

## **ESMA response to the Commission Green Paper on retail financial services**

1. ESMA welcomes the Commission Green Paper on retail financial services (the ‘Green Paper’) and its focus on how providers and customers of retail financial products can make better use of the Single Market.
2. ESMA notes that despite the wide reference to “retail financial services” the Green Paper generally focuses on the banking (retail banking and current accounts, payment services, credit cards, mortgages) and insurance retail services. However, as some of the questions raised in the Green Paper are also relevant for the securities markets, ESMA takes this opportunity to share with the Commission some reflections on a number of topics mentioned in the Green Paper which appear relevant to ESMA as well as on ESMA’s activities and their contribution to the objectives stated in the Green Paper.
3. This response should be considered in the broader context of ESMA’s response to the CMU Green Paper. The response deals with a number of topics mentioned in the Green Paper which are considered relevant to ESMA.

### **I. Introduction**

4. ESMA fully supports the objective of achieving a deeper and fairer Single Market – built on a high level of trust among customers that their interests will be protected irrespective of where the firm providing the service or product is located in the EU and on certainty for companies when doing business across borders. ESMA sees this objective fully aligned with ESMA’s core objectives, namely enhancing investor protection and promoting stable and orderly financial markets, and considers that, through its activities, it plays an important role in several areas mentioned in the Green Paper.
5. ESMA considers that this objective can be achieved through several types of initiatives (both legislative and non-legislative) in order to have maximum effectiveness. ESMA would also like to stress that strong progress has been made in the establishment of a Single Market in financial services in the recent years and would suggest that the Commission’s main focus should be on ensuring the effective and uniform implementation of these rules, as they should bring about positive changes for customers (in terms of increased transparency around products and costs and therefore comparability and competition; strengthened and more harmonised conduct of business rules increasing customers’ trust in the quality of services received, including on a cross-border basis) and financial services providers (more harmonised standards increase legal certainty and facilitate the provision of services throughout EU).

6. It is also among ESMA's priorities to ensure a proper implementation of this framework all over Europe through consistent application and supervision of the single rule book across Member States.
7. Despite such efforts it is also evident that certain regulatory differences impact the objective of a well-functioning Single Market where consumers' interests are protected in a similar manner when investing in substitutable products or when receiving similar services. ESMA invites the EC to consider specific adjustments which would deliver on the objective of similar treatment for similar products and services. Such consistency will bring benefits to consumers (who can then expect similar standards apply irrespective of the legal classification of the product in which they invest) and financial entities (due to lower costs linked to mapping/understanding various applicable requirements and to adapting practices depending on the type of product or the distribution channel used).
8. One clear example of divergent legal requirements relates to the rules applicable to the distribution of insurance-based investment products on one side and of financial instruments on the other. Notwithstanding the intention, consistently expressed by the EC, to deliver consistent protection for investors and ensure a level playing field between similar products, the final Insurance Distribution Directive (IDD) requirements in relation to some important aspects such as the provisions on independent advice or inducements rules are different:
  - the concept of independent advice under IDD does not contain a prohibition for independent advisers to receive inducements like the one under MiFID II. Moreover, the requirement for insurance intermediaries presenting themselves as independent advisers to assess a sufficiently large number of insurance products available on the market which are sufficiently diversified with regard to their type and providers and which are not limited to insurance products issued or provided by entities having close links with the intermediary is left at the discretion of MSs;
  - the IDD requirements for inducements to be acceptable when other services than independent advice are provided merely refer to the condition that the payment of such inducements does not have a detrimental impact on the quality of the relevant service to the customer, unlike the MiFID II positive requirement that the quality of the service provided to the client is enhanced as a result of those inducements being provided. In addition no similar disclosure requirements are foreseen with respect to the information to be provided on the existence, nature and amount of inducements;
  - another important difference is noted in the level of pecuniary sanctions<sup>1</sup>.
9. While it is ESMA's view that IDD and MiFID II standards should be closely aligned, the Commission should also aim at aligning the IDD delegated acts as much as possible with MiFID II delegated acts. Moreover, ESMA stands ready to cooperate with EIOPA to achieve as much consistency as possible in the conduct of business standards for the distribution of these investment products.

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<sup>1</sup> In case of legal persons the minimum of the maximum administrative pecuniary sanctions is set at up to 5% of the total turnover in IDD vs up to 10% under MiFID; in case of natural persons, up to 700 000€ in IDD vs 5 000 000€ under MiFID.

10. The joint work of the three European Supervisory Authorities (ESAs) on the development of guidelines on cross-selling of financial products revealed that legal differences in the Level 1 regulatory frameworks of the three financial sectors can make this task challenging and difficult to accomplish. This example shows that having aligned legislative provisions in different pieces of Level 1 legislation is an important prerequisite and precondition for the ESAs to accomplish their tasks of enhancing the regulatory consistency across the different financial sectors appropriately<sup>2</sup>.
11. It is also ESMA's view that the Commission should assess certain inconsistencies among UCITS, AIFMD, PRIIPs and MiFID II frameworks. Further consistency should for instance be sought in the area of cost disclosures<sup>3</sup> or in the application of product governance<sup>4</sup> and product intervention rules. Inconsistencies related to disclosure rules, due to the progressively fragmented disclosure framework, may be burdensome to both customers and firms. They materially distort the economic behaviour of ideally well-informed consumers and damage the consumers' trust and confidence. They also increase compliance costs for firms and create incentives for regulatory arbitrage. This is also true regarding the relationship between insurance and securities regulation.

## **II. ESMA's views on a selection of topics mentioned in the Green Paper**

### **II.1 Accessing financial services from anywhere in Europe and creating market opportunities for suppliers – the MiFID passport and the home-host cooperation**

#### *Issue at stake*

12. The Green Paper notes that “the current level of direct cross-border transactions in retail financial services is limited, with customers largely purchasing these products in their domestic market and firms overwhelmingly serving markets in which they are physically established”. The GP acknowledges that this may reflect cultural and national preferences and customers' and businesses' choice but likely also customers' lack of confidence in offers from other Member States or the impact of excessive operational and compliance costs on suppliers offering products in other Member States. Moreover, the GP mentions that while EU passporting rights are currently available for a number of

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<sup>2</sup> ESMA refers to the joint letter on cross-selling of financial products to Jonathan Hill, the European Commissioner for Financial Stability, Financial Services and Capital Markets Union from the Chairpersons of the three European Supervisory Authorities – EBA, EIOPA and ESMA, dated 26 January 2016.

<sup>3</sup> PRIIPs and MiFID II mandate full disclosure of all costs and charges related to the product and the investment services provided to clients. In order to avoid duplication of information, MiFID II (recital 78) clarifies that “Where sufficient information in relation to the costs and associated charges or to the risks in respect of the financial instrument itself is provided in accordance with other Union law that information should be regarded as appropriate for the purposes of providing information to clients under this Directive”. While consistency is ensured between PRIIPs disclosure on costs and MiFID II disclosures, an issue has emerged, linked to the fact that some elements (notably the disclosure of transaction costs) are not included in the UCITS KIID. This means that MiFID intermediaries have to liaise with the UCITS managers to obtain additional information on transaction costs. This also creates an additional arbitrage as UCITS managers marketing directly the product may provide the UCITS KIID without the disclosure of costs which is required by MiFID II (with the result that intermediaries and UCITS managers could provide different figures to investors). Removing such inconsistency is in line with CMU recommendation on consistent disclosure requirements and ESMA's Technical Advice to the Commission on MiFID II and MiFIR.

<sup>4</sup> This is in line with ESMA's Technical Advice to the Commission on MiFID II and MiFIR.

activities they do not extend to all products/services or could be further improved, including through “further convergence in supervisory standards (led by the ESAs) to limit issues with host state regulators”.

13. While the examples in the Green Paper focus on issues arising in the banking and insurance sectors, ESMA sees merit in considering whether more can be done to improve the functioning of the passport under MiFID in order to develop effective Europe-wide markets for retail financial services with increased levels of confidence and trust of retail investors. While MiFID established the conditions under which investment firms and banks can provide investment services in other Member States on the basis of home country authorisation (single passport) and while the MiFID passport appears to be widely used across the EU, ESMA is also aware of some practical issues emerging from the current allocation of competences and the efficiency of the cooperation among home-host authorities.

#### *Proposed actions*

14. Even if MiFID greatly contributes to the provision of services on a cross-border basis and reinforces investor protection, additional steps may be considered towards stronger market integration and greater retail investor confidence.
15. ESMA’s recent focus on supervisory convergence should lead to improved home-host cooperation and convergence in high supervisory standards and therefore limiting potential concerns on investment firms’ ability to provide services on a cross-border basis or customers’ confidence in such services<sup>5</sup>. In particular, and as also mentioned in the response to the CMU, ESMA aims at ensuring a consistent approach to authorisation and supervision of activities regulated by EU legislation (such as MiFID)<sup>6</sup>.
16. At the same time, when firms provide services on a cross-border basis the host NCAs have no powers over those firms. However, language barriers and cultural differences mentioned in the Green Paper are elements to be taken into account, together with the closeness of host NCAs to investors in their jurisdictions. Indeed, as also noted in the context of the peer review on fair and non-misleading information or in the context of the provision of services in CFDs and other speculative instruments, monitoring the provision of services on a cross-border basis may present additional challenges for home NCAs (for instance, they may need to supervise marketing materials produced in other languages or they may receive customer complaints in those other languages).
17. For these reasons, ESMA believes that consideration should be given to possible adjustments to the financial services framework for the provision of cross-border services

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<sup>5</sup> It should not be forgotten that several level 2 provisions are also expected to increase legal certainty for financial services providers (for instance by ensuring that same authorisation requirements and processes are followed across the Union) and facilitate cooperation and exchanges of information between NCAs and ESMA.

<sup>6</sup> In its response to the CMU, ESMA has mentioned its commitment to make sure that all the rules on cross-border and passporting activities are properly applied and actively seek to facilitate effective cross-border supervision and enforcement ( for instance through a co-ordinated approach to market monitoring and risk identification, or joint action by some or all NCAs).

in order to ensure the highest standards of customer protection when handling customer complaints in cross-border situations. For instance, ESMA considers that it could be beneficial if home NCAs provide to relevant host NCAs and ESMA, an annual overview of the complaints received and the firms and topics which emerged most often. These arrangements may promote deeper cooperation between home and host authorities and increase mutual awareness of cross-border activities by investment firms and help sharing, identifying and prioritising highest risk areas. Within the scope of mutual assistance and cooperation, arrangements by which NCAs meet on a regular basis to exchange information pertaining to, and plan the means of co-ordinating, the supervision of cross-border services compliance with financial services legislation could be encouraged.

18. On the basis of the above considerations, some statements in the GP concerning the provision of services cross-border could also be clarified<sup>7</sup> by stating that financial entities targeting consumers in another Member States and having concluded transactions with those clients should be prepared to interact with them, in their language, when problems arise.

## **II.2 Knowing what is available throughout Europe and encouraging comparability and portability**

### **II.2.1 Better information for customers**

#### *Issue at stake*

19. Customers should be able to know what is available elsewhere in the EU and get competitively-priced products. However, customers may face difficulties in comparing the costs of different investment products as there are currently no fund calculators or central databases on costs publicly available across Europe. The Green Paper considers that independent comparison websites can be helpful in ensuring that customers know that products exist and provide support to customers in switching, by stimulating competition between various providers and enhancing the transparency and comparability of information available to customers. Specific disclosure may also ensure that customers are more engaged with their financial decisions.

#### *Proposed actions*

20. Recent initiatives such as MiFID II and PRIIPs are expected to raise customer awareness about the different retail products available throughout the Union and improve cost disclosures for investors. ESMA wishes to restate its view (as set out in the CMU response) that it may be useful to complement the information on cost disclosure

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<sup>7</sup> In particular, statements on the fact that it can be burdensome, unattractive and challenging for financial entities to deal with customers' complaints, particularly where there are requirements to provide services in other languages, or reference to the difficulty for firms to oversee contractors dealing with clients' claims on their behalf.

mandated by the aforementioned legislation via the setting up of reliable on-line calculators or central databases.

21. In addition to referring to the report, mandated by PRIIPs, on online calculator tools providing for reliable and accurate calculations for all PRIIPs products, ESMA believes there is a role for public initiatives in ensuring that comparison websites function well and are as complete as possible to empower investors and avoid risks of misselling (by monitoring the standards followed by such websites and/or by establishing accreditation schemes and/or by establishing public comparison websites where private services do not exist or are not functioning well).

## II.2.2 Facilitating cross-border distribution of financial products

### *Issue at stake*

22. Customers often lack access to information about cross-border offers of financial products, making it difficult to shop beyond their home country. The Green Paper also notes that EU customers can rarely access financial products or services from other Member States. The GP is therefore raising the question on how to facilitate cross-border distribution of financial products through intermediaries.

### *Proposed actions*

23. ESMA first wishes to recall its response to the CMU and view that one way that cross border retail participation in UCITS could be increased is by encouraging providers of financial services to offer investors ready access to a wider choice of funds at competitive prices. ESMA also wishes to confirm its view that stimulating business models with an open architecture may contribute to increasing customer awareness about the different retail products available throughout the Union. The Commission could consider whether the MiFID II distribution rules could be strengthened to require firms to include in their assessments and offers non-domestic products. For instance, explicit reference to non-domestic products could be introduced among the requirements for independent advice (in particular in the definition of “sufficient range of financial instruments”) or taken into consideration when defining situations in which firms may accept inducements that may be deemed to enhance the quality of the service to the client.

## II.3 **Improving redress and quality of enforcement**

### *Issue at stake*

24. The Green Paper notes that, for cross-border transactions, lack of confidence from customers and a lack of legal certainty for service providers may arise from an inconsistent enforcement of EU legislation across the EU. Among the barriers which might prevent customers from directly purchasing products cross-border and firms from providing financial services cross-border, the GP mentions the lack of knowledge or trust in redress procedures in another Member State. The GP also refers to the Customer

Protection Cooperation Network and FIN-NET as potential solutions to dealing with cases where the enforcement of EU legislation emerges as a problem and encourages raising their visibility.

#### *Proposed actions*

25. ESMA agrees that customers' confidence in efficient actions in case of mis-selling or other problems is important. ESMA is aware of the role undertaken by FIN-NET as a financial dispute resolution network and has taken the initiative to establish an exchange of views with the European bodies responsible for out-of-court dispute resolution to understand issues which emerge at national level in the application of MiFID.
26. However, in order to efficiently tackle customer trust and market integration issues linked to concerns about the quality of enforcement of the financial services legislation across the EU, ESMA considers that the EC should ensure that NCAs have adequate mandates and powers to deliver effective investor protection<sup>8</sup>. This requires more harmonised sanctions and methodologies for applying sanctions and the EC should be ambitious when carrying out the review on the application of the administrative and criminal sanctions.
27. Moreover, ESMA confirms its views (expressed in the response to the CMU) that differing investment compensation schemes and divergent out-of-court settlement of disputes procedures increase the risk of poor outcomes for customers and firms. The trust in financial markets experienced by EU citizens is fundamentally dependent on the functioning of legal systems and their ability to protect customers' (and firms') interests. This also presumes effective remedies for breaches of MiFID obligations.

## **II.4 Facilitating the cross-border provision of particular financial products through the creation of autonomous or more closely harmonised EU-wide regimes**

### **II.4.1 The UCITS example and possible further improvements**

#### *Issue at stake*

28. The Green Paper notes that in some instances a separate legal framework might be the best way to increase choice of products while decreasing costs for businesses and ensuring that consumers are adequately protected. According to the GP, an opt-in regime could be a framework for identical product characteristics which would provide standardisation between Member States and overcome many national regulatory differences in some areas. It could be a useful means for offering comparable and easy-

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<sup>8</sup> For instance the fact that NCAs often cannot take action in the case of the provision of investment services without authorisation – but refer the matters to the public prosecutor – may limit their powers. In addition, the possibility to grant NCAs the power to order firms to compensate consumers in case of certain clear violations of their duties may also deserve a discussion.

to-understand financial products, thus increasing consumer trust and confidence for shopping cross border.

### *Proposed actions*

29. With respect to the question of creating autonomous/standardised regimes as a mean to overcome national regulatory differences and ensure harmonised and adequate customer protection, ESMA wishes to refer to the UCITS framework as a positive example. UCITS enjoy great and EU-wide success among retail investors. UCITS can be a tool to invest monies across different jurisdictions and across different asset classes.
30. This does not mean that further improvements cannot be considered and ESMA is contributing to the debate, in the context of the CMU, on how to deliver an effective European fund passport that eliminates disproportionate or unjustified cross-border fees and barriers to increase competition and customer choice. However, a careful balance has to be preserved: increasing cross-border participation in UCITS may only happen where distribution rules across EEA Member States are unified and provide the same high level of investor protection. Eliminating all host Member States' powers is not the most appropriate approach (in particular bearing in mind the challenge of ensuring clear and non-misleading communications in various languages). Instead a clear delineation of home-host competent authorities' duties together with improved cooperation may be seen as a more efficient tool to ensure a smooth functioning of the fund passport (as also noted in ESMA's response to the CMU).
31. In addition, and as mentioned in the introductory statements above, ESMA believes that inconsistencies among UCITS/AIFMD and MiFID II frameworks should also be assessed and further consistency should be sought in the rules applicable to the direct marketing of units/shares in UCITS/AIFs and the distribution of same units/shares via a MiFID service (irrespective of it being carried out by the UCITS/AIF manager or by a MiFID intermediary). In this sense, ESMA notes that the recently agreed IDD has extended the application of distribution rules to insurance undertakings.
32. Under MiFID, investment firms are allowed to provide certain investment services without the need to obtain information on client knowledge and experience in order to assess the appropriateness of the service or the financial instrument for the client (so-called "execution-only"). Since those services entail a relevant reduction of client protection, the review of MiFID deemed it appropriate to improve the conditions for their provision<sup>9</sup> and limit them to products which are non-complex. In particular, MiFID II excludes the possibility to provide execution-only services in conjunction with complex products<sup>10</sup> such

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<sup>9</sup> It would also seem appropriate to consider further clarifying the condition according to which the service is to be provided at the initiative of the client, in order to enhance the protection of the client.

<sup>10</sup> It should also be noted that while shares are classified as non-complex products and may therefore be sold on an execution-only basis, without the higher investor protection standards such as appropriateness tests, the entry into force of resolution mechanisms may increase the complexity and risks associated with investing in shares or similar instruments issued by financial entities subject to resolution mechanisms and put into question their current classification and the opportunity to distribute/place them without advice.



as “shares in undertakings that are not undertakings for collective investment in transferable securities (non-UCITS) and structured UCITS”.

33. In light of both the CMU and GP objectives to increase cross-border access for retail clients via standardisation and availability of safe and simple products, ESMA also believes the EC should consider assessing whether all non-structured UCITS can continue being classified as non-complex instruments (for instance when the funds invest through more complex strategies).
34. Finally, ESMA also remains committed to guaranteeing high investor protection standards via its supervisory convergence work (such as the work carried out on UCITS ETFs).

#### II.4.2 Personal pension products and covered bonds

##### *Issue at stake*

35. Under the same debate on the benefits arising from standardisation and the establishment of opt-in regimes, the Green Paper cross-refers to the CMU Action Plan and the Commission's intention to assess the case for a policy framework to establish a European market for simple, efficient and competitive personal pensions which would build on EIOPA's work on the creation of a standardised pan-European Personal Pension product (PEPP). The GP adds that such an approach could prove valuable for other products.

##### *Proposed actions*

36. Given the potential relationship between the EIOPA work on personal pension products and the asset management and MiFID distribution rules and while it is not ESMA's intention to suggest - at this stage - further categories of financial instruments for which standardisation appears necessary, ESMA takes this opportunity to state its interest in the European Commission's plan to contribute to the assessment of the case for a policy framework for personal pensions as well as its intention to contribute assessing the need for minimum quality standards or principles for covered bonds that could help improve both market discipline and disclosure practices, helping investors to compare products, to assess risk and to invest more outside their own country.

## **II.5 Impact of digital technologies on the retail financial markets**

##### *Issue at stake*

37. The Green Paper notes that the retail financial services sector is experiencing significant changes as it is affected by digitalisation, with online-only providers<sup>11</sup> and technology

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<sup>11</sup> The GP notes that the development of online distribution channels is of particular interest at the EU level as it allows providers and consumers to conclude and support distance sales more easily and at a lower cost.

companies entering the market. Both established firms and new financial technology companies (Fintechs) are exploring ways of interacting with their customers, of integrating their distribution channels for products and of providing services which are more tailored. Digital technologies such as distributed ledgers (DLT) offer the opportunity to reshape internal processes. Firms are also increasingly using 'big data' to gather information on their potential target customers. This gives them a greater understanding of customers, but also raises questions about the appropriate use of these data. Though offering opportunities for both customers and providers, innovative technologies may also pose regulatory challenges, particularly in relation to cyber-security and data protection. New players may not always be regulated to the same extent as established firms by current regulatory and supervisory frameworks, including from a customer protection perspective.

38. The GP questions which approach to follow if the opportunities presented by the growth and spread of digital technologies give rise to new customer protection risks with the aim to bring appropriate response to these challenges (including adequate security and customer protection).

#### *Proposed actions*

39. ESMA first wishes to confirm its view (as set out in its response to the CMU) that the pace at which digitalisation initiatives in the financial sector evolve requires ESMA and NCAs to be able to respond quickly to ensure the appropriate and convergent supervisory treatment of these initiatives, without preventing potential benefits being realised.
40. It is part of ESMA's and other ESAs (EBA and EIOPA) mission to follow closely financial innovation and assess how digitalisation could help foster cross-border activity and improve competition in the financial sector, provided there are adequate levels of security and investor protection. In this sense, last December, the Joint Committee of the ESAs has issued a Discussion Paper on automation in financial advice setting out related potential benefits (including lower costs, higher consistency of advice and a bigger number of customers that can be reached) and risks, the main goal being to analyse the adequacy of sectoral regulatory frameworks and identify any regulatory and/or supervisory measures which may need to be taken, if any.
41. Moreover, the 2016 Work Programme of the Joint Committee confirms that the ESAs will continue to monitor potential risks and benefits arising for customers from particular market developments and innovations and explicitly foresees (predicting the GP reference to big data) new work focusing on the opportunities and challenges related to the use of "Big Data", as well as personal data, by financial institutions to profile customers, identify patterns of consumption and make targeted offers.
42. ESMA is also considering the changes that DLT could bring to securities markets from an operational perspective and how those changes would reflect on investor protection,



financial stability and orderly markets objectives. ESMA is planning to assess whether the deployment of the DLT might create potential gaps and issues in the current regulatory framework and whether adaptations would be needed.