

## Relaunching the European Retail Finance Market Comments on the Commission's Green Paper

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*The Commission's Green Paper on retail financial services provides valuable insights into the possible benefits of a single market, as well as the obstacles to its development and the possible remedies. While this could have a positive impact on both consumers and providers, it is also important to highlight that a greater diversity of products within countries could contribute to more effective macroeconomic policies at European level. The development of such a single market for Europe where consumers can confidently purchase more profitable financial products abroad necessitates the establishment of a European body along the lines of the US Consumer Financial Protection Bureau (CFPB), or at least the establishment of closer European supervisory cooperation and enforcement. A framework for the digitalisation of financial services should not only focus on mitigating specific types of risk, such as cyber insecurity, lack of privacy and financial exclusion, but it should also continue to maintain a "space of creation" for innovative financial firms.*

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### 1. Single market still not complete

On December 10<sup>th</sup>, the European Commission published its much-awaited Green Paper on retail financial services, entitled "Better products, more choice and greater opportunities for consumers and businesses". The publication aims at creating an ambitious mapping of the benefits of a single market for financial services, as well as the obstacles to the development of this market and possible remedies. The main channel through which the Commission intends to promote the establishment of a single market for both retail insurance and banking products is to develop a framework that is conducive to increasing the market share of cross-border

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activities. For the specific case of retail financial services, the cross-border provision of services has always accounted for a small part of the total activities: only 3% of consumers have already purchased credit cards, current accounts and mortgages from another member state.<sup>1</sup>

The corresponding EU market share is only 5% for consumer credit and 3% for the total gross premiums written in the insurance market. According to the European Central Bank, in 2013 cross-border household loans within the euro area accounted for less than 1% of the total household loans in the area.

## **2. Increasing cross-border activities should benefit both consumers and providers**

According to the European Commission, the increase in these respective shares should result in numerous benefits for both consumers and service providers. In the current state of play, a diversity of products is observed across countries rather than within countries. Hence, rising cross-border activities should contribute to greater diversity of products within domestic markets. Increasing the choice of products available is likely to raise the welfare of consumers, provided that they can objectively compare the products. Meanwhile, heightened competition within domestic markets should result in more harmonious pricing: for a given risk profile, consumers could be charged similar fees all around the EU-28.<sup>2</sup> On the other hand, facilitated circulation of financial services across the EU-28 should bring new business opportunities to many providers, especially through the development of innovative financial technologies. In that context, the share of business models based on established economic rents could be on the decline, whereas some innovative players might grow.<sup>3</sup>

## **3. Further diversity of products within countries should also contribute to financial stability**

Beyond the direct positive impact on consumers and producers, a single market in retail financial services could also contribute to more effective macroeconomic policies at European level. Although it does not specifically cover the macroeconomic dimension of the single market, the Green Paper places some emphasis on the fact that fixed-rate mortgages (FRMs) are practically the only product available in some countries, such as Germany, while other domestic markets provide almost exclusively adjustable-rate mortgages (ARMs), e.g. Spain. This diversity of mortgage products across countries rather than within countries makes the formulation and implementation of some European macroeconomic policies quite difficult. For example, the ECB's monetary policy and its objective in terms of inflation will systematically favour one type of mortgage domestic market to the disadvantage of the other.

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<sup>1</sup> As discussed in the Green Paper, the practice of switching current accounts and mortgages could gradually increase as a result of the implementation of the Mortgage Credit Directive (by March 2016) and the Payment Account Directive (by September 2016). Provided that some obstacles to cross-border transactions are progressively removed, an increase in switching behaviour in these two banking segments could encourage firms to provide services from other member states.

<sup>2</sup> Questions remain on the role of inflation within this approach. No clear consensus has been reached yet on the need to use inflation-adjusted fees.

<sup>3</sup> It is worth mentioning that these innovative players could build new economic rents, notably if they have exclusivity on a specific technology or process.

Therefore, lower product fragmentation across national mortgage markets is also likely to favour further financial stability overall.

#### **4. Establishing a pan-European body for consumer protection is needed**

There are numerous obstacles to cross-border activities, but policy-makers could directly act to mitigate the negative effects of some of these barriers. In particular, institutional differentiation raises costs for providers when they enter a new domestic market (through the learning process of how to comply, where to collect data, etc.). And, as illustrated in the following remark quoted in the Green Paper (p. 18), consumers are mistrustful of purchasing products in a foreign market:

I found a great offer for a loan in another Member State, at a much lower rate than my local alternatives. I was tempted, but I was worried about the implications if something went wrong with the product. So instead I chose to buy a more expensive product on the local market.

Even though rules are better harmonised across the EU-28, differentiation in the domestic institutional framework still makes it more difficult for both providers and consumers to enter a foreign market. Many basic questions remain unanswered: Where can I submit a complaint? Who is regulating what? Where is the information available? How is the market structured? What are the types of distribution channels?

Some tools have been devised to help consumers in their cross-border contracts. For instance, in 2001 the European Commission created the Financial Dispute Resolution Network (FIN-NET), whose purpose is to facilitate the resolution of cross-border disputes in financial services. However, as highlighted in the Green Paper, hardly anyone is aware of the network's existence. One possible way to boost the self-confidence of consumers to engage in cross-border services is to follow the approach taken in the US, where, in response to the 2008-09 financial crisis, the government created the Consumer Financial Protection Bureau (CFPB). The main objective of this body is to collect and track consumer complaints about retail financial services throughout the United States, as well as to enforce rules with financial institutions. Founded in 2011, the CFPB already employs 1,400 persons and has a comfortable budget at its disposal. The development of a single market for Europe where consumers can confidently purchase more profitable financial products abroad will most likely require the establishment of a pan-European CFPB-type body, or at least the creation of a more integrated structure of cooperation amongst existing supervisors.

As a start, the three European Supervisory Authorities (ESAs) – the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) – could undertake more initiatives “related to consumer protection and financial activities” (Art. 9) individually, or through joint Committees of the ESAs. The problem, however, is that their budgets have been reduced, and they already have problems coping with their current workload of implementing legislation.

The European Commission has also developed tools to support companies in their cross-border activities. SOLVIT, for example, was designed to help companies with specific difficulties related to the exercise of their own rights in a foreign country, as long as the complaint is not lodged against another company. Nevertheless, such tools are likely to have a limited impact on the international strategy of financial firms. As a result of the progressive implementation of the single rulebook and the single supervisory mechanism (SSM), prudential and also conduct-of-business standards have become so harmonised that member

states' objections to the cross-border provision of financial services should be directly challenged. The rules have become so identical across the EU28, and even more so within the eurozone, that obstacles preventing cross-border provision of services should be generally declared as invalid.

## **5. The regulatory challenge of digitalisation: To take a “proactive” or a “wait and see” approach?**

The gradual introduction of digital technologies is widely expected to be one of the driving forces behind the development of retail financial services in the coming years. Digital innovation in that sector is having a profound impact on both products and processes. To a certain extent, digitalisation could reinforce the single market, as completely digitalised distribution channels could help overcome geographical and even language barriers (provided that the integration of several languages in the “sales and advice” functionalities of the digital distribution channels is profitable for businesses). Increasing the possibilities for the collection and use of personal data should improve the accuracy of the pricing of products, thereby mitigating financial risks for firms and promoting “fair” price practices for consumers. If financial firms have easy access to data in other member states – both negative and, when available, positive – they could find much greater opportunities to sell their services abroad.

Nevertheless, digital innovation in financial services and its related business models might trigger new types of risk or increase the existing risks, thereby requiring a specific regulatory framework. A decrease in privacy, financial exclusion of ‘digitally illiterate’ and other high-risk consumers, and cyber-insecurity exemplify the types of risk that could emerge in this new paradigm. Standardisation is one possible response to some of these issues. Regulations such as Electronic identification and trust services (eIDAS), aimed at facilitating transparent online consumer experiences without face-to-face verification, are essential in this respect. Reform of the legal framework for data protection in the EU, which could be finalised and voted upon in 2016, should address several key issues related to the collection and use of data by firms.

It is clear, however, that firms need room for innovation and regulators should continue to organise this “space of creation” by expediting digitalisation in retail financial services rather than by attempting to control it. The regulatory strategy should depend on the level of risk that is judged as “acceptable” or “necessary” for a robust and healthy growth in the sector and, indirectly, the whole economy. Depending on the gap between the acceptable level and the actual level of risk observed or anticipated in the sector, the regulator would decide whether or not to intervene.<sup>4</sup> This should involve a continuous process of back and forth movements between a “wait and see” strategy and “policy action”.

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<sup>4</sup> The main difficulty for the regulator most likely resides in the assessment of the actual risk, as the new nature of these services and processes generally imply poor historical/current data and little knowledge of the overall dynamics at stake.