to consumer and investor protection provided for in the ESA Regulations and the role played by the ESAs and their Joint Committee in the area of consumer and investor protection? If you have identified shortcomings, please specify with concrete examples how they could be addressed.**

As the major focus of ESAs work has related to creating a single rulebook, the key area of consumer protection remains underdeveloped. Also, as the European Court of Auditors pointed out in a 2014 special report, it is considered low priority and is under-resourced.

In addition, the ESA's mandate on consumer protection was the result of a political compromise and consumer protection remains sectoral, with overlapping regulatory mandates for consumer protection between different authorities. The ESA joint committee mitigates this to some extent but the sectoral approach remains problematic. For example, it is difficult to design consistent cross-sectoral Level 2 regulation when the ESAs' RTS mandates are contained in different, sector-specific Level 1 texts.

We would support some degree of structural reform of the ESAs to ensure consumer protection receives the clarity and priority it needs, for example under the ‘twin peaks’ approach.

We refer the Commission to the consultation response submitted by our member organisation BEUC calling for a twin peaks approach, part of which we reproduce here for convenience:

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“Therefore, there is a need to set up a separate EU supervisor that would focus on defending consumer interests in financial services. One of the main tasks of the new authority should be to achieve supervisory convergence and include: ensuring the development, implementation and monitoring of minimum standards of conduct-of-business supervision at Member State level.

The new EU consumer protection supervisor should be empowered to monitor the quality of the national supervisory practices by, inter alia, running random mystery shopping exercises and publishing their results. The new supervisor should have the sanctioning powers in case the national competent authorities do not implement the measures recommended by the EU supervisor aimed at improving the quality of market conduct supervision.

The new EU supervisor should also be mandated with monitoring and assessing the way national markets function and any cross-market trends, while trying to prevent risky developments and consumer detriment in order to gain more intelligence and understanding on problematic issues for consumers in the markets, e.g. by measuring detriment and detecting mis-selling behaviour. The monitoring should be followed by analysis of the root causes that lead to the detrimental results of markets for consumers. On the basis of this, appropriate choices of measures for mitigation of the detriment should be formulated. ...

[T]he EU consumer protection supervisor should be granted direct supervisory and effective product intervention powers with regard to cross-border issues, as well as EU-wide negative trends and risky products/practices that are widespread across several Member States.”

**Q7-What are the possible fields of activity, not yet dealt with by ESAs, in which the ESA's involvement could be beneficial for consumer protection? If you identify specific areas, please list them and provide examples.**

Enhanced consumer protection is an important new direction for public policy and the financial services industry. Consumers are increasingly affected both by the micro-effects of new product designs and distribution practices and the macro-effects of product availability as providers choose to modify their strategies. Enhanced measures are vital for preserving consumer welfare in complex financial markets where good decision making is both difficult and consequential. At the same time, new policies to protect consumers, if not properly structured, can be ineffective and result in outcomes unintended by policy makers as product providers modify their practices and strategies.

There are several newly emerging areas such as fintech, insurance tech or robo-advice where developing new regulatory and supervisory approaches is needed and ESAs should be involved in developing the right standards. We cannot simply rely on self-regulation by market participants as is currently suggested. Most of these FinTech business models are shifting financial risks to their users because FinTech operators – unlike banks – are not risk takers themselves. Therefore consumer protection becomes of overall importance. But consumers are not able to identify the characteristics of a product until after they have purchased it. Financial product characteristics are complex and difficult to understand and the information about these products is often too technical for consumers to understand. But even information standards, which enable consumers to make rational decisions about risk and return are not sufficient, knowing from behavioural economics that consumers are often biased in decision making. With the rise of the FinTech industry, financial regulation must focus much more on appropriate measures to counterbalance, for example, any ill-effects from the framing and nudging of consumers' decision making, in order to effectively protect end users.

Consumer protection is an important role for regulatory authorities in financial services because of the existence of asymmetric information flows. In the provision of financial services it is more likely than not that relevant information will be in the hands of the service providers and customers may not easily have access to them. Most business models of FinTechs rely on transaction fees of their users. This payment model provides a steady incentive to stimulate the platform's transaction volume by exaggerating investment opportunities and profit chances, while the risks of investment projects are rather played down or concealed.

Following the FinTech examples commercial banks will transform their businesses towards automated and scalable interfaces with their clients by using big data, algorithms and intelligent software. Know your client principles might be substituted by digital footprints. The question is how to control this constantly learning algorithm software? What data are they allowed to use and which personal data should be prohibited in order to avoid discrimination against some clients and stakeholders? Who is accountable if the software makes wrong decisions?

We would like to see an increase of the competences of ESAs to issue warnings (such as issued by ESMA on virtual currencies, on contract for difference, trading in forex etc). We find that this competence would be particularly useful when issuing early warnings after problems have occurred in one or other member state.

Also, the ESA's power to temporarily prohibit or restrict certain financial activities should be extended to include consumer protection considerations. Art 9 (5) of ESAs regulations currently provides for such bans or restrictions if activities "threaten the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system" under certain conditions. We would prefer to see a direct reference to enhancing consumer protection included in this article. As currently stated, the ESAs would ultimately have to justify such a prohibition based on protection of the financial markets or financial stability and could only cite consumer protection indirectly.

As detailed in a recent letter to ESMA co-signed with other civil society organisations, we believe it is high time that ESA's engage on the issue of the purpose of finance, beyond prudential supervision and consumer protection. Arguably, if this question of purpose – questioning the evolution of the size and nature of activities of the financial sector over the past 30 years – had been put central by the G20 after the crisis, the financial system would be very different today. ESAs should not seen as lagging behind the international momentum for green and broader sustainable finance (how to finance the SDGs?). If anything, many of the issues related to sustainable finance (include climate) represent a material risk to financial stability and returns for consumers.

**Q9- Should the ESA' s role in monitoring and implementation work following an equivalence decision by the Commission be strengthened and if so, how? For example, should the ESAs be empowered to monitor regulatory, supervisory and market developments in third countries and/or to monitor supervisory co-operation involving EU NCAs and third country counterparts? Please elaborate and provide examples.**

We believe that the ESAs should be granted a certain amount of discretion in decisions on equivalency due to their role in developing the single rulebook. The final decision should be with the Commission, however ESAs could have a role in the initial assessment of third country equivalence. The ESAs could also provide ongoing monitoring of legislative and regulatory developments once the decision of equivalency has been granted. This could be especially useful after Brexit, as UK financial regulation may start diverging from the EU rules.

**Q11 Are there areas where the ESAs should be granted additional powers to require information from market participants? Please elaborate on what areas could usefully benefit from such new powers and explain what would be the advantages and disadvantages.**

ESAs rely on information received from national supervisory authorities for their day-to-day supervision and data collection. This lack of direct access to data was pointed out by the IMF as one of the major weaknesses of the ESAs. Looking at the different policy fields, we can say that targeted and timely access to comprehensive, reliable, and accurate information is important to ensure compliance with EU law, as well as to identify regulatory and market failures.

Therefore we believe that ESAs should have possibility to request data when it is necessary to promote an efficient, competitive and integrated financial system underpinned by financial stability and consumer protection considerations.

We think that a certain level of market information should also be accessible to the general public (academic, journalists, civil society) to support independent analysis and scrutiny of the ESA's work.

**Q22. To what extent do you consider that the current governance set-up in terms of composition of the Board of Supervisors and the Management Board, and the role of the Chairperson have allowed the ESAs to effectively fulfil their mandates? If you have identified shortcomings in specific areas please elaborate and specify how these could be mitigated.**

As BEUC has noted, the current composition of the ESAs Boards of Supervisors (BoS) results in a situation where not all national authorities that are in charge of consumer protection in financial services are represented on the BoS which makes it difficult for consumer protection issues to get as much attention as other issues that directly come under the responsibility of all members of the BoS.

**Q26 To what extent are the provisions in the ESA Regulations appropriate for stakeholder groups to be effective? How could the current practices and provisions be improved to address any weaknesses? Please elaborate and provide concrete examples.**

The major challenge that non-industry stakeholders face while participating in stakeholder groups is lack of sufficient resources. Looking at the complexity of the issues that are being reviewed by the stakeholders group, there is an uneven playing field that benefits industry representatives, who can dedicate much more resources (sometimes even a whole team) in their preparation for the stakeholder group. If influence is defined as the amount of resource each stakeholder can deploy for their preferred outcome, some stakeholders will find it easier than others to increase the resources backing their preferred outcome.

Non-industry stakeholders should continue to be remunerated for the time that they dedicate to the stakeholders group, and this should be extended to include adequate preparation time. In addition, non-industry stakeholders should have access to, or a budget for, secretariat support, which would help them to be on a more equal footing with industry participants.

In addition, we support BEUC's proposals that there should be more explicit feedback from ESAs on the opinions published by the stakeholder groups, for instance, explaining the reasons why a recommendation has not been accepted; and that there is scope for a more systematic collaboration between the ESA stakeholder groups.

**Q28 Would there be merit in maximising synergies (both from an efficiency and effectiveness perspective) between the EBA and EIOPA while possibly consolidating certain consumer protection powers within ESMA in addition to the ESMA's current responsibilities? Or should EBA and EIOPA remain as standalone authorities?**

We believe that the ESAs should move into a supervisory structure that will enhance their financial stability objectives and a development of thorough financial consumers' protection at the European level.

While the new European framework is still based on the sectoral model, we believe that it may not fully reflect the new realities of the European financial market and is not providing the desired level of consumer protection (indicated in our response to question 6).

Enforced consumer protection should be a focal point, however the current structure of the authorities is not delivering on it to its fullest potential because overlapping competences between authorities create complexity.

Providing better consumer and investor protection at the European level is needed if we are to continue with developing capital markets in Europe including engaging more retail investors and creating cross boarder financial products for retail consumers. This initiative shows the need for strong, independent and accountable financial regulators at the European level focusing especially on consumer and retail investor protection.

Therefore we believe that certain changes are necessary in the way that ESAs are structured and how they operate. We agree that establishing a strong banking supervisor in the form of the SSM and Brexit are changing the dynamic of the sectoral divide.

We believe that the twin peaks model, in which a distinct market conduct authority is mandated with consumer and investor protection next to an integrated authority responsible for prudential supervision, could be an option for the Commission to consider, especially as this model aims to guarantee higher standards of consumer protection.

If the ESAs are consolidated, refocused and granted certain responsibilities to oversee the business conduct of financial institutions relating to all financial sectors regardless of their systemic relevance (including what products they sell and the disclosures they make about those products), it will benefit consumers. Consumers often lack the requisite knowledge to identify which product best suits their needs or even circumstances. Further to this, consumers are unable to compare product value or to understand disclosures and product characteristics and customers do not know the channels through which to lodge complaints in case they are dissatisfied with a product or service. Therefore we believe that a twin peaks model would allow for a stronger focus on consumer protection.

On the other hand, especially after Brexit, ESMA should be given a stronger mandate to forge common supervisory standards across the EU27 to avoid companies heading to the countries with the laxest standards. By all measures we should try to avoid regulatory arbitrage and a race to the bottom, which certain governments may wish to do to attract businesses relocating from the UK.

The obvious solution would be to enhance ESMA's responsibilities, especially over those wholesale market segments that are currently concentrated in London and that require uniform, high quality supervision. Expanded responsibilities could include the authorization of significant investment intermediaries (e.g., banks and securities firms) under MiFID/MiFIR; the registration, supervision, and resolution of CCPs, and supervision of audit firms and the enforcement of IFRS standards.

**Q 29. The current ESAs funding arrangement is based on public contributions:**

**a) should they be changed to a system fully funded by the industry?**

No. The disadvantage is that it could give the industry undue influence over the ESA's work.

**b) should they be changed to a system partly funded by industry?**

Yes. There are different model of financing supervisory authorities. In the case of the ESAs we believe that they should have sufficient budget to deliver on their mandate.

The US experience with the Consumer Financial Protection Bureau shows that any changes to the ESAs must leave them fully protected from attempts to undermine their funding or independence, and therefore their ability to deliver their mission.

We believe that the operations of the ESAs should be co-financed by public and private sources of financing. It is reasonable that the supervised financial undertakings contribute to the financing of the ESAs. The public financing provides however for better democratic scrutiny as the parliament will have overview and control over the budget.

We acknowledge that supervised undertakings may oppose the concept of paying for their own supervision. They may also attempt to pass the costs directly to consumers. Nevertheless, we believe that the private sector financing should be linked to the risk level, so that supervisory fees are proportionate to the size and complexity of the regulated sector. It should not be too high a proportion, however, to avoid the financial industry gaining influence over the regulators' work.

Funding of ESAs should have a high degree of stability and certainty from year to year. This promotes long-term planning and increases efficiencies by avoiding unnecessary short-term costs. Funding should also promote operational independence. This encourages effective and unbiased regulation.

**Q31. Currently, many NCAs already collect fees from financial institutions and market participants; to what extent could a European system lever on that structure? What would be the advantages and disadvantages of doing so? Please elaborate.**

The US experience with the Consumer Financial Protection Bureau shows that any changes to the ESAs must leave them fully protected from attempts to undermine their funding or independence, and therefore their ability to deliver their mission.

We agree with BEUC that ESAs need adequate and sustainable funding in order to meet ambitious supervisory targets, including with regard to consumer protection, and welcome the Commission's proposal to improve the ESA's funding. As BEUC noted, "the authorities could be at least partly financed by industry contributions. This would make them more independent vis-à-vis the EU institutions and national competent authorities. The channel via which the industry contributions are provided to the ESAs (i.e. directly, through NCAs, or an alternative EU fund) should be well thought through – the sources and channels of funding should not influence the ESAs' independence and supranational orientation."

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