## CONSUMER PROTECTION IN THE FINANCIAL SECTOR

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### WHY IS CONSUMER PROTECTION NEEDED IN THE FINANCIAL SECTOR?



### **BACKGROUND**

- EU now in the 3<sup>rd</sup> phase of the financial crisis:
  - Financial markets crisis: arcane, not well understood, quickly transformed into
  - Economic crisis: severe recession in EU states, on-going, limited recovery in many states resulted in
  - Social crisis: impact on longer term economic sustainability, public finances, welfare spending, social programmes
- But, ongoing, chronic market failure in financial services (misselling, ineffective competition, access problems – markets not working for consumers, real economy and society)
- So now policymakers/ civil society groups pushing for 3 major reform priorities:
  - Financial system stability/ resilience: macro-prudential regulation and systemic risk management
  - Sound financial institutions: better micro-prudential regulation
  - Competitive, efficient, fair wholesale, institutional and retail financial markets: competition reforms, corporate governance, and consumer protection

#### WHAT DOES A SUCCESSFUL MARKET LOOK LIKE?

- Consumer groups judge markets according to primary outcomes:
  - Access, choice of appropriate products and services
  - Safety, security and resilience
  - Fairness and integrity
  - Performance, efficiency, innovation, and social utility (enhances consumer welfare and benefits real economy)
  - Optimal decisions, choices, suitable consumption/ usage of products/ services
  - Redress and accountability
  - Confidence and trust (deserved)
  - Limited externalities
- NB: applies not just to retail value and contribution of wholesale/ institutional markets to consumers/ real economy critical

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#### **KEY ISSUES IN PENSIONS AND INSURANCE**

- General and life insurance affected differently but some common issues
- Fair treatment of policyholders, balancing rights of different generations of policyholders, leavers vs stayers
- Unfair contracts issues/ unfair charging structures
- Market inefficiencies
- FSUG notes that bad, not good, products/ practices exported across EU
- Exploitation of 'captive' policyholders
- Transparency issues/ confusion marketing
- 'Discriminatory' pricing, exploitation of behavioural biases, exemptions etc
- Big data/ fintech
- Service issues eg claims handing
- The basic value proposition
- Bancassurance/ dominant distribution/ barriers to true single market
- Wider externalities/ social costs coming under scrutiny
- 'Zombie' firms how many out there?



### **COMPARATIVE TRUST**

• FS one of least trusted industry globally (Edelman Insights 2015), % trusting:

<ul><li>Technology</li></ul>	78%
<ul> <li>Consumer electronics</li> </ul>	75%
<ul><li>Car industry</li></ul>	71%
<ul><li>Food</li></ul>	67%
<ul><li>Telecoms</li></ul>	63%
<ul><li>Pharma</li></ul>	61%
<ul><li>Energy</li></ul>	60%
<ul><li>Fin Services</li></ul>	54% amongst 'informed public', 48% general pop.
<ul><li>Media</li></ul>	51%

Consumers in the EU least trusting of major economic areas – 38% of EU consumers trust insurance industry compared to 52% globally

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#### **HOW DOES PENSIONS AND INSURANCE COMPARE?**

**Based on EU Consumer Market Scoreboard 2014 edition** 

EU WIDE	MPI	Overall satisfaction	Trust-to comply with regs+rules	Enough choice	How easy to compare
	out of 31	out of 31	out of 31	out of 31	out of 31
CAR	9	8	14	4	9
НОМЕ	11	13	16	5	12
LIFE	21	26	23	10	23
PENSIONS	31	31	28	17	31



## WHY DO FINANCIAL MARKETS FAIL SO OFTEN AND SO BADLY?



### **LESSONS FROM OTHER INDUSTRIES**

- Other major sectors been through similar crises to financial services
- Crises were almost 'existential'
- Major safety risks, network/ systemic breakdowns
- Wholesale, institutional, and 'retail' scandals, supply chain distortions
- Evidence of misselling/overpricing/ price exploitation
- Crises of confidence/ trust, reputational damage
- Three 'domains' safety, consumer markets/ competition, and wider public policy impacts (because of nature of goods/services)
- Impact on vulnerable consumers, social exclusion problems
- Over/under-consumption of goods
- Huge externality costs for society (clean up, transfer of risk/cost to future generations)

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### **LESSONS FROM OTHER INDUSTRIES**

- Root causes similar
  - Failures of governance, risk management, regulation
  - Failures to understand, police and maintain networks/ supply chains
  - Failure of institutional shareholders/ analysts to exercise fiduciary duty/ due diligence
  - Competitive distortions
  - Aggressive business models/ strategies
  - Demand side/ consumer sovereignty weak
  - Lack of confidence/ vision on part of state, regulators on future of the industries involved or respective roles in making markets work
- Industries recovered to varying degrees, lessons for the FS industry
- There are grounds for optimism, certain industries came out stronger, more competitive, responsive to consumer needs
- But the problems much greater in financial services



### WHY DO FINANCIAL MARKETS FAIL?

- For markets to work requires three conditions: the right regulation; the right conduct and culture (high standards of corporate governance and ethics); and the right market dynamics
- But in financial markets we saw major failures in each of those:
  - Regulation was too *permissive*, slow and reactive, failed to tackle root causes of market failure (relied on discredited choice and competition theory)
  - Poor standards of corporate governance, poor cultures, conflicts of interest, board members/ senior managers followed tick-box approach to compliance with regulations, major gaps between firms' perceptions of products, service delivery, fairness, reputation, trustworthiness, and organisational effectiveness and consumer perceptions (the 'conduct risk gap')
  - Competition worked against the interests of consumers, consumer sovereignty very weak, institutional shareholders/ analysts/ information providers failed to exercise oversight and due diligence



# HOW DO WE MAKE FINANCIAL MARKETS WORK FOR SOCIETY?



### CHALLENGES GREATER IN FINANCIAL SERVICES

- Financial services faces very difficult economic future the new economic and financial reality
- For most part, consumers do not have same degree of familiarity/ repeat usage
- Not same imperative to use FS products/ services, need to be sold/ persuaded to overcome inertia
- Legacy costs/ business models to overcome (inc. product design and distribution)
- What do prudential regulators do about 'zombie' firms?
- FS products still regarded as more complex, less interesting/important
- Long term, uncertain nature of certain products
- Value harder to discern ex-ante
- Real innovation harder to discern and communicate
- Simply starting from further back in terms of trust



### **MAKING MARKETS WORK**

- Need the 'holy trinity' of market reforms better regulation, enhanced governance and ethics, and more effective market forces/ competition
- From experience, the most effective regulation has been *precautionary* rather than *permissive*, ex ante rather than ex post
- With shared 'vision', clear standards, clarity about respective roles of regulators/ regulated, tough enforcement
- Must be realistic about the potential for consumer led competition
- Demand side interventions (eg financial capability) have very limited effect, supply side/ structural interventions much more effective
- We do not need more choice we need fewer, simpler, better quality, better value products
- Product regulation is very effective alongside the right conduct rules
- An true single market will not be demand led, need consistent enforcement of tough EU regulations at national level
- Must focus on role of dominant distributors/ intermediaries



### **MAKING MARKETS WORK**

- But not all down to regulation lessons from other industries this is not the only way to get the desired outcomes
- FS industry, the market, and civil society have duty to incentivise positive behaviour as well as deter bad behaviour
- Enhanced corporate governance/ ethics and transparency should be industry led, underpinned by regulation
- Senior directors (especially non-executives) must identify and deal with conduct risks within firms
- Pension funds/ institutional investors, analysts, consumer groups and independent intermediaries also need to shape up
- Exercise greater due diligence and fiduciary duty, use financial clout to exert positive influence on markets, expose bad practice but also reward good behaviour, leverage roles as choice editors/ trusted intermediaries
- To conclude, challenge is huge in financial services but not impossible

