



Consumer protection in financial services

May 24, 2011

Educated and informed consumers are an important factor in innovative, fast-paced and sustained economic development. It is therefore in the interests of all concerned to keep the discrepancy between the idealised image of the rational consumer and the real-life consumer as small as possible.

Consumer protection comes at a cost – for the consumer as well. Finding the right mix of measures and their dosage is paramount.

Consumer protection must be nuanced. Consumer behaviour depends partly on the product, on the share of a particular good in overall household expenditure, on the distribution channel and on education, knowledge, experience and information use.

Transparency and a sound knowledge of the risks and opportunities involved in a financial product or an investment or loan decision are the best form of consumer protection. But more information does not necessarily equate to better information.

The impacts on all players must be considered. Systematic cost-benefit analyses encompassing all players and circumstances are important to prevent measures having unintended side-effects and to make consumer protection efficient and on target.

Better consumer protection policy can be achieved with the aid of ratios/measures of the level of consumer protection and by framing and measuring specific targets. This would create a basis for monitoring target achievement by regulation in this area.

European and national consumer protection policies need to be closely coordinated. The co-existence of different requirements works to the detriment of consumers and sellers/providers and diminishes the benefits of the internal market.

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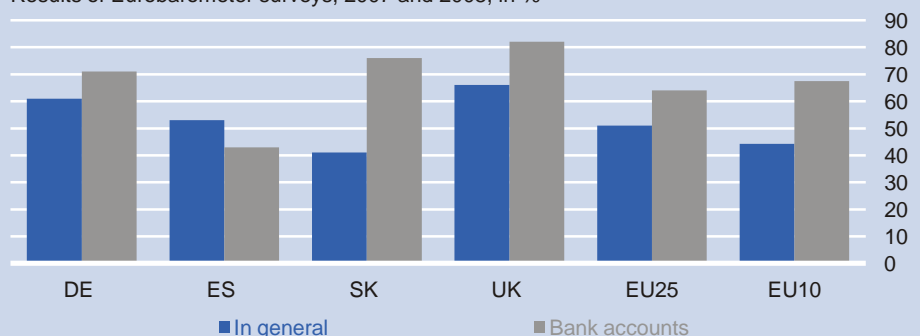
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How well consumers feel protected

Results of Eurobarometer surveys, 2007 and 2008, in %



Sources: European Commission, DB Research

“We commit to protect the integrity of the world’s financial markets by bolstering investor and consumer protection, (...)”

Excerpt from the statement from the meeting of G20 leaders on November 15, 2008

“Enhancing consumer protection: We asked the FSB to work in collaboration with the OECD and other international organizations to explore, and report back by the next summit, on options to advance consumer finance protection through informed choice that includes disclosure, transparency and education; protection from fraud, abuse and errors; and recourse and advocacy.”

Excerpt from the statement from the meeting of G20 leaders on October 12, 2010

Consumer protection – what for?

In the wake of the financial crisis the consumer protection debate has focused heavily on financial services. A host of different as well as overlapping measures are being discussed nationally, at the EU level and globally (in the G20). There is no question that appropriate consumer protection in financial services forms one pillar of a stable financial market.

New rules are necessary in certain areas – but equally so analysis of their relative costs and benefits. Paramount is the correct mix of consumer protection measures alongside the targeted and efficient rectification of failings or structural market malfunctions.

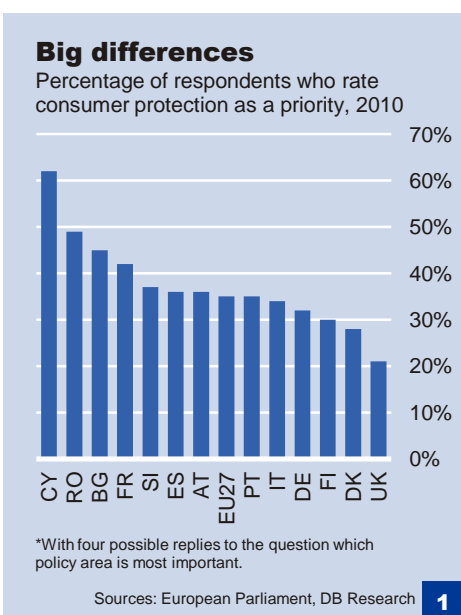
This gives rise to the question of whether the national and European regulatory initiatives¹ are helpful and pertinent. Do they deliver an appropriate response to the shortcomings revealed by the financial crisis?

Relevance of consumer protection in financial services

Consumers perceive a bank account as one of the most essential services.² When taking out a housing loan they tie up a large part of their income. Financial services are extremely important in the average consumer’s daily life. Surveys indicate that consumers regard clear and transparent pricing as one of the most important means of consumer protection.³ Subsequently, however, they do not make use of these clear and transparent prices for financial services: 57% of German consumers regularly compare fuel prices, for example, but only around 10% contrast terms for financial services – even though more people have an account than own a car.⁴ It is precisely in this area of tension between important services, demands for consumer protection and irrational economic behaviour that the debate on increased protection for consumers of financial services is taking place.

What is consumer protection?

The term ‘consumer protection’ implies that consumers need to be protected. In the first instance, a free market system rests on the premise that contracting parties conclude contracts voluntarily or refrain from doing so if one or the other party feels it is at a disadvantage. This is predicated on the market working properly. One cornerstone of market functionality is competition policy, the aim of which is to establish a level playing field for all participants. Furthermore, under certain circumstances it is expedient not to expose consumers to the consequences of their consumption decisions, for example where profiteering or fraud are involved. These obvious instances aside, consumers need protecting because they are at a structural disadvantage inasmuch as they have difficulty exercising their market power since their heterogeneity and mass make it difficult for them to organise themselves into pressure groups. Additionally, the fixed costs of procuring information can be high. A greater degree of protection may therefore make sense for certain products whose quality is



¹ The French G20 presidency is pressing ahead with debate in the G20 this year, but so far no concrete results have emerged.

² 86% of EU citizens considered a bank account important in day-to-day life, see European Commission. Eurobarometer 260 Summary. 2007. P. 9.

³ European Commission. Eurobarometer 298. QC19. 2008.

⁴ Comdirect. Kunden-Motive 2010.



When does the consumer deserve protection?

difficult for customers to determine prior to their acquisition and which they seldom purchase, as a result of which they have little knowledge and experience of the product.

Trade-offs/Conflicting objectives

Consumer protection measures always entail costs. It is therefore important to achieve a balance between competing objectives and a justifiable cost-benefit ratio.

Costs – all for one?

Cost of protecting individual consumers can increase costs for all

Protection can refer to the protection of individuals or protection of the body of consumers as a whole. Protection for individuals does not necessarily have a positive outcome on the protection of all consumers⁵, for instance if the cost of protecting individuals increases the costs for all consumers regardless of whether they are affected or not and irrespective of the benefits to them. One illustration in the financial services sector is the introduction in January 2010 of a compulsory advisory protocol on securities advisory services in Germany. This is also mandatory for investors who do not specifically want to have a record made because they are familiar with the subject matter and the time involved is out of all proportion to the outcome for them. The regulation places these consumers in a worse position than before.

Distribution channel

Another piece of consumer protection from the German Securities Trading Act gives the customer the right to withdraw from securities transactions arranged by telephone within one week of receipt of the advisory protocol. This has caused some providers to cease offering advice on securities over the phone – to the detriment of consumers, whose use of this sales channel is now restricted.

Product and service variety

Excessively strict regulation can cause products to disappear from the market because it is no longer worth providers' while to offer them or they would have to carry such a high price tag that consumers would no longer be interested in them. This narrows the range of products and leaves consumers less choice. One example is the restriction on early repayment compensation, which has led to a marked reduction in long-term fixed-rate loans on offer in some European countries.⁶

Provider concentration

Regulation often hits small providers harder

As a rule regulation also entails high one-off costs (fixed costs).⁷ Consequently, smaller providers tend to suffer more severely from regulation since the ratio of fixed costs to revenues is higher for them than for the big players. Over time, pressure to consolidate thus builds up among providers. This way too, the variety of products offered to consumers may ultimately be reduced as products are discontinued or sales outlets closed, for example.

⁵ Kohlert, Daniel (2008). Anlageberatung und Qualität – ein Widerspruch? Nomos. P. 128.

⁶ Ahlswede, Sophie. 'Easy way out' will raise costs for everyone. DB Research. Research Briefing. 23 March 2011.

⁷ Recurring costs are also high: The costs of financial market information requirements alone amount to roughly EUR 1.2 bn a year for providers in Germany, see BMF. Bürokratiekostenbelastung im Finanzmarktbereich. Monthly Report. October 2008.

Who can influence consumer protection?

There is not just the one consumer, there are many with different knowledge, abilities and preferences

Providers have an interest in customer satisfaction

Consumer policy in Germany

Consumer protection and consumer policy are comparatively new policy areas in Germany. Not until 2001 was the Federal Ministry of Food, Agriculture and Forestry renamed the Ministry of Consumer Protection, Food and Agriculture. The Federal Ministry of Food, Agriculture and Consumer Protection (BMELV), as it is now called, associates information and transparency, balanced rights and effective law enforcement, justified confidence in safe products and services and "organisational strengthening of consumer policy" with consumer protection. The protection of consumer's economic rights (as opposed to consumer health protection) has only been assigned a sub-department of its own in the BMELV since 2002.

The aim must therefore be to secure a level of protection deemed appropriate without triggering undesirable and disproportionate side-effects while proceeding as selectively and efficiently as possible.

Players and their interests

Three players are instrumental in shaping the substance and scope of consumer protection: consumers themselves, suppliers of goods and services, and government.

Consumers

Consumers form the largest but also the most diverse group. Some consumers are virtually experts with regard to certain products/services, possibly because they deal with them in the course of their work or possess years of experience in handling them. At the other end of the scale are consumers who are not even aware of the existence of these products and services.

Aside from the differences in their product knowledge, consumers also have different preferences: whilst some are prepared to tolerate higher transaction costs (longer searches and information-gathering) in return for a lower price, others prefer supplier proximity, for which they are willing to pay a premium. Basically, consumers are interested in an ample supply of high-quality, easy-to-reach goods and services, ideally at the lowest possible prices and transaction costs.

Providers

Providers differ in terms of their size and business strategy and in their products, sales channels and locations. They aim to maximise profit in order to keep their business going and expand it. All providers have one thing in common – an interest in identifying consumer needs and satisfying them to the benefit of both sides. Customer dissatisfaction implies lower future sales opportunities for providers. It is therefore in providers' own interests to keep their customers happy, which is why many invest in ways to increase customer satisfaction (more about this later). Particularly with financial services, a long-term, trust-based relationship often serves the interests of provider and consumer alike. Safeguarding customers' interests is an important competitive factor for financial services providers, given that many financial services are otherwise essentially interchangeable. Consequently, serving clients' best interests at all times is designed not only to avoid dissatisfied customers – in the positive sense it is also a way for providers to set themselves apart from their competitors.

Generally speaking, competition between providers increases product variety and results in lower prices. Intermediaries or brokers are a sub-category of providers who play an important role in some markets, especially in the financial services sector.⁸

Government

It is the task of the state, or government, to step in where market mechanisms do not work, and the public sector carries out duties that individuals cannot meaningfully organise for themselves – one example being general consumer protection. For the purpose, the state employs the services of various intermediaries, some of them independent, such as the judiciary, supervisory and regulatory bodies, special-purpose agencies and test centres. Since the government has to stand regularly for (re-)election it has a vested

⁸ Europe Economics. Study on credit intermediaries in the internal market. 2009.

Systematic departures

Availability: People take more notice of and overemphasise 'new' information just released.

Framing: The way information is presented (order, type, negative/positive) influences a decision.

Status quo bias: Consumers take the status quo as the benchmark against which they measure everything else.

Justifiability bias: Consumers are inclined to stick with past decisions and defend them even when circumstances suggest the advisability of altering that decision.

Information sources effect: Congruent information from different sources strengthens confidence in decisions taken on the basis of that information. Other information that does not tally with it is disregarded.

Illusion of control: Consumers believe they can influence uncertain situations, although as a rule this is not so. It can cause them to take the credit for positive outcomes while attributing negative outcomes to chance or circumstance.

Reflection effect, loss aversion: On the basis of the status quo, people strongly prefer avoiding losses to acquiring gains. The willingness to take risk in respect of gains is often greater than in respect of losses (e.g. with insurance).

Sunk cost effect: Viewed rationally, past costs should not play any part in future decisions – but they do.

Home bias: The tendency preferably to buy investment products from the home country/region, instead of diversifying optimally.

interest in maximising the electorate's (=consumers') satisfaction with its achievements while in office. Current events (such as food scandals) may therefore influence the measures that a government adopts. Distinctions are not always made between whether the case in point is an isolated one or symptomatic of a structural problem, responses being driven instead by public opinion. This can result in ad hoc measures that produce unintended side-effects or do not make optimum use of resources.

Types of consumer protection

Consumer protection can come in various shapes and sizes, with the different measures needing to intermesh. For example, in the long run no benefit is to be expected from consumer protection that focuses too one-sidedly on means of enforcement. In the 1960s and 1970s consumer protection legislation was introduced in America that has since ballooned into a liability lawsuit industry, which does not always have positive repercussions for consumers either.⁹ The correct dosage of individual measures is therefore vital to achieve the right overall outcome.

Consumer purchase decisions

The most effective way for individual consumers to bring influence to bear is through their purchase decisions. By deciding to purchase or 'vote with their feet' they pass judgement on the quality of the product/service offered and can impose sanctions. This presupposes that they do so deliberately as informed consumers. Information and comparisons between offers are important for this, but they are not the only factors. Often, consumers do not behave like the benefit-maximising *homo economicus*; viewed objectively they act irrationally. Behavioural economics research has revealed a broad range of systematic departures from rational behaviour that play a part in consumer decisions.¹⁰ For example, consumers make little use of the information offered to them¹¹, they change providers less often than economically sensible¹² and are too confident of their own knowledge (see sidebar).

Information as a basis

Information is an important basis for consumers' purchase decisions. How important information, knowledge and comparing different offers is, depends partly on the product or service in question (see Figure 2).¹³

In order to be able to evaluate and weigh up information critically, consumers must have a certain basic understanding of the subject matter. Consumer protection in financial services should therefore

Different goods, different circumstances

	Quality assessment	Information costs	Example in financial sector
Search goods	Easy, before decision	Low	Account, credit card, basic savings products
Ex-perience goods	Medium, some only after decision	Medium	Investment products
Credence goods	Difficult, even after decision	High	Life insurance/loans

Source: DB Research **2**

⁹ Butler, Henry and Jason Johnston (2010). Reforming State Consumer Protection Liability – An Economic Approach. Columbia Business Law Review. 2010.
¹⁰ Schneider, Stefan (2010). Homo Economicus – or more like Homer Simpson? DB Research. Current issues, June 29, 2010; FSA. Financial Capability. A Behavioural Economics Perspective. July 2008.
¹¹ FSA. Mortgage effectiveness review – Stage 1 Report. 2006. P. 17: Less than 30% of consumers who had taken out a mortgage in the 12 months prior to being questioned remembered receiving information and reading it before signing the contract (60% recalled receiving the information; 46% of these said they had read it carefully).
¹² Cseres, K.J. (2008). What has Competition Done for Consumers in Liberalised Markets? The Competition Law Review. Volume 4. Issue 2. July 2008. P. 88.
¹³ Oehler, Andreas und Lucia Reisch (2008). Behavioural Economics – eine neue Grundlage für Verbraucherpolitik? P. 8.

Courses of action available for consumer protection

Provider	Consumer	Government/legislator
Self-regulation, codes of conduct, qualification, training, incentives	Purchase decision	Evidence-based regulation, framing and measurement of target achievement
Benchmarking	Comparison	Supervision
Fair advertising, transparent pricing, information	Use of information	Information, warning system
Education	Education	Education
Efficient complaint management, arbitration body	Active feedback, complaint, assessment	Law enforcement and sanctions

Source: DB Research **3**

begin at school, to provide everyone with basic knowledge of financial matters. Online comparison sites and consumer ratings also exercise a powerful function.¹⁴

For information to be used, first and foremost it must be succinct and clear. When consumers were asked why they had not read the terms and conditions the two most common answers were: 1. they were too long and 2. the print size was too small (35%).¹⁵ The problem of information asymmetry between providers and consumers is not solved simply by providers or government making information available. A unilateral focus on information as the basis for better consumer decisions thus falls short of the mark. As yet no comprehensive research exists on the use that consumers make of information, particularly material on financial products.¹⁶

Organisation of consumer interests

The sheer size of the body of consumers and the differences within the group restricts the scope for organisation and hence the efficient representation of consumer interests. This makes it correspondingly more difficult for consumers to exert influence on providers or government measures, except in their purchase decisions, at elections and by making complaints. Consumer protection organisations can help bridge this gap. But as a rule the problems with collective consumer action mean these organisations are reliant on public grants. Government can have greater regard for consumer interests by involving more consumer expertise when drafting regulation. There are various ways of achieving this. For example, consumers can be consulted on possible measures in surveys; consumer representatives or other experts can be heard; or a dedicated agency can be installed to deal with issues of consumer protection in financial services.

Self-regulation by providers

With voluntary self-regulation and codes of conduct, providers can ratchet up the pressure on each individual company to comply with certain minimum standards and can draw consumers' attention to this. Furthermore, in the German Unfair Competition Act (UWG, based on an EU Directive) misrepresentations on compliance with a code of conduct are deemed unfair commercial practice. Self-regulation has the advantage that provider organisations can adopt needs-based rules swiftly and that it addresses both customers' and providers' concerns. The downside is that it does not generally establish a legal claim for consumers and might not be drawn up in sufficient detail. However, a legal claim may not necessarily be required if and insofar as all parties involved accept the rules voluntarily and consumers are familiar with the rule book and assert their rights.

Prohibitions and requirements

Government or legislators can influence the behaviour of providers, consumers or both groups by enacting prohibitions and require-

¹⁴ One example of this in the financial services sector is www.whofinance.de, where consumers can rate their investment advisors. 57% of consumers used the internet in the past 12 months to compare prices, see European Commission (2011). Eurobarometer 342. QA4.

¹⁵ European Commission (2011). Eurobarometer 342. QA15.

¹⁶ A beginning was made in a recently published study: Chater, Nick, Steffen Huck and Roman Inderst. Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective. November 2010. However, this deals only with investment products.



ments. In addition to direct intervention of this kind, government can alter the institutional framework (e.g. better education, taxes or other transaction costs). Legislators bear special responsibility in that the parameters they set have a regulative effect and establish framework conditions for the future. Ideally, legislators will determine which measures are best suited to the efficient achievement of which objectives with reference to an evidence-based, open-ended impact assessment of the various options.¹⁷ Their analysis should embrace the current status of research and stakeholder expertise while also taking account of other overriding objectives such as environmental protection. Ideally, measures will have a target whose achievement is measurable.

The “right” compensation for investment advice?

There are essentially two types of compensation for investment advisory services, commission-based and fee-based.

With commission-based consultancy, advisors receive compensation from the product manufacturer for offering and selling the product. This compensation can be paid either as a lump sum on conclusion of the transaction or on the basis of the amount invested. The advisor's compensation is borne by the investor, either in the form of front-end or other charges, and is usually spread over several periods.

With fee-based consultancy, advisors sometimes also receive compensation from the product manufacturer, but they may then pay this out to the client. Clients pay a flat rate for the advisory service, irrespective of whether they purchase investments or not. The amount of the fee may vary according to the sum the client plans to invest.

Both types of compensation have advantages and disadvantages for clients, depending on the investment amount, the holding period and other customer preferences.

Mystery shopping and monitoring counselling quality

Mystery shopping is one of several useful ways of monitoring the quality of advisory services. Many financial services providers already use the mystery shopping tool to identify potential for improvement in their internal operations. In Germany, external tests are also conducted regularly by Stiftung Warentest, a consumer watchdog, the magazine Capital, FMH, the Deutsches Institut für Service-Qualität and others. However, their findings are often contradictory, depending on the test criteria. The Federal Ministry of Food, Agriculture and Consumer Protection has commissioned a study to test possible standards for measuring the benefit to customers of the advice provided by investment consultants.

Enforcement

Even after contract conclusion, consumers still have ways of bringing pressure to bear. They can give the provider feedback and file a complaint or, in the event of failure to reach agreement, seek advice and support from consumer organisations, arbitration boards and ombudspersons. Legal action is the final resort. Consumers can also voice their concerns and objections to political decision-makers and/or consumer protection organisations.¹⁸ For example, in Germany there is also the possibility of collective action through consumer associations. In this case a consumer protection organisation sues for enforcement of the rights of the public at large on the basis of the Injunction Act or the Unfair Competition Act. For effective enforcement of structural problems in particular, the individual consumer is not the only one who must step up to the plate. Government can also lay the basis for enforcement through supervision and control. Supervision must, however, be targeted and efficient. A negative example is the blanket registration of all investment advisors and other sales staff recently adopted in the German Investor Protection Act. More to the point would be registration of those advisors who have already attracted attention for malpractice.

Key elements of consumer protection in financial services

Measures by providers

Financial services are often deeply rooted in personal interaction between consumers and the financial service provider's staff. By training and guiding their employees, providers can therefore make a contribution towards consumer protection. Suitable measures include codes of conduct, requirements of staff skills and qualification, staff training and internal incentive systems (e.g. fixed or variable compensation, pay scales based on customer-related ratios). Anonymous staff surveys and idea management can be used as tools to identify ways of improvement.

By making comparisons with competitors, providers can also adopt best practices. The concept of a customer advocate or customer advisory committee has already been established in many companies, with a group of employees and/or customers ensuring that product and process design addresses customer needs (e.g.

¹⁷ OECD. Consumer Policy Toolkit. P. 11. 2010.

¹⁸ For self-regulation on bank account switching, for example, the European Commission has made a feedback form available to consumers on its website.

Initiatives planned in consumer protection

2008	Directive establishing the principle of equal treatment
2008	Consumer Rights Directive
2011	Amendment to the e-Signatures Directive
2010/2011	Consultation on collective redress
2011	New legal framework for personal data protection
2011	Communication on the functioning of electronic commerce
2011	Initiative on the use of alternative dispute resolution
2011	Recommendation for FIN-NET
2011	Intensification of the dialogue with civil society
2011	Initiative on European contract law
2012	Resolution on the mutual recognition of electronic identification/authentication
2012	Communication on consumer empowerment
2012	Initiative on a European online dispute resolution system for eCommerce transactions

Sources: EUR-Lex, DB Research

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A uniform European Contract Law?

Differences in contract law and consumer law pose an obstacle to cross-border trade. One possible answer to this problem is a uniform European contract law. There is little support for this, however. In the past years a group of experts has drawn up a "Common Frame of Reference" as a kind of "toolbox" to ensure the coherence of future legislative acts and to be used when existing legislation is recast.

Another response to the differences in national consumer rights is the attempt to combine various directives already in existence by means of a "horizontal" consumer rights directive. But given the limited scope of application, this will not suffice to alter the present situation substantially.

An expert group set up by the European Commission drafted an optional European contract law that can be applied to contracts between consumers and providers. This optional instrument could be available as a "blue button" on which the parties to a contract could agree as the law applicable to the transaction, alternatively to national law. The Commission plans to propose legislation with respect to this in autumn 2011.

simple pricing structures). Investment advisers apply IT tools that display products matching the investor's risk classification. Providers use mystery shopping (see sidebar on page 7) to test the quality of their own counselling and operate an internal benchmarking system against the performance model that they have set themselves. The results of customer surveys and other indicators of customer satisfaction are included in the calculation of the variable salary portion. Fair advertising, transparent information, social commitment and education initiatives are elements of a company that consumers perceive as a long-term business partner. Efficient complaint management and membership of an arbitration body round off the ways for businesses to influence consumer protection. And with active membership in associations providers can further contribute to an informed legislative process.

Current legal status

More and more of the legislation on financial services and consumer protection is coming from Europe. The crisis and its impacts have underscored yet again how important uniform regulation is as the EU internal market grows closer together. Yet it has also emerged how differently individual markets suffered from the crisis: whereas UK consumers were hit harder by the direct fallout from the bursting of the housing and lending bubble, retail investors in Germany bemoaned the indirect impact from the loss in value of their portfolios. National legislators consequently continue to focus on areas in which their domestic market has the greatest interest. Lawmakers in Germany are concentrating on investment products, while the United Kingdom is also taking action on loan products.

EU consumer protection legislation

86% of European citizens favour closer coordination in Europe on measures to combat the economic and financial crisis.¹⁹ The crisis aside, differences in national legislation and difficulties in the cross-border enforcement of rights pose the biggest obstacle to cross-border trade.²⁰

There is still no uniform European contract law governing the relationship between consumers and companies; all that exists is so-called 'collision law'. In the case of conflicting legislation this regulates which law is to be applied to consumer contracts agreed by parties in different countries (Rome I Regulation on the law applicable to contractual obligations). Apart from that, national civil law applies. This contains some traces of EU consumer protection law, most of which is sector-specific, e.g. on distance selling of financial services. This means there is little general EU legislation that applies equally to, say, buying butter and taking out an insurance policy. Not even the notion of 'consumer' is defined uniformly EU-wide.²¹ And even where overarching legislation does exist, it is often full of exceptions for individual sectors.

For the rest, European legislators have so far mainly followed a minimum harmonisation approach. Minimum harmonisation means that certain minimum standards are introduced in all EU countries.²² Building on these minimum standards, national lawmakers have in many cases set up or retained additional rules. As a result, in

¹⁹ European Commission. Eurobarometer 73. 2010. P. 31.

²⁰ European Commission. Flash Eurobarometer 224. 2008. P. 21.

²¹ Consumer Law Compendium. Part 3.

²² Schulte-Nölke, Hans (2007). Überprüfung des gemeinschaftlichen Besitzstandes im Verbraucherschutz. June 2007.



Selection of planned initiatives in the financial services sector

2010	Amendment to the Investor Compensation Scheme Directive
2010	Reform of the Deposit Guarantee Scheme Directive
2010	White paper on Insurance Guarantee Schemes
2010	Communication on removing cross-border tax obstacles
2010	Regulation on SEPA migration
2011	Initiative on access to basic payment accounts
2011	Self-regulation on transparency in bank charges by end-2011
2011	Directive on credit agreements relating to residential property
2011	Directive on pre-contractual information and conduct of business in PRIPs
2011	Review of the MiFID Directive
2011	Amendment to the Capital Requirements Directive (CRD IV)
2011	Regulation for more efficient cross-border enforcement of judgements; attachment of bank accounts
2011	Amendment to the Regulation on Credit Rating Agencies
2011	Amendment to the Insurance Mediation Directive
2011	Crisis management framework in the banking sector
2011	Initiative on the taxation of banks
2011	Amendment to the Market Abuse Directive
2011	Amendment to the UCITS Directive in respect of UCITS depositories and UCITS remuneration policy
2011	Regulation on Central Securities Depositories
2011	Establishment of an EU framework for the approximation of sanctioning regimes in the financial sector
2011	Directive on Insurance Guarantee Schemes
2011/2012	Consultation on corporate governance
2012	Communication on the taxation of cross-border dividends
2012	Initiative to promote long-term savings and investment in infrastructure/ innovative projects

Sources: European Commission, DB Research

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accommodating special national features they have also created or failed to remove obstacles to cross-border trade.

The Unfair Commercial Practices Directive is one of the first cross-sector consumer protection directives effectively to introduce full harmonisation in business practices between companies and consumers.²³ Another horizontal directive is currently being discussed in the European Parliament and Council – the Consumer Rights Directive. However, this has moved away from full harmonisation in favour of a “targeted harmonisation” approach.

EU financial services legislation

The regulatory measures can be divided roughly into the following areas: banking, insurance, securities markets. There is some overlapping in their application since, for example, banks that sell securities or insurance policies are obliged to comply with the relevant regulations. But consumer protection regulation differs in the various areas. With sales of securities, for example, customers must be categorised and providers are obliged to advise them differently on the basis of this. So far, however, no such categorisation is required with taking out a loan. Further differences exist in information obligations, contract termination possibilities, duties of intermediaries, organisational requirements, supervisory requirements etc.

Back in 1999 the European Commission submitted its first comprehensive approach on European financial market regulation, the Financial Services Action Plan (FSAP). The regulatory measures it proposed were designed *inter alia* with the objective of open and safe retail markets and have since been implemented into national law in all Member States.²⁴ However, some outcomes are not yet quantifiable or have been distorted by the financial crisis.²⁵ The White Paper Financial Services Policy 2005-2010 took as its motto “Dynamic Consolidation of Financial Services”; most of the measures contained in it have been, or are in the process of being, transposed into national law in the Member States. In the wake of the financial crisis the European Commission has published several communications on how it plans to proceed with regard to regulation of the financial sector (see Figure 4).²⁶ Several consumer protection measures are also scheduled (see Figure 5).²⁷

On the whole, the measures envisaged on retail financial services are conspicuous for their marked shift in focus from internal market integration towards more consumer protection issues. But consumer protection and internal market integration are not a contradiction in terms; rather, they are complementary inasmuch as further integration of the internal market will benefit consumers through cross-border competition, a broader range of products and lower prices. The foundation for further integration of the internal market

²³ Rischkowsky, Franziska (2010). Verbraucherschutz im Binnenmarkt: Mehr als nur Wettbewerbspolitik? Zeitschrift für Wirtschaftspolitik. Sonderheft 2010: Europäischer Wettbewerb und der Binnenmarkt in Deutschland. P. 63.

²⁴ http://ec.europa.eu/internal_market/finances/docs/actionplan/index/100825-transposition_en.pdf

²⁵ CRA International (2009). Evaluation of the Economic Impact of the Financial Services Action Plan. March 2009.

²⁶ European Commission. Driving European Recovery. COM(2009) 114. 4.3.2009. On the follow up in retail financial services to the consumer markets scoreboard. SEC(2009) 1251. 22.9.2009. Regulating financial services for sustainable growth. COM(2010) 301. 2.6.2010. Towards a Single Market Act. COM(2010) 608.

27.10.2010. Commission Work Programme 2011. COM(2010) 623. 27.10.2010.

²⁷ European Commission. A digital agenda for Europe. COM(2010) 245 final/2. 26.8.2010. EU Citizenship Report 2010. COM(2010) 603/4. 27.10.2010.

for financial services (e.g. uniform requirements when opening an account, uniform valuation criteria for residential property) should therefore be laid in parallel with harmonised consumer protection.

How do you measure consumer protection?

In any international comparison of the level of consumer protection, debate has so far been driven by prejudices. This reflects a lack of hard data. But what exactly is a consumer protection level, and how can it be measured?

Consideration of the methodology

In the light of the above, the extent to which agents make use of the courses of action open to them (Figure 3) ought to be measured. For this purpose the courses of action available would have to be broken down into subtasks and indicators determined. With the indicators, a further distinction must be made between input indicators and result indicators.

It would seem logical to assume a connection between input and result, i.e. the greater the input the better the result. Similarly, it may be assumed that the marginal utility of each additional unit of input decreases; for example, investing the entire budget in information campaigns is not necessarily likely to raise the level of consumer protection. Input indicators are appropriate where they offer a good explanation of the result, i.e. if, based on the above hypothesis (provided this proves correct), the causal linkage between input and result is plausible, stable and statistically significant. In “absolute form” result indicators can enable comparison between different countries, but when viewed in isolation it is not possible to infer from them how efficiently these results were achieved. Where results are contrasted in isolation, it is all the more important fully to cover all possible courses of action to avoid obtaining a distorted comparison. That could happen if, say, only the result of enforcing consumer rights was considered without also comparing the quality of the consumer rights alongside this.

The next step would be to establish which data is suitable for the indicators. The findings of surveys on consumers’ subjective perception have the advantage of immediacy and the fact that, with a survey result on such a general question as that of perception, a lot of information is ‘priced in’, so to speak. But a problem with the use of survey results is that perception is not very standardised and may be interpreted differently by the respondents. To put the findings of surveys of perception into better context, consumers would also have to be asked about their preferences and knowledge. “Hard data” is better in terms of comparability, but there are often no standard European definitions of the terminology – for example when something is described as a complaint or when a loan is considered defaulted.

What is more, only qualitative information exists for many optional courses of action. In order to compare state regulation/legislation options, a legal comparison, categorisation and scale analysis would be necessary.²⁸

²⁸ Beginnings have been made here, for example the IW Regulation Index, which also contains a separate capital market regulation index, and the OECD Regulation Index.

Having determined the indicators and data gathering methodology, a comparison could be made between different countries or against a predefined benchmark. Based on the results, conclusions could be drawn on the action that the agents involved need to take. Finally, to prioritise the need for action it would be necessary to examine where the input of additional resources generates the greatest benefit for all market participants.

Measurement of the level of consumer protection by the European Commission

The European Commission has measured the level of consumer protection since 2008 with a Consumer Markets Scoreboard focusing on the three aspects: (i) EU retail financial market integration, (ii) market malfunctioning in certain sectors and (iii) benchmarking the general consumer environment. Aspect (i) is based on the assumption that more cross-border competition is good for European consumers. The measurement of malfunctions in consumer markets aims to identify sectors in which action needs to be taken.

A major problem with all three aspects is that the data is incomplete and not comparable. Another problem is the choice of indicators and the way they are treated. The indicators selected do not model all potential courses of action by all agents. Nor is a distinction made between indicators measuring input (e.g. spending on consumer organisations) and performance indicators measuring results (such as the level of education). There is no weighting of the impact that individual measures have on the improvement of consumer protection. Some indicators are viewed one-sidedly, with high numbers of complaints being factored into the indices as a negative²⁹, although it is a known fact that consumers apparently feel better protected in countries where people complain more (see Figure 8). Taken in combination, these measurement problems may cause the wrong markets to be identified as “malfunctioning”. This would mean resources being directed into inefficient measures – to the detriment of all market participants.

Recently, the Commission published a survey on consumer empowerment, meaning consumers’ skills, knowledge and engagement and established a Consumer Empowerment Index (CEI).³⁰

Proposals on measuring the level of consumer protection

It is difficult to assess consumer protection in financial services on the basis of general data on consumer protection because many sector-specific circumstances are likely to have an effect. Firstly, regulation differs. Even when concentrating on the financial services sector, there are still considerable differences between existing state measures regarding payment services, lending business and the purchase and sale of securities, for example.

The behaviour of providers and consumers depends on the circumstances (e.g. sales channel, competition) and the type of product/service.³¹ Information behaviour also varies enormously, with anecdotal evidence suggesting that very few consumers

Consumer Markets Scoreboard indicators

1. Benchmarking general consumer conditions
 - Enforcement regimes
 - Redress
 - Independent consumer organisations
 - Consumer empowerment (education, knowledge, information)
2. Integration of the retail single market
 - Cross-border purchases by consumers
 - Cross-border information, complaints, disputes, enforcement possibilities
3. Market malfunctions in individual sectors
 - Prices
 - Number of problems and complaints
 - Satisfaction
 - Safety
 - Frequency of switching
 - Trust/confidence
 - Comparison

Allow for sector- and product-specific differences

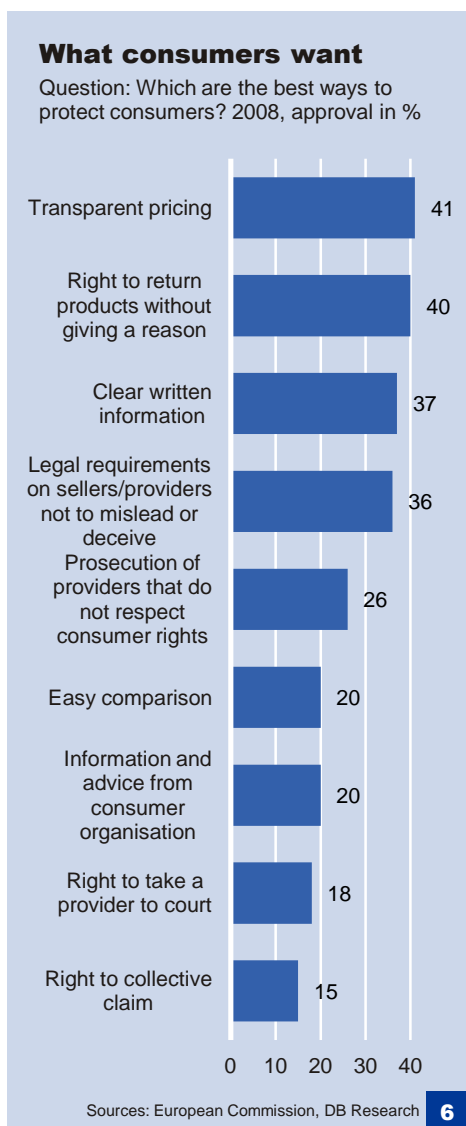
Allow for differences in behaviour towards different goods

²⁹ For example in GfK. The monitoring of consumer markets in the European Union. 2010. P. 330.

³⁰ http://ec.europa.eu/consumers/consumer_empowerment/index_en.htm

³¹ Oehler/Reisch (2008).

Behaviour differs according to sales channel



regularly compare the prices of financial services.³² An EU-wide behavioural economics study recently found that only 27% of retail investors compare offers in order to find the most competitively priced investment product.³³ All else being equal, investors in possession of simply presented and readily comparable information made better investment decisions. Their decision was influenced by the way in which the information was presented. Consumers' behaviour depended partly on the sales channel used, with consumers to whom their advisor's commission had been disclosed acting differently depending on whether they were sitting face-to-face with the advisor or were surveyed online.³⁴ Consumers who shopped over the internet said more frequently that they had read the terms and conditions.³⁵ Behavioural patterns of this kind should also be investigated for other product groups (loans, payment products) and should enter into assessment of the level of consumer protection.

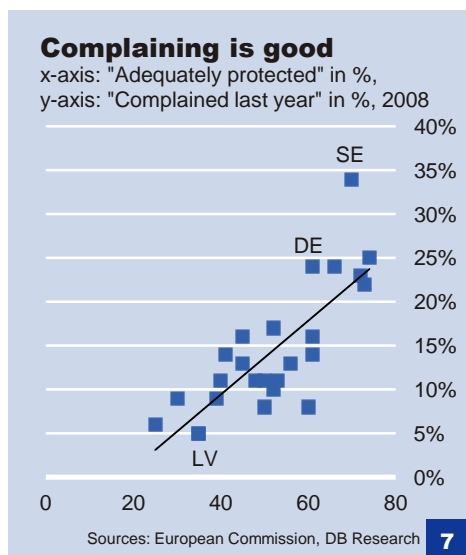
The assessment should also take account of consumer preferences. In Eurobarometer polls³⁶ one question was: "Among the following, which are the best ways to protect consumers?" Top of the list in 2008 was "The right to replace, repair, ask for a price reduction or terminate the contract when you buy a faulty product." However, this right is not specific to consumer protection; it is part of the general law of contracts that applies to consumers and companies alike. Other proposals which received strong support in the poll included clear and transparent pricing, the right to return products within the cooling-off period, and written information. There was a preference for disclosure, followed by regulation of gross misconduct on the part of providers and prosecution of the same. From consumers' point of view legal redress was the last of the best ways to provide effective protection. However, these preferences are very generalised and could differ for specific goods/services. Surveys on consumers' views of how best to protect their rights should therefore also be sector-specific.

Another appropriate strategy would be to prioritise the regulation agenda according to the importance of the respective product or service to consumers. Three factors are decisive here: (1) Is the product/service necessary to participation in social life (electricity, for instance, or a bank account, depending on the country)? (2) The share of their average income that consumers have to spend on its use. (3) Do the goods have search, credence or experience qualities (see Figure 2)? It would seem appropriate to assign high priority when either very many consumers spend small proportions of their budget on a good or few consumers spend large sums relative to their income. High priority would similarly appear appropriate with goods displaying credence or experience qualities and products/services of general interest.

Which indicators?

Indicators measuring input

These would include government input such as the existing degree of regulation (quantitative, qualitative), access to enforcement possibilities and their funding in relation to the case numbers, requirements of persons responsible for implementation (e.g.



³² Comdirect. Kunden-Motive 2010.

³³ Chater, Huck, Inderst (2010).

³⁴ Chater, Huck, Inderst (2010). P. 22.

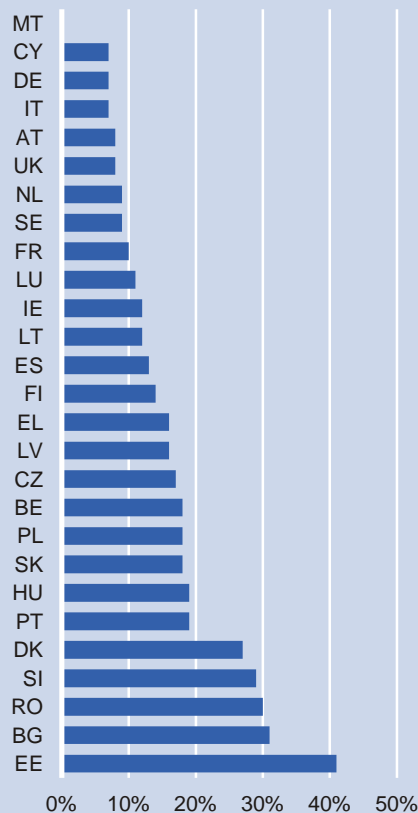
³⁵ European Commission (2011). Eurobarometer 342. QA14 and 21.

³⁶ European Commission. Eurobarometer 252. 2006 and Eurobarometer 298. 2008.



Had problems but did not complain

EU27 survey results on bank account service, 2010



Sources: European Commission, DB Research

8

General perception of consumer protection

Dependent variable: respondents who feel adequately protected by existing consumer protection measures

Data: survey results in EU25 from the Special Eurobarometer 298, 2008; Eurostat

Investment in education as % of GDP	4.89
Financial support for consumer protection organisations	(1.77)*
Easy to settle disputes through courts	0.00
Easy out of court settlement	-1.53
Coefficient of determination	0.09
	-0.29
	0.49
	(1.70)*
	0.53

* 10%

Source: DB Research

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teachers, supervisors, providers) or the appropriation of funds for certain areas/measures (e.g. education, supervision, information).

Provider input could be measured with reference to information policy (transparent and easily accessible vs. complicated and difficult to access), the organisation of internal incentive systems, expenditure on staff training and the availability and efficiency of complaint management (response time, proportion of complaints addressed satisfactorily). A problem with provider inputs could be that many of them are internal data.

Possible input factors from the consumer side could be receptivity to information provided and the readiness to compare offers, awareness and use of rights, and the willingness actively to provide feedback (in the form of feedback, complaints). With complaints, their number is less important than the ratio of problems to complaints. If this is highly disproportionate it would suggest market malfunction, but this would not necessarily be the case with a large number of complaints as such (see Figures 7/8).

Performance indicators

On the government side these would be indicators that measure target achievement due to regulation (for which suitable indicators would need to be framed and assigned), the length and costs of lawsuits, the level of education (general and specific), consumer perception of government, and the efficacy of supervision and sanctions.

Possible supply-side indicators would be consumer perception of providers, companies' long-term success and awards received, and the results of surveys on product/service quality.

An important consumer indicator would be consumer perception of the level of protection. A distinction would have to be made here between a general survey and a poll of consumers with specific experience of certain consumer protection measures. The Commission has described consumer opinions as the "acid test" of how well a market is working.³⁷ Further suitable performance indicators would be awareness and use of enforcement possibilities and complaint quality.

Evaluation of possible indicators

In the following, the results of surveys on the perception of consumer protection were used as the dependent variable. A problem is that some data has to be used from different years, as a result of which the results are only indicative.

Investment on education, enforcement possibilities, financial assistance

As was to be expected from what has been said in the above, regression analysis using survey results on the general perception of consumer protection as the dependent variable and education spending as a percentage of GDP, survey findings on possibilities for settlement in and out of court, and financial assistance for consumer protection organisations from the state as explanatory variables produces hardly any meaningful outcomes (see Figure 9).

The possibility of enforcement action in court and financial aid for consumer protection organisations appear to make little impact on the perception of consumer protection. Legal settlement is very low on the list of consumer preferences, so its scant significance for the

³⁷ European Commission. 4th Consumer Markets Scoreboard. 2010. P. 7.

Perception of consumer protection with bank accounts

Dependent variable: Surveyed individuals that felt adequately protected by existing consumer protection measure regarding bank accounts

Data: Survey data from EU25 in Eurobarometer 260, 2007 und Eurobarometer 342, 2011

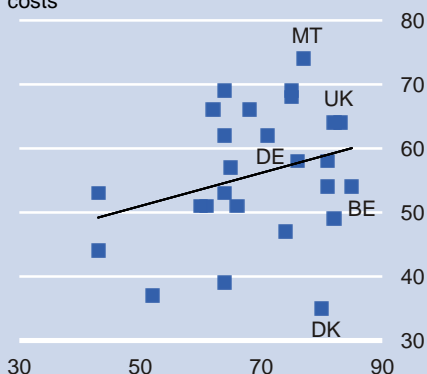
Complained in the last 2 years	-0.28 (-0.38)
Price comparison is easy	0.38 (1.96)**
Basic numerical skills (in % of right answers)	1.08 (4.80)**
Switched provider	-0.67 (-0.98)
R ²	0.58

** 1%

Source: DB Research **10**

Correlation weak

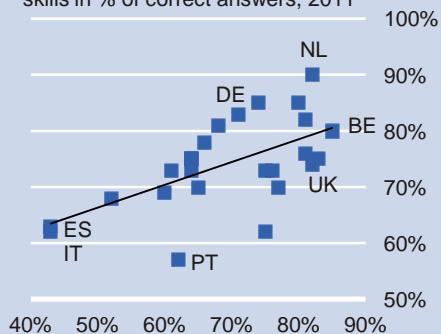
2007, x-axis: perception of consumer protection with regard to bank accounts; y-axis: "Easy to compare bank account costs"



Sources: European Commission, DB Research **11**

Better protected with basic numerical skills

x-axis: "well protected re. bank accounts", 2007; y-axis: basic numerical skills in % of correct answers, 2011



Sources: European Commission, DB Research **12**

perception of consumer protection is not surprising. Education spending as a percentage of GDP and possibilities for out-of-court settlement exhibit a weak positive correlation.

Simple price comparison, level of switching and complaints

Price transparency is important for consumers. In countries where consumers perceive prices as easy to compare and have basic numerical skills they feel better protected (see table 10). 58% of the variation in consumer protection perception can be explained by this. Only a weak correlation can be identified when considering consumer protection perceptions and easy price comparison in isolation. An explanation for this could be that only good basic numerical skills enable consumers to use transparent price information. The level of switching and complaints cannot sufficiently explain differences in the perception of consumer protection for bank accounts.

Suitable indicators

Very few suitable indicators are to be found among those available so far. One problem is data availability, another the small panel, from which it is very difficult to draw conclusions since it covers only 25 observations (EU25).³⁸ It would be interesting to consider sector-specific indicators such as financial literacy, ideally divided into borrowing, investment, payment transactions; comparison behaviour; availability and the use of information on these products; complaints not addressed satisfactorily.³⁹

Conclusions

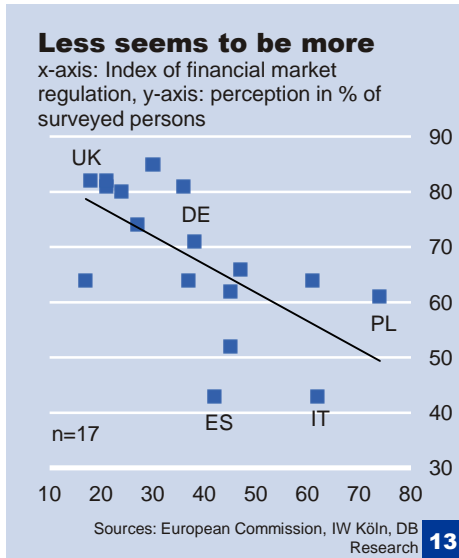
- The hypothesis "greater input = better result" is borne out – at least in its tendency – even if the correlation is often weak. By way of illustration, in countries where education spending as a percentage of GDP was higher, the general consumer perception was also better. However, considering individual factors in isolation is not productive, especially with regard to possible courses of action.
- The only indicator that points in the opposite direction is capital markets regulation where less seems to be more (chart 13). However, the data comes from different years and there are only 17 observations.
- The use of general indicators seems to have little informative value. Sector-specific data are therefore preferable.
- The level of switching and the number of complaints do not deliver an adequate explanation for consumer perception of bank accounts. The MPI⁴⁰ and consumer perception of bank accounts likewise show a correlation of just 0.5.
- In the Consumer Markets Scoreboards and studies published so far there has never been a systematic examination of how consumers use written information and under what circumstances.⁴¹ Since this is often used as a regulatory

³⁸ The regression analysis may be distorted by not taking into account all factors that could have an effect on consumer protection or on its perception due to a lack of data.

³⁹ Data on some of these points has been collected partly for the first time in the Eurobarometer 342 on consumer empowerment.

⁴⁰ Market Performance Indicator, see European Commission. 4th Consumer Markets Scoreboard. 2010.

⁴¹ Apart from the FSA, Mortgage effectiveness review – Stage 1 Report, 2006, although this, too, only examines the treatment of product information leaflets in the UK mortgage market.



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consumer protection tool precisely in the financial services sector, it would make sense to examine whether this measure is helpful. Isolated surveys and studies suggest that consumers do not make sufficient use of information.⁴² Factors encouraging consumers to make better use of information should be examined. Standardised information confined to the essentials can evidently help people make better decisions.⁴³

- The disclosure of conflicts of interest (for example by revealing brokerage commissions) can lead to knee-jerk consumer resistance, subsequently resulting in suboptimal investment decisions.⁴⁴
- Sound consumer education could have a positive impact on the efficient use of information by consumers. Behavioural economics studies strongly suggest that better educated consumers tend to make better investment decisions.⁴⁵ No comparable data on consumer education and financial literacy is available yet in the EU.⁴⁶

Recommendations on designing consumer protection

Form

When designing consumer protection we not only have to answer the question of which measures are most sensible and expedient in terms of their content, how this is achieved is also important. Any measure gives rise to direct or indirect costs for all involved. Achieving the identified objective (remedying market malfunctions) as efficiently as possible is therefore in the interests of all market participants. Minimally invasive measures, combined with clear goal-setting and the appropriate monitoring⁴⁷, therefore appear the most sensible way. Often, much can be achieved by self-regulation or a code of conduct.

Regulatory level

In an increasingly harmonised internal European market there is also the issue of the level at which market malfunction should be combated. In principle, European regulation is preferable to unilateral measures at the national level. But where problems differ vastly from one country to another or have different root causes, in some instances a national response may be more appropriate. It

Responsibility at the EU level

Responsibility lies with the Commissioner for Health and Consumer Policy (currently John Dalli) as head of the Directorate General GD SANCO. However, when a new European Commission was formed early in 2010 some areas of consumer protection (Consumer Rights Directive, Common European Contract Law) were assigned to the Commissioner for Justice, Fundamental Rights and Citizenship (GD JUSTICE), Viviane Reding. Michel Barnier, the Commissioner in charge of the Internal Market and Services (GD MARKT) also has an important part to play in matters of consumer protection for financial services.

Enforcement of the *acquis communautaire* in the realm of consumer protection takes place in the Member States' national courts. It is, however, the duty of the Commission to adopt measures to support, supplement and monitor the policy pursued by the Member States in this area (Article 169 (2) b) TFEU.

⁴² Beshears, John and James Choi, David Laibson, Brigitte Madrian (2010). How does simplified disclosure affect individuals' mutual fund choices? July 2010.

⁴³ Chater, Huck, Inderst (2010).

⁴⁴ Lacko, James and Pappalardo, Janis (2004). The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment. Federal Trade Commission. Bureau of Economics Staff Report. February 2004.

⁴⁵ Choi, James and David Laibson, Brigitte Madrian (2005). 100\$ bills on the sidewalk: Suboptimal saving in 401(k) plans. July 2005. But personal characteristics (capacity for self-control, planning and patience) evidently sometimes carry greater weight than education: McCarthy, Yvonne (2011). Behavioural Characteristics and Financial Distress. ECB Working Paper Series No. 1303. February 2011.

⁴⁶ An OECD study on the subject is planned: http://www.oecd.org/document/42/0,3746,en_2649_37455_47185322_1_1_1_37455,00.html

⁴⁷ Brok, Sascha and Raimar Dieckmann (2007). Better Regulation in Germany and the EU. Deutsche Bank Research. EU Monitor 47. August 30, 2007. Frankfurt am Main.

would then be advisable to investigate which factors are behind the differences and which countries lessons can be learnt from.

Post-crisis regulation

By way of illustration, two pieces of proposed EU legislation on retail banking are discussed in the following.

Consumer protection in the European Union

Consumer protection has formed part of Community policy since the Treaty of Maastricht (1992), prompted by the realisation that it was not possible to complete the EU's internal market by concentrating exclusively on the supply side. European consumer protection policy was further upgraded and expanded in the Treaty of Amsterdam (1997), since when it has existed (largely unchanged) in the version of the Treaty on the Functioning of the European Union (TFEU) in force since December 2009:

Article 4 (2): "Shared competence between the Union and the Member States applies in the following principal areas: (...) f) consumer protection."

Article 12: "Consumer protection requirements shall be taken into account in defining and implementing other Union policies and activities."

Article 169 (1): "In order to promote the interests of consumers and to ensure a high level of consumer protection, the Union shall contribute to protecting the health, safety and economic interests of consumers, as well as to promoting their right to information, education and to organise themselves in order to safeguard their interests."

Creditworthiness assessment need not be regulated by EU

Responsible lending and borrowing

The European Commission has proposed a Directive on credit agreements relating to residential property.⁴⁸ The following elements are included:

1. Information obligations in advertising and marketing
2. Creditworthiness and suitability assessment
3. Pre-contractual information for credit institutions and credit intermediaries
4. Adequate explanations and advice standards
5. Harmonised calculation of the annual percentage rate of charge (APRC)
6. Registration, supervision, authorisation and professional requirements of credit intermediaries
7. Provision on early repayment.⁴⁹

Upon introduction of the Consumer Credit Directive it was found that credit institutions used interest rates less in their promotion since doing so involves compliance with additional complex information obligations. On the other hand is the consumer, who does not benefit from this regulation. Research by the FSA⁵⁰ has shown that in most cases consumers do not even use the written pre-contractual information offered them. It would make more sense to standardise the formula and assumptions for calculation of the APRC displayed in banks' promotion, in order to give consumers a real initial comparison on the basis of advertisements.

Like bank customers, credit institutions also have an interest in reliable examination of whether and on what basis their customers are able to repay the loans granted. This is accomplished by means of the creditworthiness assessment. Here, the interests of both parties tally. This casts doubt on the need for regulation, unless problems resulting from inadequate creditworthiness assessments actually are identified. That may be the case in some EU Member States, but a basis for regulation on the EU level exists only if such regulation is proportionate and not in breach of the principle of subsidiarity. The Commission is examining whether it should be made obligatory for credit institutions to refuse loans in the event of negative creditworthiness assessments. However, that would fail to take account of factors that do not form part of the creditworthiness assessment. It would make access to borrowing more difficult for some consumers while probably not substantially reducing loan defaults. In most cases private individuals fail to repay their loans as a result of losing their job, their partner's falling ill/dying or following

⁴⁸ European Commission (2011). Proposal for a Directive of the European Parliament and the Council on credit agreements relating to residential property. KOM(2011) 142. 31 March 2011.

⁴⁹ See Schäfer, Stefan (2006). There is no free lunch. Deutsche Bank Research. EU Monitor 36. July 7, 2006. Frankfurt am Main and Ahlswede, Sophie (2011). "Easy way out" will raise costs for everyone. Deutsche Bank Research. Research Briefing. Frankfurt am Main. March 23. 2011.

⁵⁰ FSA. Mortgage effectiveness review – Stage 1 Report. 2006.



Ultimately, only consumers themselves can judge suitability

a divorce. But no creditworthiness assessment can provide for events of this kind.

The Commission is also planning a suitability assessment, in the course of which a sufficiently large selection of “not unsuitable” products are to be identified for customers. The fundamental issue here is whether lenders can judge what is suitable for their customers and what not. The requirement to identify suitable products is not basically misplaced and is already happening in practice. But a statutory requirement has the disadvantage that it creates liability situations.

Pre-contractual information already exists – it’s the use of it that matters!

Pre-contractual information is already handed out on the basis of the Code of Conduct on Pre-contractual Information for Home Loans. Legislation will therefore be of little added benefit.

Transparency of credit intermediaries may not only be a good thing

With regard to credit intermediaries, some Member States have extended the requirements of the Consumer Credit Directive to housing loans; attention must therefore be paid to consistency here. According to the planned proposal, independent credit intermediaries would have to draw attention to the existence of commissions they receive from the lender. At customers’ request they would have to disclose differences in the commission paid by different lenders and would have to begin by notifying customers of their right to request this information. Although transparency generally protects customers, in this case the benefits are doubtful. In a study by the US Federal Trade Commission dating from 2004⁵¹ it was established in a controlled experiment that consumers were confused by the disclosure of commission fees. Consumers to whom commission fees were revealed often chose the more expensive loan products than test subjects not in possession of such information. On the basis of this finding, regulation should take this unintended side-effect into account.

Begin by removing obstacles to mortgage credit market integration

Consumer protection measures are without doubt an important complementary element of an integrated mortgage credit market. But essential obstacles to cross-border lending would first have to be cleared away. This would necessitate the harmonisation of land registers and foreclosure procedures, Europe-wide property valuation standards and the integration of mortgage funding markets, to name but a few. It would add genuine value for consumers in the form of more competition, a broader range of products and lower prices.

Transparency in bank charges

The banking industry is expected to come forward by mid-2011 with self-regulation to improve the transparency of bank account prices. The Commission has concrete ideas on what this should look like, with uniform European terminology for bank fees. The financial services industry is also required to draw up a glossary of all charges and to issue standardised information leaflets on bank accounts. Credit institutions are expected to deliver regular, standardised data to a central price comparison website and provide regular schedules of all fees to the customer.

Proper prioritisation?

It might be advisable to consider whether this extensive initiative is justified given that on average 56% of consumers find it easy to compare offers from different providers of bank accounts⁵², account

⁵¹ Lacko, Pappalardo (2004).

⁵² European Commission. Eurobarometer 260. 2007.

First examine consumers' use of information

charges consume an extremely small part of the average household budget⁵³ and tend to belong in the category "search goods".

The danger of standardising product terminology is that in the medium term this will also trigger a process of standardisation of the products themselves. This could narrow the product range for consumers.

Standardised leaflet may make sense under certain conditions

Very few consumers are likely to be interested in a glossary of all fees. A clear, standardised and short leaflet would presumably be more useful here. The question is, however, whether and what use consumers will make of this, especially since schedules of bank charges must already be displayed by law in many countries. There is not yet any comprehensive research on this. Comparison websites already exist on the internet, offering an important initial source of information for consumers.⁵⁴ There is no plausible justification for government organisation of this information. Here, too, it would be interesting to examine more closely the existing sites and the use consumers make of them.

Customers are already provided with regular overviews of debit and credit interest and account maintenance fees. They can find all other charges (e.g. for withdrawals from cash machines operated by other providers, transfer charges, costs of replacing lost cards) in their account statements. Issuing another regular list of all fees would be very expensive for the banks and do no more than give information already in the consumer's possession.

First remove obstacles to opening accounts across borders

In the first instance self-regulation would certainly be the right tool here, particularly since there is no evident market malfunction Europe-wide. Measures to improve the transparency of bank charges may be constructive and sensible for consumers in Europe if, at the same time, obstacles are removed to opening accounts across borders – by, for example, harmonising the rules on what is needed to open an account (proof of identity, proof of address etc.) and on how it can be made possible to open an account entirely online.

Conclusions

All agents can play a role

It has become clear that all agents have ways of influencing consumer protection – even consumers themselves. Behavioural economics research plays an important part in helping to understand how far they are able, and can reasonably be expected, to do so.

Sensible distinctions by product/service

There are varying degrees of consumer protection for different products and services. This is reasonable since agents behave differently with different products and services. Consumer protection regulation should be prioritised accordingly – bearing in mind that whilst different behaviour calls for different regulation, conversely regulation also influences the behaviour of the people involved.

⁵³ Ahlswede, Sophie (2009). How high are account charges in Europe really? DB Research. Talking Point. November 27. 2009.

⁵⁴ Meyer, Thomas (2010). Majority of bank customers do research online. DB Research. E-economics 79. October 14, 2010. Frankfurt am Main and European Commission (2011). Eurobarometer 342. QA4.



Impact of financial services regulation

One outcome of increasing regulation will be price rises for consumers. Imperfect competition will ensure that these costs are not passed on one-to-one, but customers will ultimately still foot the bill for greater consumer protection and financial market stability. As a rule, another upshot of greater regulation is higher fixed costs, increasing pressure for consolidation in the respective sector. This runs counter to efforts to prevent financial institutions from becoming too big and interlinked. It is therefore all the more important that the measures are on-target and efficient and that they genuinely add value for consumers.

Cost-benefit analysis is important

When weighing up whether regulation is necessary or not, the cost-benefit ratio should be taken into consideration for all market players. The relevance to the individual and to the economy as a whole and unintended side-effects are crucial factors in this analysis. An illustration: high contributions by the banks and a high level of coverage by a deposit guarantee scheme sound good to begin with. But in the long run they can be expected to push up account maintenance fees and lending rates. Depending on their magnitude, higher lending rates in particular can negatively impact an economy's growth.

Measurability and data availability a challenge

The availability of more, better quality and above all granular data on consumer protection would be helpful. The European Commission's 4th Consumer Markets Scoreboard, which monitors 50 goods and services markets, is an opening move as is the consumer empowerment survey. However, allocation and scaling of some survey scores is a problem, leading to distorted results.

Responsibility for regulation outcomes

Concrete target definition and the measurement of target achievement belong in an efficiently designed consumer protection policy. This would create a clear responsibility for regulation outcomes on the part of national governments or supranational authorities. Impact assessment studies by the Commission and bodies such as Germany's regulatory impact unit, the *Normenkontrollrat*, are steps in this direction, and these now need to be taken further forward. The national or European legislator needs to see itself more as a service supplier and solution provider, by whose successful outcomes it is judged.

Consistent regulation and implementation

In the interests of European consumers and providers European and national legislative bodies should work together to promote consumer protection efficiently and purposefully. Only through coordinated and consistent use of the courses of action open to it can the internal market in Europe unfold its benefits for all market participants. The development of modern IT is acting as a catalyst for cross-border markets – and in line with this consumer protection must also be carried further forward beyond national confines.

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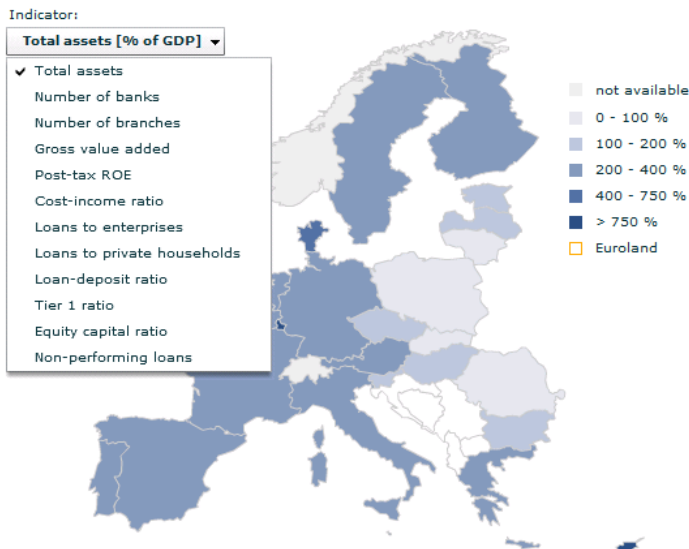


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