Which?

Select Committee Evidence

House of Lords EU Financial Affairs Sub-Committee: Inquiry into financial regulation and supervision following Brexit

Which? is the largest consumer organisation in the UK with more than 1.5 million members and supporters. We operate as an independent, apolitical, social enterprise working for all consumers and funded solely by our commercial ventures. We receive no government money, public donations, or other fundraising income. Which?'s mission is to make individuals as powerful as the organisations they have to deal with in their daily lives, by empowering them to make informed decisions and by campaigning to make people's lives fairer, simpler and safer.

Summary

1. Which? welcomes this opportunity to submit evidence to the House of Lords EU Committee Financial Affairs Inquiry into financial regulation and supervision following Brexit. The UK has an opportunity through the Brexit process to create a new economy, where essential markets currently failing consumers are reformed, and where consumers have the confidence to spend and propel growth. The UK's approach to financial services policy and regulation going forward will be a crucial element of this.

2. The overall objective of the EU financial services regime is to promote the interests of EU citizens through competition and choice, consumer protection, financing of non-financial sector investment, and financial stability. Which? strongly supports a financial services regime which promotes the interests of consumers through competition and choice, consumer protection and stability and wants these objectives to continue without dilution throughout and following EU exit. Furthermore, Which? would be concerned about the impact of any loss of UK financial services exports on the wider economy, especially on inflation, job prospects, and economic growth, resulting from Brexit.

3. It is essential that in exiting the EU, the UK retains important consumer rights and protections, such as the right of access to basic bank accounts and the right to withdraw from credit agreements. The UK should also take the opportunity to review the current financial services framework to ensure that it is working as effectively as possible for consumers. For example it should review how consumer information for financial services products is provided, taking into account insights from behavioural economics.

4. In the more immediate term, consumers must be assured that products they have purchased, notably insurance and longer-term investments, are protected.

5. In order to deliver a successful, well-functioning financial services regime, and maintain consumer confidence in financial services markets post-Brexit, consumer interests have to be given a greater priority by the Government. This includes including a consumer organisation, such as Which?, in the Government's Business Forum, to help ensure that consumer impacts and confidence are central to the Brexit negotiations.

Background

6. Maintaining consumer confidence in the financial services sector is essential both for consumers and the wider economy.

7. Both the retail and wholesale financial services are relevant to consumers. Retail is how consumers use financial services directly. In contrast, wholesale is critical to the success of the wider UK economy, and is therefore indirectly relevant to consumer welfare. Moreover, economic shocks are rapidly propagated through the financial system, chiefly in interest rates and availability of credit. It is vital therefore that Government seeks to minimise any such shocks from the UK leaving the EU, especially given the limited financial resilience facing many consumers.

8. The EU financial services regime is ultimately concerned with promoting the interests of EU citizens through competition and choice, consumer protection, financing of investment, and financial stability. Which? supports all of these objectives and is keen to ensure they are not hampered by Brexit given their impact on UK consumers.

9. Which? has responded to selected questions from the Call for Inputs, below, primarily focusing on the EU financial services regime in relation to retail financial services.

Current regulatory regimes

Q1. What is your overall assessment of the EU's financial services regime, in light of its current application to the UK? To what extent is it effective, and for whom?

10. In general, the current regime works well for consumers, but the opportunity should be taken as we leave the EU to improve and build on what exists.

11. Effective regulation of wholesale financial services is essential for financial stability and for financing investment of the non-financial sector. Wholesale financial regulation is particularly important to the UK's success in exporting financial services to other EU countries.

12. Effective regulation of retail financial services is essential for protecting consumers, primarily through promoting competition and innovation, as well as direct consumer protections.

13. Much of the current EU financial services regime has developed as part of post-financial crisis reforms, as well as development of the Single Market in services. Post-financial crisis reforms have included a wide range of measures, including activities to strengthen financial supervision, to aid bank recovery and resolution, to protect depositors, to and improve the regulatory framework for banks, insurance, and securities markets.

14. The Single Market for services represents 70% of EU GDP, having the objective of one territory without internal borders or other regulatory obstacles to the free movement of services within the EU (and EEA). It means that EU companies have the freedom to establish themselves in other EU countries, and the freedom to provide services in countries other than the one in which they are established. The EU adopted the Services Directive to simplify the provision of cross-border services, strengthen the rights of service recipients, and ensure easier access to a wide range of services.

15. The development of a single market for financial services has focused on the removal of barriers to cross-border retail and wholesale financial services, including initiatives such as banking union and capital markets union. Like other services sectors, the single market in financial services is far from complete. Most of these services still operate largely on a national basis, which can thereby limit competition, choice, and innovation.

16. The EU has made a number of initiatives to develop the Single Market in retail financial services, including:
    - right of access to basic bank accounts;
    - deposit protection in event of bank failure;
    - development of an integrated payment services market;
    - promotion of cross-border distribution and consumer protection for insurance, mortgages, and other consumer credit; and
    - requirement for disclosure of key information and charges for retail investment products.

17. Following the UK's exit from the EU, Which? wants the Government to maintain the above provisions, although the EU disclosure regime could be significantly improved, particularly the maintenance of consumer protections and promotion of cross-border services, and the level of competition and choice that go with this.

18. There are, however, a range of opportunities to diverge potentially from EU financial services regulations where this may allow regulation that is more suited to UK consumers, rather than to the EU broadly. Opportunities to develop new rules where current EU regulation has been ill-designed or has unintended consequences also need to be taken. The key opportunities for this are in payments, consumer credit, and savings and investment products.

Payments

19. Of all retail financial services, the Single Market is most developed in payment services. This focus began with the EU Payment Services Directive 2007, now followed by the revised Payment Services Directive ("PSD2"), which comes into force in 2018. These are implemented into UK law as the Payment Services Regulations. A further key payments regulation is the payment card interchange fee regulation (IFR).

20. The Payments Services Regulations provide vital protections to users of payments services, both domestically and cross-border. Payments are the most tangible cross-border retail financial service, allowing consumers to send and receive money abroad, and to make payments when travelling abroad.

21. The chief new development of PSD2 is to allow third party providers (TPPs) to be able to make payments from a consumer's account on the consumer's behalf, and to allow TPPs to access a consumer's account information on a consumer's behalf, in order to offer new value added services. PSD2 should therefore promote the development of innovative new services, including cross-border bank accounts and cross-border market entry.

22. The UK has been developing a parallel initiative to PSD2 – "Open Banking" – which has similar objectives of promoting greater competition and innovation in retail banking through third party access to consumer's account transaction information. There are, nevertheless, large differences between the intended objectives for Open Banking and what PSD2 requires, as a maximum harmonisation directive. This may have the effect of compromising the effectiveness of the UK Open Banking project. For example, PSD2 prohibits contractual agreements between TPPs and consumer account providers, thereby precluding the development of a scheme to resolve likely disputes. This is likely to critical to establishing consumer trust and confidence, and thereby the benefits of Open Banking.

23. Accordingly, the potential opportunity to diverge from PSD2 after Brexit may allow the development of a more effective UK market in payment services. This of course must be weighed against any loss of cross-border business with the EU that relies on common EU payment services rules.

Consumer credit

24. In consumer credit, the UK market is national with limited, if any, cross border consumer lending. The EU Consumer Credit Directive (CCD) 2008 nevertheless

underlies UK regulation of consumer credit, in seeking to ensure a high level of consumer protection, through transparency and consumer rights, as well as promoting the integration of the consumer credit market across the EU.

25. In particular, the CCD stipulates that consumers should be given a comprehensible set of pre-contract product information, in order to help consumers understand what they are buying and to promote effective shopping around. This includes providing consumers with an Annual Percentage Rate (APR) charge, which is a single figure, harmonised at EU level, representing the total cost of credit. The CCD specifies the calculation of the APR, set out in the FCA Handbook. The CCD also grants two important rights to consumers: the right to withdraw from a credit agreement within 14 days, and the right to repay credit early subject to fair and objectively justified compensation to the lender.

26. Which? strongly supports such fundamental consumer rights, as well as the ability for consumers to shop around easily and compare alternative credit offers. However, while this may be the aim of the CCD, in practice Which? is concerned that the APR requirement has not achieved its intended objectives. In particular, many consumers do not understand APRs, and they may not allow effective comparison for some products, such as mortgages. Moreover, the APR rules are too rigid to allow alternative means of price comparison.

27. In previous Which? testing on consumer understanding of mortgage fees and charges, when APR was removed from the information displayed alongside the total cost, the proportion of participants identifying the cheapest option rose by eight percentage points (to 70%)[1].

28. Some credit products have also apparently escaped the APR rules, for example, overdrafts - one of the highest cost credit products of all.

29. These examples illustrate where the ability for the UK to dis-apply EU rules after leaving the EU, while holding on to core principles underpinning them, may create benefits for consumers.

Savings and investments

30. In investment products, especially pensions, consumers suffer significant detriment through lack of price and product transparency and associated lack of effective competition. For example, a recent FCA market study of the £4tn UK asset management market found that "asset management firms typically do not compete on price", and that "there is no clear relationship between charges and performance"[2]. Which? estimates an annual consumer detriment of around £20bn in the asset management market as a result of excessive charges.

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[1] Which? Consumer Insight mortgages test, August 2014.
[2] Asset Management Market Study Final Report, Financial Conduct Authority, 2017.

31. Nonetheless, EU regulation has sought in part to address these problems through greater transparency and disclosure requirements on providers. These regulations are contained in the Markets in Financial Instruments Directive (MiFID) II, and Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation. MiFID II requires the disclosure of a single all-in fee to investors using intermediaries. PRIIPs requires key pre-contract product information to be disclosed to prospective customers.

32. It is important for consumers to encounter transparent pricing and product information in order to empower them to make informed decisions. This does however have to be done in a consumer friendly and appropriate manner. A prime example of this being executed poorly is in the EU's requirements for disclosure across many financial services which has been too burdensome and confusing for consumers – achieving the opposite result to its intention. We would therefore welcome the opportunity to diverge from such requirements after leaving the EU, so as to deliver a more consumer friendly approach to disclosure as this could greatly improve consumer choice and competition, while holding on to the underpinning protections that they are based on.

Reciprocal Arrangements

33. It is essential that the Government works to provide certainty over reciprocal arrangements between the UK and EU as early as possible given the implications they have for consumers both practically and financially. This is demonstrated by in the cases of the European Health Insurance Card (EHIC) and Motor Insurance.

34. The EHIC is a necessity for UK travellers when in the EU. The free card provides consumers with access to state funded healthcare in Europe in certain circumstances. The Association of British Travel Association reports that in 2015 the EHIC was used over 215,000 times by UK citizens[3].

35. Which? has welcomed the progress that negotiators have made to ensure that the EHIC card will remain valid for UK citizens living in the EU and vice versa, however this provision now needs to be secured for all consumers.

36. There is an additional time pressure to this aspect of the negotiation given the impact the EHIC has on travel insurance policies. According to the Association for British Insurers (ABI), insurers start offering annual travel policies in April 2018[4]. Therefore if the status of the EHIC card is left uncertain, insurers could adopt a worst case scenario and add to their usual costs the cost of providing the basic provisions of an EHIC card.

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[3] ABTA Sets out priorities for Brexit negotiations for travel and tourism: https://abta.com/about-us/press/abta-sets-out-priorities-for-brexit-negotiations-for-travel-and-tourism#_ftn2

[4] Leaving the EU without a deal not acceptable warns the ABI: https://www.abi.org.uk/news/news-articles/2017/06/leaving-the-eu-without-a-deal-not-acceptable-warns-the-abi/

37. Likewise in Motor Insurance, as members of the EU, UK drivers are covered by the motor insurance Green Card. This guarantees that motorists have third party insurance when visiting other countries. In addition to this, victims of road accidents are able to seek compensation in their own country if they are involved in an incident with a visiting motorist. Clearly this is a preferential route for consumers, rather than having to seek redress through foreign courts.

38. If suitable arrangements are not agreed in the negotiations, there will be significant inconvenience to consumers who may have to purchase extra cover when driving in Europe, as well as provide a Green Card for border checks. This would not only provide inconvenience and extra expense for consumers when travelling but also for consumers in Northern Ireland when travelling to and from work in Ireland.

Q3. What are the key differences between financial regulation as agreed at the international, EU and UK levels, and where are the gaps? How important is it to maintain a level playing field for regulation?

39. Much of UK financial regulation is determined at the EU level, especially given the extent of UK-EU financial services exports and the UK's past commitment to the development of the single market in financial services. The EU is also one of the main voices of international regulation, especially bank supervision and prudential regulation. Trade in services depends substantially on a level playing field for regulation, as well as consumer protections.

40. The UK nevertheless has a highly developed and innovative financial services regulatory regime, which itself has been greatly influential on EU and global regulation. This provides a strong foundation for financial services regulation after the UK leaves the EU. Much of this position has been developed on strong co-operation with other EU financial regulators, which must also continue after the UK leaves the EU.

Current regulatory regimes

41. Effective consumer engagement will be essential in shaping the UK's financial services regime going forward and it is essential that this, along with open and transparent processes, are central to the future UK approach.

42. The Government has established a Business Forum to advise the Secretary of State for Exiting the European Union, as well as meeting with senior representatives of the financial services sector about Brexit. Which? is concerned and disappointed that the Government has so far excluded consumer representatives from these discussions.

Which?
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