FINANSINSPEKTIONEN

Consumer protection on the financial market

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CONTENTS

Summary

One of the main goals of financial supervision is to help provide a high level of protection for consumers. In its annual report, *Consumer Protection on the Financial Market*, Finansinspektionen (FI) presents the most prioritised areas of its consumer protection supervision as well as areas where consumer protection may need to be strengthened.

Three of the prioritised risks that FI is targeting are the risk that consumption loans will lead to over-indebtedness, the risk that consumers will receive advice about financial products that is not suitable based on their needs or circumstances and the risk that fund management companies will not provide a fair description of the focus and activity of their fund management.

In order to ensure a comprehensive, high level of protection for consumers, there need to be rules in place that govern the conduct of business of financial companies with regard to their interaction with consumers. In many cases, these rules target the provision of information. In several of FI's prioritised areas, it is important for financial companies to ensure that their customers receive relevant and clear information, for example the manner in which fund management companies inform consumers about how they manage their funds. Other examples include how the interest rate is set for mortgages, the information that should be provided when transferring pension insurance and how insurance undertakings ensure the transparent management of surpluses in traditional life insurance.

Rules regarding the provision of information are supplemented with other requirements on the companies' interaction with consumers and their internal governance and control. When consumers take out loans for consumption, for example, there are requirements on how the lender must ensure that the consumer is able to pay the fees and make the amortisation payments that come with the loan.

When providing financial advice to consumers, companies that both sell financial products and offer advice about them face incentives to recommend the product that gives the highest compensation instead of the one that is most suitable based on the consumer's needs and circumstances. Often, this type of conflict of interest stems from the fact that the advisor receives payment from other companies in the form of commission. FI therefore believes that a broad commission ban should be implemented.

The financial market is constantly evolving. This introduces both challenges and opportunities for consumers. One clear example of this is the greater degree of digitalisation on the financial market, which on the one hand can lead to cost-efficient solutions that are adapted to different needs but on the other hand can introduce new risks for consumers.

FI and consumer protection

Consumers on the financial market are particularly vulnerable, which means that there is a need for a strong focus on consumer protection in rules and supervision. In this report, FI describes the areas it prioritises in consumer protection supervision and recommends areas where consumer protection may need strengthening. The report also discusses some of the challenges and opportunities for consumers resulting from the digitalisation of the financial market.

THE NEED FOR CONSUMER PROTECTION ON THE FINANCIAL MARKET

The financial market plays a crucial role in the economy. It converts savings into investments, manages risks and provides the conditions for efficient and secure payments. This is important not only for companies and institutions, but also for individual consumers, who may wish to finance a home, insure themselves, their family or their possessions, pay bills or set money aside for future consumption. In the past few decades, consumers have had to shoulder an increasing amount of responsibility for their future finances and therefore must make many difficult and important financial decisions, for example related to their pension savings. Occupational pensions are becoming an increasingly important part of consumers' final pension, and consumers must to a great extent make decisions about it themselves. The financial market is also constantly evolving and offering a growing number of products – not least through digitalisation.

The position of consumers on the financial market is different from the position of consumers on other markets because of major information asymmetries between buyers and sellers of financial products. On the financial market consumers are faced with a wide range of products, which is also the case for many other markets, but the major difference is that it is much more difficult for consumers to assess the quality of financial products. For example, the quality of savings products is dependent on the relationship between expected return and risk. A lot of people find this concept very difficult, i.e. judging how savings with different risk levels might perform in different market situations. In some cases, this analysis is further complicated by the fact that financial products are often complex in their character and structure. A single financial product might for example consist of several different types of other financial products. However, this difficulty in assessing the quality of the products also largely applies to less complex savings products, such as funds, as well as other product types of products, such as insurance and loans.

Many consumers find it difficult to calculate percentages, and many do not understand fundamental financial concepts such as interest and inflation. A study conducted by FI shows that half of the queried consumers lack fundamental financial literacy.[1] At the same time, the price of many financial products is expressed as a percentage, for example as a share of assets under management, a share of the size of a transaction or

1 In May 2015, FI and four independent researchers jointly published a memorandum, "Räkneförmåga och finansiell förmåga", which concluded that one out of two consumers are unable to answer three questions about interest, inflation and financial risk. FI Ref. 15-1579. (http://www.fi.se/Tillsyn/Skrivelser/Listan/Halften-av-konsumenterna-saknar-grundlaggande-finanskunskap/)

as a combination of a number of different fees. This can make it more difficult to understand what the total cost will be.

Another factor that makes it more difficult to assess the quality and price of financial products is that, when buying a financial product, consumers often enter into what essentially is a long-term business relationship. This is the case for both savings (e.g. pension insurance) and mortgages. Many non-financial products differ considerably in this respect, since the consumer pays for them at a specific point in time and is able to relatively quickly assess their quality. In contrast, the quality of financial products in many cases only becomes apparent after a long time has passed – if at all. Similarly, the price is often paid over time and thus can sometimes change due to factors that the consumer can neither understand nor influence.

Furthermore, financial decisions often include large sums of money, which means that any problems that might arise could have major implications for the finances of individual consumers. When considering the effects of all of these factors combined, it is clear that consumers on the financial market need protection.

Consumer protection and financial stability are two of the main goals of financial supervision, and they are closely intertwined. Financial companies must be stable if they are to honour their obligations to their customers. At the same time, general confidence in financial companies could be undermined by shortcomings in consumer protection, which potentially could have a negative effect on how well the financial market functions and how efficient it is. FI has also been tasked with counteracting financial imbalances through a macroprudential supervision mandate, which allows FI to take measures that reduce risks to the economy. One example of this is the recently proposed amortisation requirement, which will better protect highly leveraged consumers.

Amortisation requirements and consumer protection

In FI's opinion, the majority of households with mortgages are able to withstand economic shocks. The risk that households will not be able to pay off their mortgages, and thus that lending institutions will suffer substantial credit losses, is currently limited. That said, however, FI has proposed an amortisation requirement for mortgages because there are macroeconomic risks associated with household indebtedness. Highly leveraged households demonstrate more of a tendency to cut back on consumption following an economic shock – such as higher interest rates or a drop in house prices or income – which in turn could trigger and amplify a recession. By increasing the number of households that amortise their mortgages, highly leveraged households will reduce their indebtedness over time, which also reduces the risk to macroeconomic stability.

An amortisation requirement also enhances consumer protection, since increased amortisation reduces household indebtedness and strengthens the resilience of households to economic shocks.[2] However, this resilience is conditional on the possibility of an exemption from the requirement, which may be granted in the presence of specific conditions, such as unemployment, illness, death, divorce, etc. If there were no possibilities for exemption from the requirement, there would be a risk that households would become less resilient to economic shocks. It is also important to allow households an

2 Prop. 2015/16:89, p. 24

exemption from the requirement in order to switch banks, since the possibility to change from one provider to another is an important condition for high consumer protection. Amortisation increases a household's housing expenses but fundamentally serves as a form of savings that results in lower future interest expenses.

FI currently shares the responsibility for consumer protection on the financial market with other authorities and organisations, the duties of which differ. For example, FI is not responsible for intervening in the dealings of individual consumers with individual companies. The Swedish Consumer Agency supervises marketing and contract terms; the Consumer Ombudsman assists individual consumers in court cases of principle importance to the entire consumer collective and the Swedish National Board for Consumer Complaints offers a forum to which consumers can bring disputes with business proprietors.[3]

WHAT DOES IT TAKE TO ATTAIN A HIGH LEVEL OFF CONSUMER PROTECTION?

Regulation of consumer protection on the financial market

As described above, the regulatory framework and supervision exist to protect consumers. The purpose of the regulatory framework is to ensure that companies maintain a high standard in their operations and fulfil the demands imposed on conducting financial business. One of the fundamental ways to ensure a high level of consumer protection is to prevent questionable companies from entering into the market in general. It is possible to argue that because of the regulations there are fewer companies on the market than what would have been the case if the requirements not been so extensive. However, the special nature of the financial market does not automatically equate a large number of entities with healthy competition. As mentioned earlier, it is difficult to compare the quality and price of financial products, which limits the ability of consumers to influence the products available on the market by "voting with their feet" and terminating unsatisfactory business relationships. When FI introduces or proposes new regulations, it weighs the costs of these regulations against their benefits for consumer protection.

Consumers are vulnerable on the financial market mainly because they have much less information at their disposal than the companies offering financial products. It may therefore seem easy to draw the conclusion that all that is needed is more information; in other words, if consumers have access to more information about risks and fees, they will be better protected and make better decisions. It is true that consumers need relevant, comprehensible information in order to make informed decisions, and this conclusion is reflected in the fact that a great deal of European and national consumer protection regulations on the financial market contain different types of information requirements.

3 Other authorities and organisations with responsibility in the area are: the Swedish Pensions Agency, which bears a responsibility for information provided to consumers in the field of pensions; the Swedish National Debt Office, which bears a responsibility for information about and the management of the deposit guarantee and investor protection; the Data Inspection Board, which supervises credit information and debt recovery companies; and the Swedish Competition Authority, which works towards efficient competition to the benefit of consumers. The Swedish Consumers' Banking and Finance Bureau, the Swedish Consumers' Insurance Bureau, the municipal budget and debt advisors and consumer counsellors guide and inform consumers.

However, merely imposing requirements on more information for consumers does not sufficiently address the asymmetry of information inherent in the consumers' position on the financial market. This imbalance is not only due to companies failing to make all relevant information available, but also to the fact that consumers are not always able to or interested in assimilating the information provided.

It is not merely the information that is available that is of interest, but also how this information is presented and adapted to individual consumers. Some information is standardised, such as key information documents, and other information is more tailored, such as the information obtained by consumers when they lodge a complaint with a company.

Information can also be used to educate consumers through the use of illustrations and scenarios that demonstrate potential risks to their financial situation. One example is the calculation of an individual household's housing costs that a lender must perform as part of its assessment of the repayment capacity when granting a mortgage. The lender is obligated to inform the consumer about the calculation and its purpose and demonstrate how the consumer's expenses could be affected by factors such as changes in interest rates or amended tax rules.

However, consumers often act irrationally even when information is available, which would suggest that the regulations on the provision of information should be supplemented by additional requirements on how companies conduct themselves in their relationships with consumers and on their internal governance and control. For examples, regulations may be needed regarding how companies should manage conflicts of interest, how they should handle complaints, which products they may offer and how these products are offered and about the knowledge and competence of their management and employees.

The need to regulate consumer protection on the financial market must be continuously analysed as new experiences come to light and the market and companies continue to evolve. FI has recently highlighted the need for enhanced consumer protection in two areas: crowdfunding and commissions. In December 2015, FI published a report analysing the crowdfunding market. In this report, which had been commissioned by the Government, FI urged the Government to review the need to regulate this area. In February 2016, FI published a report analysing the need for and the implications of a broad ban on commissions in financial advice.

Applications for authorisation and supervision

FI continuously monitors companies that conduct financial operations. If a company does not follow the rules, FI can intervene by ordering the company to take measures or pay an administrative fine. In serious cases, FI can withdraw the company's authorisation to conduct business. However, FI's work on ensuring that companies follow the consumer protection rules starts as early as when a company applies for authorisation to conduct financial operations. This way, if a company is deemed unable to meet the existing regulations, it can be prevented from entering the market at an early stage.

In 2015, FI reviewed how companies provide information to consumers. FI verified that the companies offering private pension savings informed their customers about changes to the tax-deductibility for such saving. FI also followed up on its task to promote an industry agreement regarding information in connection with pension insurance transfers. Furthermore, FI has maintained a dialogue with the banks about how they have implemented the new rules on continuously publishing their average mortgage rates.

FI has also conducted other supervisory investigations focusing on consumer protection, many of which are described in this report and include investigations into companies that lend money or offer financial advice to consumers. In addition to the areas addressed in this report, FI also investigated how securities companies follow the regulations governing the separation of customers' financial instruments and funds from the company's own assets, and analysed the risks that may arise when a company outsources it compliance function. FI also inspected how large fund management companies manage their conflicts of interest in relation to unit-holders, which may arise when the company has close contacts with other companies in the same group. In the insurance area, FI conducted a number of investigations into the controls that insurance companies must perform of their tied insurance intermediaries.

Educating the general public in financial matters

A specific part of FI's assignment is to empower consumers on the financial market by educating them in financial matters. Much of the work associated with this educational project is conducted in cooperation with companies, organisations and other authorities and aims to empower consumers by increasing their awareness of and knowledge about personal finances. The educational project customises its initiatives to target different consumer groups since needs vary between people in different life situations.

In terms of implementation, FI educates a number of participants as instructors, who in turn spread their knowledge to others, thus enabling greater dissemination effects. Instructors include representatives from trade unions and pensioner organisations, as well as students specialising in human resources at universities and colleges. FI has also produced training material for secondary schools and material about personal finances that can be used in the Swedish language classes offered to new arrivals (SFI). FI also started training trustees during the year and, as part of its Money Smart project, FI has educated unemployed youths about day-to-day finances and consumer law.

FI's assignment to educate the general public in financial matters has also enabled it to work with independent researchers in order to study how knowledgeable Swedish savers are about personal finances and financial concepts, thus potentially identifying needs for additional initiatives. One of these studies indicated that it is important to educate children and youth about financial concepts at an early age, so in the spring of 2016 FI entered into cooperation with Mid Sweden University on a research project to include personal finances in the curriculum as early as preschool.

A REPORT ON RISKS, EXPERIENCES AND MEASURES

Like all supervisory work, FI's efforts to enhance the position of consumers on the financial market apply a risk-based approach. This means that FI's supervision focuses on the risks that are considered to be most relevant and on the companies where these risks, if they materialise, might have the greatest implications. FI conducts a risk assessment and risk classification every year to identify and rank the risks that may affect the stability of the financial system, the ability of the financial system to function well and consumer protection.[4] It is unrealistic to expect there to be a never-ending supply of resources that allows FI to individually monitor every single entity on the financial market. Prioritisation and selection should not be viewed as a necessary evil, but rather serve as the foundation on which to conduct efficient supervision.

This report provides FI with a channel for identifying the areas it has prioritised for consumer protection on the financial market. It also describes the measures which FI has taken or intends to take to enhance consumer protection, and highlights where it is necessary to further develop the rules in this area. The report also enables FI to describe in more general terms the observations it made during its supervision, such as market developments and trends.[5]

The risks to consumers that are presented in the report are primarily those classed as having the highest priority in FI's annual risk assessment. The exception to this is the final chapter of the report, which discusses the opportunities and challenges that digitalisation is presenting to consumers on the financial market. This chapter describes a clear market trend and not a prioritised risk.

Finally, it should be emphasised that this report is not an exhaustive representation of all of FI's consumer protection work. The Bank, Insurance and Market sections at FI each publish their own supervision reports, and the activities included in these reports contribute to maintaining a high level of consumer protection on the financial market.[6]

4 For details, see FI's complete supervision strategy, FI Ref. 13–12064. (http://www.fi.se/upload/90_English/10_About/Whatwedo/tillsynsstrategi-eng.pdf)

5 Section 3, point 4 of Finansinspektionen's Instructions Ordinance (2009:93).

6 FI also publishes a Stability Report twice a year about stability in the financial system, an annual report about the Swedish mortgage market, and several FI Analysis comments a year.

Information for consumers

Companies need to provide consumers with relevant, comprehensible information in order to reduce the information disadvantage of consumers. It is important to focus both on the content of the information and the manner in which the information is provided.

Today, many of the information requirements in the rules governing the financial market in Sweden are based on the content of the information to be provided, rather than the manner in which it is provided. FI finds that there needs to be a greater focus on how information for consumers should be devised and presented, not only for the companies currently providing the information but also for future regulatory work. Other Swedish authorities have also called attention to such a need. For example, the Swedish Social Insurance Inspectorate concluded in a report from December 2015 that the manner in which insurance companies devise information and forms related to occupational pension appears to have an influence on whether people select a time-limited disbursement of their occupational pension or a life-long disbursement.[7]

Some countries have started to take into consideration how consumers assimilate information when devising new rules. In this context, research in "behavioural economics" is often used as a basis. Behavioural economics can be described as the overlapping area between economics and psychology that focuses on how individuals make financial decisions in practice. This research shows that consumers' choices are often influenced by "biases", i.e. thought patterns that would not exist if consumers acted as rationally as assumed by traditional economic research. For example, the same information can give rise to two different choices depending on the order in which the information is presented or whether one alternative is preselected.[8] Sometimes behavioural economics theories lie behind regulations inspired by "nudging" – a term coined by Rickard Thaler and Cass Sunstein[9] that refers to "gently pushing" people into making more rational choices without actually limiting their options. Nudging may be used to achieve something that is in people's best interests or to attain another objective, such as more environmentally friendly behaviour.

Behavioural economics and financial regulation in other countries

There are several examples of initiatives that take account of research in behavioural economics in financial market regulation.

In the US, Cass Sunstein was head of a unit at the Executive Office of the President during the years 2009-2012. He helped devise new rules about information on credit card fees and repayment terms (the CARD Act) that are based on behavioural economics.

7 "Att välja uttagstid av tjänstepension", Report 2015:15

8 See for example Thaler ("Misbehaving", 2015), which presents a study of information on historical return. When information about the past year's return was presented before information about the average annual return of the past 30 years, people in the study chose a completely different portfolio than when the same information was presented in the opposite order (pp. 196–197).

9 See Thaler and Sunstein (2008), "Nudge"

In the UK, Richard Thaler is an advisor to the Behavioural Insights Team (BIT) of the UK Government Offices. BIT's explicit purpose is to support a behavioural sciences approach to the thought process behind legislation and regulations and make it easier for consumers to make good choices. The Financial Conduct Authority (FCA), which is responsible in the UK for consumer protection in financial matters, has also created a unit within its organisation to provide analyses of how behavioural economics theory can be used in supervision activities. FCA also published a report on the subject in 2013.[10]

Behavioural economics theory has been used in Brazil to promote educating the general public in financial matters, and the EU Commission has formed a separate unit dedicated to behavioural economics. The latter concluded back in 2010 that straightforward, standardised product information can improve investment decisions for consumers in the EU, and this has had a bearing on the rules in the new PRIIPS regulation (see the box below).

There also appears to be an increased focus in European legislative work on how information is presented. One example is the standardised key information documents about investments in packaged retail and insurance-based investment products (PRIIPs) which, according to the text of the Regulation, shall take into account "existing and ongoing research into consumer behaviour", and which have been prepared using extensive consumer testing.

Key information documents in packaged retail and insurance-based investment products

In November 2014, the EU decided on rules for a common key information documents for packaged retail and insurance-based investment products sold to non-professional investors.[11] Such products are often abbreviated PRIIPs.

The common key information document resembles the key information document that must exist for certain funds today. The rules aim to make the products easier to compare by providing consumers with clear information about the risk level and cost of the product in question. One example of how they achieve this is by requiring that costs be presented uniformly, both as a percentage and in the national currency. The rules come into force in December 2016, at which time companies that market this type of product must produce compliant key information documents.[12]

10 Occasional Paper No.1 , "Applying behavioural economics at the Financial Conduct Authority", April 2013

11 Regulation (EC) No. 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products.

12 The products covered by the rules are mainly structured products, derivatives, alternative investment funds marketed to non-professional investors, and investment funds. However, there is an exemption for funds that already have a key information document in that there is a transition period until December 2019. The rules also cover insurance products with a value upon payout or a redemption value which is wholly or partially, directly or indirectly, exposed to market fluctuations (with the exception of private pension insurance and occupational pension insurance).

CLOSET INDEX FUNDS

Key information documents for funds are already subject to regulations on standardised information, and the aim of these regulations is to provide investors with easy access to information about the fund's focus, fees and past performance. Because Swedish households save a lot in funds (both directly and through insurance), one of FI's top priorities is to verify that the information meets a sufficiently high level of quality, particularly in terms of the fund's management focus.

A distinction is often drawn between index funds and actively managed funds. An index fund is a fund that has the same composition as a specific index.[13] An actively managed fund instead has a manager who makes active investment choices, i.e. diverges from the fund's benchmark index, in order to obtain a higher return. An actively managed fund consequently requires greater management, such as conducting an analysis of which investments to make. Therefore, an actively managed fund is often more expensive than an index fund with an equivalent investment focus. Consumers choosing an actively managed fund pay a higher fee for the manager to make active investment choices rather than following an index. The consumer thus "buys" an opportunity to achieve a higher return.

Funds that claim to be actively managed, but which deliver a tracking error and return that resemble passively managed index funds, are often called closet index funds. The problem with such funds is that they are presented as being more actively managed than they actually are, and fund management companies therefore charge a higher management fee for something which the funds are unable to deliver in practice. In an investigation in 2015, FI determined that fund management companies sometimes exaggerate information about the funds' management activity (see the box below). Because of this, consumers might have to pay a higher fee than what is justifiable compared with a passively managed index fund. This is particularly clear in cases where the same fund company also offers index funds with an equivalent investment focus at a third of the management fee of the active fund. When the tracking error in both the active and passive funds are similar, it can be questioned whether unit-holders have the chance of obtaining the surplus return for which they are paying.

FI's previous investigation

In 2015, FI conducted an investigation that showed deficiencies in how fund companies describe the objective and investment focus of their funds in the compulsory key information documents. In a number of key information documents, the fund companies had chosen to highlight the fund's management activity by describing the fund's active investment strategy and analysis of individual companies. Some funds also expressed explicit targets to outperform a benchmark index or the average of the Stockholm stock exchange. The historical investments of the funds imply in many cases that they have been managed relatively close to an index, and FI therefore concluded that the descriptions in the key information documents risk painting a distorted picture of the funds' management and prompting unrealistic expectations among consumers.

Several of the fund companies felt that their investment process was not pas-

13 Examples of Swedish indexes are OMX Stockholm GI and SIX Portfolio Return Index.

sive, and that it was correct to classify their funds as active. In FI's opinion, it ought to be possible to describe the activity of the funds more fairly based on how the management is devised and how the fund usually correlates with the relevant benchmark index.

At the end of the investigation, FI urged the industry to take measures to make information about the funds' management fairer and more transparent. One potential example of this would be to show, where appropriate, the performance of a relevant benchmark index beside the performance of the fund so that consumers can evaluate the fund's performance more easily. FI also urged the fund companies to improve transparency regarding how active their management is, for example by presenting the fund's active share and tracking error in the annual report. Since then, the Swedish Investment Fund Association has issued clear recommendations to its members on this specific topic. FI also emphasised in conjunction with the investigation that it is the boards of directors of fund management companies that are responsible for monitoring and taking action in the event that the fund management is not in alignment with fund's objective.

In 2016, in its supervision and issuance of authorisations related to funds, FI will be focusing on ensuring that information set out in the fund rules, key information documents and prospectuses regarding objectives and the investment focus are clear, fair and not misleading. FI will thus follow up on whether the industry has taken any of the measures FI recommended in connection with last year's investigation. The conclusions from this follow-up will be presented in 2016 at an FI Forum (seminars arranged by FI for the financial industry).

It is also worth noting that the Government has issued a supplementary directive to the fund inquiry it established in 2014 to also propose measures to clarify for investors the difference between actively and passively managed funds.[14] The inquiry will submit its report by 30 June 2016.

GREATER OPENNESS ABOUT MORTGAGE RATES

A large percentage of Sweden's population borrows money when purchasing a home. For many households a mortgage is their greatest financial undertaking, and mortgage rates therefore have a major bearing on household finances. However, insight into and understanding of how the mortgage rate is set is limited. The rates published by lenders in marketing material can deviate substantially from the individually negotiated interest rates which consumers are then offered in their mortgage contracts. While there are rules requiring a lender to disclose to consumers the details of the credit agreement that the consumer needs, this information is governed entirely by the requests from individual consumers.[15] Because the information they have received has been deficient, it is difficult for consumers to make informed decisions about their mortgages and compare offerings from different companies. It also puts the consumer in a worse position to negotiate, which might be one reason for the general inertia on the mortgage market, i.e. that consumers are cautious about switching banks.

In order to improve openness on mortgage rates, FI introduced rules on 1 June 2015 requiring banks and credit market companies that offer mortgages to consumers to provide specific information about the inte-

14 Dir. 2015:28

15 Section 6 of the Consumer Credit Act (2010:1846).

rest rates on these loans.[16] This information must contain the average interest rate for each fixation period offered by the company. The average interest rate shall be disclosed for the previous month, together with historical data for the past 12 months. The company shall also provide information about the circumstances surrounding the consumer, the loan or the collateral that the company considers when setting the interest rate.[17] According to the rules, the company should preferably provide the information on its website.

In the autumn of 2015 FI met with the five largest companies on the mortgage market to discuss the effects of the new rules. FI was able to ascertain that these entities comply with the new rules and that consumers therefore face improved possibilities for comparing their personal mortgage offering with the interest rates actually applied by the lenders. However, it is too early to draw any firm conclusions about the effects of the requirements, such as whether the terms offered to consumers have improved or whether the market has become less inert.

In FI's annual mortgage survey, FI asked the banks about the average interest rate in August 2015, both for new loans and for amended terms and conditions (i.e. renegotiation of the interest rate on existing loans). In general, the average interest rate offered for new loans is lower than that offered when existing loans are renegotiated, although the extent of the difference varies between the banks. For some banks, the average interest rate for new and old loans with a 3-month fixation period differs by more than 10 basis points (i.e. 0.1 percentage points). The difference is probably mainly a manifestation of the fact that mortgage customers are more inclined to switch banks when taking out a new mortgage than when renegotiating an existing loan.

FI continuously follows developments on the mortgage market. There is reason to believe that many consumers do not sufficiently understand the difference between the listed rate and the average rate.[18] FI therefore intends to continue to work toward greater transparency surrounding the process for determining the mortgage rate and toward improved possibilities for consumers to compare different offerings. The next step in FI's work is to analyse how lenders inform consumers about the average rates.

INFORMATION IN THE TRANSFER OF PENSION INSURANCE

Increased transparency in the transfer of pension insurance

The ability of a consumer who is dissatisfied with a product to exchange this product for an alternative is a fundamental feature of a well-functioning market. Consumers currently have limited rights to transfer the capital they have invested in pension insurance, such as through occupational pension. A few years ago, a Government inquiry suggested that

16 FFFS 2015:1 regarding information concerning interest rates on housing loans.

17 Similar rules are set out in the new Mortgage Directive (Directive of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010). See also the section on new rules in the chapter "Financial advice" further on in this report.

18 See, for example, SBAB's "Hard to navigate the mortgage jungle" (Svårt att navigera i bolånedjungeln), in which the bank states that between 25 and 40 per cent of those queried are familiar with the terms listed rate and average rate.

the right of transfer should be extended to cover all pensions.[19]

FI finds that there are a number of challenges on the pensions market that must be addressed in order for such a right of transfer to simultaneously function properly and guarantee a high level of consumer protection. First, commissions must be banned in order to prevent transfers based on incentives other than the consumer's best interests (see the chapter on financial advice). Second, information that is given to consumers must be clearer and more comprehensible so as to enable a comparison between the terms of different products and facilitate an understanding of the financial consequences of a transfer.

In accordance with an assignment from the Government, FI has been promoting an agreement within the life insurance and pensions industry since 2014 on a standard for transparency and information in connection with transferring pension capital in order to reduce the problem of deficient information. The goal is for consumers to receive at the time of transfer straightforward, standardised information about their own transferable amount and the characteristics and fees of their own insurance.[20]

FI has presented a series of reports to the Government. In the latest of these, FI announced that the insurance industry (headed by Insurance Sweden) had reached an agreement in the form of a recommendation regarding standardised information when transferring insurance capital. The recommendation applies as of 1 January 2016. In March 2016, FI observed that there was still work that needed to be done in terms of the implementation of calculation procedures for benchmark pricing, initially for new collectively bargained occupational pension insurance.[21] FI is concerned about the slow pace at which this work is progressing and intends to follow up in 2016 on whether the standardised information has been introduced as described and the companies are following the industry agreement. FI will also carefully monitor further development work. A new status report will be submitted to the Government in 2016.

Changed tax-deductibility on private pension savings

On 1 January 2015, the amount of tax-free private pension savings was cut from SEK 1,000/month to SEK 150/month, and on 1 January 2016 tax-free private pension savings were abolished altogether. Consumers who continue to save in private pension insurance or in an individual pension saving scheme (IPS) will be taxed twice, since they will pay tax once on the money they are putting into the scheme and again when they receive the pension disbursement.

It is FI's opinion that companies that offer private pension saving have a responsibility to inform their customers about the change. FI therefore contacted these companies in order to verify that they informed their customers about the change in allowable deductions.

The responses showed that all of the companies had informed their customers. However, a study conducted by the Swedish Pensions Agency

19 See the report of the Life insurance inquiry "Strengthened Policyholder Protection" (SOU 2012:64.

20 It is important to note that the policyholder transfers an amount, not the agreement. There are several ways of determining this amount, known as the transferable amount.

21 FI Ref. 14-8233 (http://www.fi.se/Tillsyn/Skrivelser/Listan/Battre-information-om-flyttratt-for-pensionssparare-pa-vag/).

shows that almost half of the consumers queried in the autumn of 2015 were not aware that there had been a change in the allowable deductions.[22] The same study also shows that more than half of the queried consumers with private pension savings had either not altered their savings or did not know whether they had done so. FI must therefore further follow up on this matter. In 2016, FI will verify how companies informed consumers about the elimination of tax-free private pension savings and the effect this information had on customers' savings.

INFORMATION ABOUT SURPLUS MANAGEMENT IN TRADITIONAL LIFE INSURANCE SAVINGS

Many Swedish consumers have savings in life insurance.[23] There are basically two broad types of life insurance, one in which consumers themselves take responsibility for selecting the risk level and investment focus – either in funds or other financial instruments – and one that is considered traditional life insurance and which is managed by the insurance company.[24] The basic concept of traditional life insurance is that the company provides the customer with a guarantee in the form of a floor for the return on the savings (known as the guaranteed interest rate). However, the return on the capital to which the customer has contributed might turn out to be higher than the guaranteed interest rate. The costs for the insurance company might also turn out to be lower than expected. In such cases, a surplus arises, which may accrue to the customer in the form of a bonus. It is therefore possible that the customer may receive more pay outs from the insurance than only the guaranteed amounts.

A key element in managing this surplus is the "contribution principle", which is based on the assumption that policyholders are entitled to the surplus to which their insurance has contributed. This principle is set out in law, but leaves great scope for interpretation.[25] The risks for consumers that FI has observed in relation to surplus management are associated with the fact that the terms and methods developed in the industry are difficult for the average consumer to understand. This makes it difficult for consumers to know whether they have received what they are entitled during both the contribution and disbursement period. There are also pros and cons to the different methods the companies use to distribute any surpluses. For example, methods that use a smoothed bonus interest rate may be considered stable from the customer's standpoint, but consumers might not receive part of the surplus to which they have contributed.[26] These methods may also result in customers receiving a surplus to which they did not contribute, which might be the case

22 "More than half of those who save in a private pension scheme risk being taxed double after 1 January" (Mer än hälften av de som sparar privat till pensionen riskerar dubbel beskattning efter nyår) (https://secure.pensionsmyndigheten.se/Avdrag15.html).

23 Almost 40% of the financial assets of households are in individual or collective insurance savings, excluding premium pension.

24 The choice of management type is basically the same in private pension insurance, endowment insurance and many occupational pension insurance solutions.

25 Chapter 11, section 18 and Chapter 12, section 69 of the Insurance Business Act (2010:2043).

26 The bonus interest rate is the rate of interest used for distributing the company's total return between policyholders. It is set by the company based on past and expected return and expenses. Some companies use instead the "interest rate on return", which is set once the return is known.

if a high bonus interest rate is used to entice new customers.

FI would like to ensure that the customers' right to this surplus is appropriately and clearly managed and therefore intends to intensify its supervision of this area. The aim of the work is to prompt companies to clarify their procedures, increase their transparency and improve their information for customers. FI will review the companies' internal guidelines and procedures relating to the distribution of surpluses and how they verify and evaluate such procedures. FI will also look more closely at the information the companies provide to their customers about how surpluses are generated and distributed. In FI's view, one of the important topics about which a company must inform its customers is the company's view on fairness between different customer groups with regard to surplus management and how it ensures that its distribution is fair. It is also important for the information to specify how the company calculates its bonus interest rate, how this calculation is affected by the company's total return and which principles are used by the company in any smoothing of the bonus interest rate between different customer groups. This information will help customers make well-informed decisions.

The management of surpluses in traditional life insurance savings is discussed in more detail in FI's report, *Supervision of insurance companies*, which was published on 17 May.

COMPLAINTS HANDLING

One of the key elements in the way financial companies communicate with their customers is how complaints are handled. A functional complaints handling procedure enables consumers to communicate their dissatisfaction with a product or service, which in turn enables the companies to allow consumer demand to influence their offering. In some situations, companies may also discover through their complaints handling that their information to consumers has not been sufficiently clear or comprehensive. It also enables the companies to capture and remedy other problems and take preventive measures, which are important steps in their work with internal governance and control.

In 2015 FI completed an investigation into how the four largest banks handle complaints. The investigation consisted of an onsite visit to local bank branches across Sweden. One of the conclusions drawn from the investigation was that the term "complaint" had different definitions both within and between banks, which could mean that customers might be treated differently depending on where they are received within the organisation. These differing definitions also pose a risk that existing problems – such as ambiguous product terms – might remain undetected, and thus not be available to the company to improve its operations.

FI is now reviewing the general guidelines regarding complaints handling at financial companies and it is taking into consideration the observations from its investigations as well as guidelines published by the European supervisory authorities. The primary objective is to ensure uniform handling of complaints at financial companies.

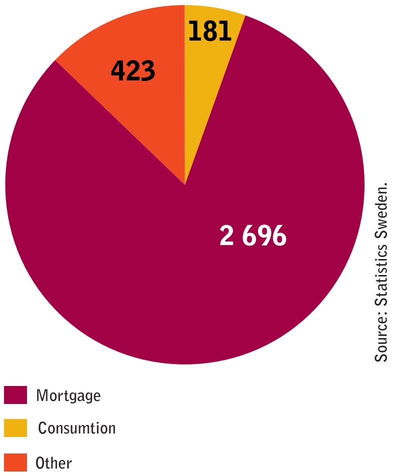
Consumer credit

Credit enables consumers to spread out their consumption over time, but it also increases the risk of them taking on greater debt than they can afford. For this reason, it is important for companies that lend money to consumers to verify that the consumer has the financial capacity to repay the loan as well as other debt servicing costs (interest and fees).

THE CONSUMER CREDIT MARKET

The possibility to borrow money means that capital not currently in use can be used elsewhere in the economy in return for a fee (interest). This distributes resources in the economy more efficiently, which is one of the core functions of the financial market. For individual consumers this means that they can consume as the need arises rather than saving in advance.

1. LENDING TO HOUSEHOLDS BY PURPOSE (SEK billion)



Note: The chart is based on outstanding loans from Swedish monetary financial institutions (MFI) to households as at December 2015. The lending of consumer credit institutions is not included.

Lending represents a large portion of the business of most banks and credit market companies (hereinafter called credit institutions). There are also other companies that lend money to consumers or mediate such loans. They are formally called consumer credit institutions and consist of companies that grant small consumer loans (sometimes called instant loans or payday loans) and mediate loans from other creditors. There are also a number of companies whose core business does not consist of lending, but who nevertheless grant consumer credits as part of their business, such as mail-order companies and other companies that sell goods on credit.[27]

Credit institutions issue the majority of the loans granted to consumers. Most of these loans are mortgages, i.e. loans collateralised by a home. This chapter does not focus on such loans, but rather those used to enable consumption.[28] The Swedish mortgage market is studied in a separate mortgage survey that FI conducts every year to monitor developments on the mortgage market.[29] The aggregate volume of the consumer loans issued by credit institutions that are the focus of this report amounts to just over SEK 180 billion (see Diagram 1).

Compared with credit institutions, consumer credit institutions account for a small percentage of total household lending. At the end of 2015, the outstanding credit volume of consumer credit institutions was SEK 1.2 billion (Diagram 2), constituting only around 1 % of total lending for consumption.

Consumer credit institutions can also mediate loans, both for other consumer credit institutions and for credit institutions. While the loans issued by the consumer credit institutions themselves are relatively small (the average size of loans granted in Q4 2015 was around SEK 4,200

27 Consumer credit institutions which have lending or mediation as their main business must be authorised under the under the Certain Consumer Credit-related Operations Act (2014:275).

28 Such consumer loans can sometimes be secured, for example by a car or a boat purchased with borrowed money. However, it is often a case of unsecured loans.

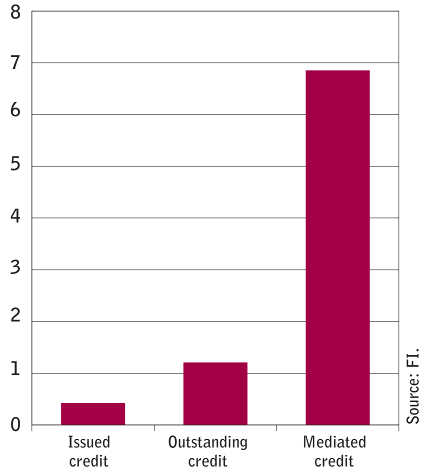
29 FI describes the findings of the survey in a report that provides an overall presentation of developments on the mortgage market (last published in April 2016, FI Ref. 16-3181). FI also uses the survey as a part of its supervision of the largest companies on the mortgage market.

according to the information reported by the companies) the loans they mediate for other companies can be quite large.[30] It is also clear that the aggregate volume of the loans mediated by consumer credit institutions is much higher than the credit volume they themselves issue (Diagram 2).

CONSUMER PROTECTION ON THE CONSUMER CREDIT MARKET

The greatest risk associated with the access to consumer loans is that consumers may borrow beyond their disposable income and end up with a high level of debt. There are several regulations aimed at protecting consumers who take out consumer loans. Core sections of these regulations state that these types of operations require authorisation and that a credit assessment must always be performed.[31] Supervision of these rules is in some cases shared between FI and the Swedish Consumer Agency (SCA). In terms of supervision of the companies complying with the credit assessment rules, FI supervises credit institutions and SCA consumer credit institutions. However, FI is responsible for granting authorisation for consumer credit institutions, and therefore supervises their conduct and management of credit risk, and internal governance, control and documentation processes.

2. THE LENDING OF CONSUMER CREDIT INSTITUTIONS – Q4 2015 (SEK billion)



Note: The chart is based on the reporting of the companies authorised under the Certain Consumer Credit-related Operations Act (2014:275) as of Q4 2015.

Requirements for authorisation

Companies that grant and mediate loans to consumers but are not credit institutions, i.e. consumer credit institutions, were not always required to obtain authorisation to conduct business. Authorisation requirements were introduced to counteract the risk of over-indebtedness from erroneously granted loans.[32] The authorisation also requires consumer credit institutions to have governance and control systems.

Consumer credit institutions must also report information about, for example, granted credit, interest income, unpaid credit and credit losses to FI on a quarterly basis. This enables FI to monitor developments on the market for consumer loans that are granted or mediated by entities other than credit institutions.

In April 2016, 55 companies had been given authorisation to grant or mediate consumer credits (see Table 1). Thirty applications were at that time still being processed.

TABLE 1: Companies authorised for certain consumer credit-related operations

Mediating credit	27
Issuing credit	22
Both mediating and issuing credit	6
Total	**55**

In FI's opinion, the authorisation obligation for consumer credit institutions has reduced the risk of erroneously granted loans. These institu-

30 Some companies mediate mortgages, for example. However, such mortgage intermediaries will, in most cases, need to apply for specific authorisation according to the rules of the new mortgage directive which will soon be implemented in Swedish law.

31 The Banking and Financing Business Act (2004:297), the Consumer Credit Act (2010:1846) and the Certain Consumer Credit-related Operations Act (2014:275).

32 Since 1 July 2014, companies that are not credit institutions must be authorised by FI in order to grant credit or mediate credit to consumers. The companies had to apply for authorisation by 1 January 2015.

tions are now required to comply with regulations regarding internal governance and control of their credit process. FI is therefore able to deny authorisation to companies it does not consider to be appropriately equipped to operate on the market, for example if the company does not have adequate credit assessment procedures.[33] On the whole, this increases consumer protection. During the year, FI has conducted five investigations into the internal procedures and control functions at consumer credit institutions; all of which were closed with no further action needed.

Credit assessment

The provisions of the Consumer Credit Act play an important role in protecting consumers during the lending process. One of the most important provisions of this act is that all companies that offer loans to consumers, whatever the size of the loan, must perform a credit assessment prior to granting the loan.[34] The purpose of the credit assessment is to ensure that the consumer has the financial capacity to pay the loan interest, fees and instalments. This means that the consumer's ability to repay the loan must be assessed before a loan can be granted.

In January 2016 a number of rulings were issued by the Karlstad Administrative Court which clarified the credit assessment requirement of this act. The Administrative Court determined that the creditor must verify that the consumer is able to repay the loan and the costs of the loan, and that this requires the creditor to perform an individual assessment of the consumer based on current information about the consumer's income, expenditure, assets and liabilities.

If the creditor grants a loan without having performed a sufficient credit assessment, there is a risk that the implications for the consumer could be extensive, and events could progress as far as the creditor transferring the debt to the Swedish Enforcement Authority. Even if the situation does not reach this point, the increased costs brought about by a late payment of a loan can still have a major impact on a consumer's personal finances. This could happen even with very small loans if the consumer has a narrow financial margin. It is therefore very important for the creditor to verify before granting a loan that the consumer will be able to repay it, even if it the loan poses a limited credit risk to the lender.

In 2016 FI will analyse the consumer credit market and how creditors work with consumer credit in order to gain a better understanding of the how consumer loans are issued and managed on the market.

JOINT SUPERVISION

As mentioned above, FI and SCA share the supervision of the consumer credit area. FI has expressed to the Government in other reports that the joint supervisory responsibility is not appropriate at times.

When two authorities share supervision, it is inevitable that each authority's activities will come into contact with circumstances that concern the other authority's area of responsibility. The preparatory works for the Certain Consumer Credit-related Operations Act state that a shared supervisory responsibility requires cooperation between the two authorities in order to implement the Government's measures against over-

33 As at April 2016, 13 applications had been rejected.

34 Section 12 of the Consumer Credit Act (2010:1846).

indebtedness.[35] FI agrees that cooperation is essential if the authorities are to succeed in their tasks, given how the supervision rules are devised today. FI is of the opinion that its cooperation with SCA works well, and the cooperation is even formalised to a certain extent through a cooperation agreement. However, the preparatory works lack an analysis of how this cooperation should be structured, for example with regard to existing regulation on public access to information and secrecy.[36]

FI has found that rules governing secrecy are preventing the authorities from working together as in the way that the legislator seems to have intended. For example, the authorities cannot share certain information with each other with reference to these rules. The joint supervisory responsibility thus risks leading to double work in some situations, but the main problem is that the possibility of conducting efficient supervision becomes more difficult. Situations have arisen where the authorities have not found grounds on their own to intervene against a company, but a joint assessment of the deficiencies identified by both the authorities may have led to a sanction. FI finds that in such a situation joint supervision impairs consumer protection.

A Government inquiry is currently investigating measures that would make the consumer credit market more responsible.[37] The inquiry is supposed to consider a number of potential measures, such as limiting the interest rates or other fees that may be charged and the possibility of extending loans. However, the question of the joint supervision is not an explicit part of the inquiry's assignment, which FI finds unfortunate. In FI's opinion, it is crucial that the joint supervision of the provisions in the Certain Consumer Credit-related Operations Act (2014:275) be reviewed in order to achieve well-functioning and efficient supervision of market entities. This is important for ensuring high consumer protection in the area.

35 Prop. 2013/14:107, page 61.

36 The Public Access to Information and Secrecy Act (2009:400).

37 ”En mer ansvarsfull marknad för konsumentkrediter”, Dir. 2015:43.

Financial advice

Financial advice for consumers is almost always offered by companies that also sell savings products – either their own or those of others. How much money advisors earn is therefore often dependent on the products they recommend. This could introduce a conflict of interest between of the advisor and the consumer.

CONFLICTS OF INTEREST IN ADVICE

Making informed choices about long-term saving is difficult for consumers. The outcome of an investment is often not immediately evident, which makes it difficult to evaluate savings products based on price and quality. Investment choices are made based on judgements about the level of the return the savings might be expected to generate and how high the risk is that an outcome might not meet expectations. Making such judgements requires knowledge and experience, and many consumers would therefore benefit from assistance in evaluating the large number of options on the market and assessing the suitability of these options given their individual needs and circumstances.

If financial advice is to serve its purpose, it must suggest the best solutions given the needs of the consumer without being affected by any other factors. There is currently a very limited supply of this kind of independent advice on the market since the banks, securities companies and insurance intermediaries that provide advice about financial products are almost always the same companies that sell or mediate the product. This gives rise to conflicts of interest, because the earnings of the advisors are dependent on the products they recommend.

Commission-based advice

FI has been calling attention for a long time to the remuneration-related problems on the advisory market. These problems arise when the recommendations made by advisors are influenced by the commission they receive from the producers of savings products. Because commission can vary a great deal between products and companies, advisors face strong incentives to steer consumers toward products that generate the highest payment rather than the products best suited to consumers' needs. This type of conflict of interest has been prevalent in practically all of FI's advice-related sanctions cases in the past few years.

The rules that are currently in place regarding how companies should manage conflicts of interest have proven to be insufficient. The self-regulation initiatives of the industry in the form of certification and disciplinary boards have not been enough, either. The problem is not the absence of rules, lack of knowledge about the rules or a lack of supervision. The problem is that commissions present advisors and intermediaries with the wrong incentives, which neither the current rules nor the industry have proven effective at managing. Two Government inquiries have recently proposed that FI should be given the right to ban commissions that risk having a negative impact on consumers' interests.[38] FI has also expressed on several occasions that a ban should apply to all types

38 ”Stärkt konsumentskydd vid försäkringsförmedling” (Ds 2014:22) and ”Värdepappersmarknaden MiFID 2 och MiFIR” (SOU 2015:2).

of commission paid in investment advice, portfolio management and the mediation of life insurance with elements of saving.[39]

In 2015 FI conducted a number of industry-wide investigations to identify, for example, how commission payments are devised for different businesses and products and how different types of saving products are distributed. One conclusion of this investigation was that commissions represent the lion's share of revenues for the vast majority of insurance intermediaries and securities companies. The majority of commission income is generated by the mediation of insurance that enables further advice about financial instruments, and by advice about complex structured products. FI's investigations also show that funds sold through advisory companies, such as insurance intermediaries, generally have higher fees than those sold through, for example, fund trading platforms.

Switching from a business model in which the price of a service is not displayed to the customer to a model in which the price is presented as a fee is a challenge. Companies will need to demonstrate much more clearly the value that the service is adding to the consumer. Companies that pay high commissions to get their products onto the market must instead compete on pricing and quality. FI believes this will lead to simplified advisory services and an increased range of lower-fee products. The transition costs must therefore be set against the gains inherent in a savings market that functions better in the long term. Several countries, such as the UK, the Netherlands and Australia, have drawn the same conclusion as FI and have already introduced bans on commissions.

Banning commissions does not solve all of the problems on the savings market. Companies that sell their own savings products still face incentives to steer customers toward their own products, for example because these products offer a better margin (see the next section). However, it is only once the incentives caused by commission payments are gone that the conditions will be in place for an independent advisory market to emerge. This will also increase the probability that the supply of advisory services and savings products will to a greater extent be tailored to the needs of consumers.

Advice about a company's own products

Several banks, insurance undertakings and securities companies that offer financial advice to consumers also sell their own products. These products could be structured products that a bank or securities company has developed themselves or insurance or funds from companies in the same group.

Although these companies also receive commissions for selling products from other providers, their own products often have a higher margin, which means higher earnings. Advisors might therefore be facing an incentive to recommend their own company's products first. The company also faces strong incentives to gather the consumer's entire business – from insurance to savings and, where relevant, loans – within the company's own group. There is therefore a considerable risk that the company's needs, and not those of the consumer, will determine which products are recommended to the consumer. This can result in an infe-

39 See e.g. FI's consultation response to "Värdepappersmarknaden MiFID 2 och MiFIR" (SOU 2015:2), FI ref. 15-2488, and the report "Consumer protection on the financial market" FI Ref. 15-6895 (http://www.fi.se/upload/90_English/20_Publications/10_Reports/2015/konsumentrapp_2015engNY.pdf).

rior solution for consumers' savings, which generates a poorer return or is not suitable given their needs and circumstances. Because this conflict of interest is not due to commissions from other companies, it cannot be managed using a ban on commissions. Other measures are instead required.

There is always a risk that companies offering both financial advice and savings products will face incentives to recommend their own products. However, FI finds this risk to be most prevalent at the banks, which often have a natural point of access to consumers' savings through their mortgage business. Many consumers need to apply for a mortgage at some point in their lives to purchase a house or apartment. Because purchasing a home is often the biggest transaction people make, one might be motivated, for example, to transfer pension savings to the bank in order to obtain some sort of discount on the mortgage rate or to be granted a mortgage at all.

FI's mortgage survey shows that many households that take out mortgages with the large banks also transfer or initiate savings with that bank. There is a high risk in such a scenario that consumers will not consider the bigger picture, i.e. that a lower mortgage rate is often temporary, while a higher fee on, for example, occupational pension insurance that they transferred to the bank might have a more long-term effect through a lower return on their pension savings. The total cost paid by the consumer might ultimately be higher than what it would have been without the discounted interest rate.

New rules set higher standards for the advice and sales of companies

The new Mortgage Directive, which will soon be implemented in Sweden, establishes new rules for products offered in connection with mortgages. As a result of these rules, a bank may no longer require a consumer to purchase other products in order to be granted a mortgage. For example, a bank may not require a customer to transfer their pension savings to the bank in order to be granted a mortgage. It will still be possible to offer a better interest rate to consumers with a broader customer relationship with the bank, but the rules tighten the requirements on the consumer receiving clear information about the cost of each individual product.[40]

The new MiFID regulations[41] contain rules that aim to address some of the problems related to financial advice promoting own products. For example, the rules more clearly specify that companies developing and distributing savings products must assume responsibility for ensuring that the right products end up with the right consumers by predefining a target market for their products (see the box). The existing rules are also being tightened in that the internal remuneration models of these companies may not be structured in such a manner as to rise to conflicts of interest, for instance by basing a salary on the number of sold products or giving a sales bonus for certain products.

40 See " Stärkt konsumentskydd på bolånemarknaden" (SOU 2015:40)

41 Directive (EU) 2014/65 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast).

Right products for the right target group

According to the new MiFID regulations, securities companies that prepare and develop savings products must have processes and procedures for governing these products. The objective of these processes and procedures is to ensure that the companies are devising products based on the needs of a predetermined target group. The companies must also have a distribution strategy and monitor that the product is sold to the intended target group, irrespective of whether it is sold through own sales channels or external distributors. Distributors are also subject to the process and procedure requirements, in that they must be knowledgeable about the products they are offering and only distribute products that meet the needs of the customer.

The new rules imply a greater obligation for companies to identify the consumers to whom their products are best suited – as early as in the development stage. The purpose is to clarify that the responsibility for determining whether or not a product is suitable for a certain consumer does not only rest with the distribution channel, but is also shouldered by the management and board of the company that produces the products. FI views this a positive progression and will prioritise supervision of compliance with these rules.

The MiFID regulations cover financial instruments, but equivalent rules are also being written for banking and insurance products.[42]

Financial advice is a prioritised area for supervision

One of the greatest risks that FI sees on the savings market is the risk that consumers will receive advice to buy products that are unsuitable given the consumer's needs and circumstances. Financial advice is therefore a prioritised area for supervision. During the year, like in previous years, FI has conducted a number of investigations of advisory entities. A recurring general observation is that companies need to become much better at documenting the advice that the give. FI has also observed that companies tend to hand over the responsibility for assessing whether or not a product is suitable to consumers themselves. For example, companies rely entirely on consumers' own judgements of whether or not they have sufficient knowledge about and experience in the products that are being offered. It should be the reverse; consumers must be able to rely on the companies to make the assessment of suitability.

Financial advice is fundamentally motivated by the fact that the advisor possesses much more knowledge about and experience in financial products than the consumer, and can therefore help the consumer to make informed investment choices. In order for advice to make a difference to the consumer, however, the company must act in the interests of the consumer. Besides the regulatory changes discussed earlier, FI also believes that companies need to take further steps to create a sounder market for financial advice. Companies need to create a corporate culture in which their advice revolves around the interests of consumers. Clear and distinct internal guidelines and procedures are needed to help advisors gather the appropriate information and analyse and document this information. There also need to be adequate support systems in place to help advisors act in the best interests of consumers. Furthermore, this requi-

42 For insurance products through the new insurance distribution directive (Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast)), and for banking products through the European Banking Authority's (EBA) guidelines on product oversight and governance (EBA/GL/2015/18).

res companies to present their advisors with incentives to act in the best interests of their customers, and management must continuously follow up on and perform controls of the business. FI will continue to focus on the advisory market and how the companies act when providing advice.

ADVICE ON ALTERNATIVE INVESTMENTS

Because of the low interest rates on the global financial markets in the past few years, low-risk investments, such as bond funds, generally yield a low return. Many investors, both professional investors and consumers, are instead seeking out riskier investments in their search for higher returns. This means that more attention is being given to alternative investments, both existing products and products that are new to the market.

Examples of alternative investment products include certain types of structured and unlisted products. These products serve a purpose given the right context, for example enabling financing for businesses or giving investors a higher return than other products. However, it is often difficult to price and assess the risk of these products. It is hard to believe that ordinary savers would have sufficient knowledge and experience to understand these risks, which means that it would not be suitable for advisors to recommend these products to the majority of their customers. Nevertheless, FI has observed through its supervision that these types of products are increasingly being sold to consumers through advice.

In terms of investments in unlisted products, there is a considerable risk that consumers will not be able to change their mind about their investments because there is no market for re-sale. Such products are said to be "illiquid".

Contingent convertibles (cocos)

In last year's consumer protection report, FI highlighted the risks associated with contingent convertibles (cocos). These products are basically bonds but, given certain predetermined events, they risk losing all or part of their value or being converted into shares.

Several supervisory authorities have highlighted the risks presented by cocos. For example, the European Securities and Markets Authority (ESMA) communicated in a statement in 2014 that cocos in particular pose risks to consumers (in the sense of non-professional investors). In the UK, the Financial Conduct Authority (FCA) has limited the distribution of cocos to consumers. Because of the difficulty to assess the risk and price of the products, the FCA does not consider them suitable for ordinary savers. FI has also communicated that cocos are not suitable for most consumers because understanding the risks associated with them requires a very high level of knowledge and experience.

Despite this, a general analysis of cocos transactions between 2014 and 2016 has enabled FI to conclude that cocos are sold to a relatively great extent to consumers. In some cases, the sales were the result of advice from banks and securities companies. FI is concerned about these developments and is now following up on its findings with these companies.

Possibility of banning or limiting how individual products are sold

In the near future, FI will be able to limit and even ban how individual products are sold if there is a risk that they will harm investors or have a negative impact on how the market functions or the stability of the financial system.[43] The new rules will also enable the European supervisory authorities (EBA, EIOPA and ESMA) to ban products that pose problems for the entire European market, which naturally would also include Sweden.

FI can occasionally communicate an opinion regarding specific categories of products, for example when it finds that it is difficult to justify the recommendation of these products to consumers. In general, however, FI does not wish to limit the market by banning products, unless absolutely necessary.

What is most important, from FI's standpoint, is for financial companies to take responsibility for the products they introduce on the market and ensure that these products do not have a harmful effect on consumers or the market at large. As mentioned previously, this responsibility has been clarified through product approval rules in the MiFID regulations that will soon go into effect, but FI expects companies to shoulder this responsibility already today.

Products not classed as financial instruments

All entities that offer advice about financial instruments must be authorised by FI.[44] Normally, these entities are not allowed to provide advice about products that are not classed as financial instruments. In order for a security to be classed as a financial instrument, it must be possible to disseminate it to a sufficiently high number of people and it must be subject to organised trade on a trading venue.[45] This means, for example, that shares in private companies are not defined as financial instruments. The same applies to subscription rights and debt instruments, such as participating loans and principal-linked participating debentures in private companies.

Advice about products not classed as financial instruments pose the same (and in many cases greater) risk to consumers as advice about financial instruments. Nevertheless, advice about this type of product is not covered by the consumer protection rules that apply to advice about financial instruments. For a consumer, however, it may be difficult to determine if a product is classed as a financial instrument – and hence if it is covered by the consumer protection rules that apply to financial advice. It is therefore important that companies authorised to give advice do not simultaneously give advice about products that are not classed as financial instruments. Consumers might think that all of the advice is covered by the same consumer protection rules.

43 The new MiFID regulations introduce these possibilities for investment products and structured deposits, and the PRIIPS regulations contain the same mandate for certain insurance products.

44 Either authorised under the Securities Market Act (2007:528) or authorised under the Insurance Mediation Act (2005:405).

45 According to Chapter 1, section 4 of the Securities Market Act (2007:528) financial instruments are defined as transferable securities, money-market instruments, units in collective investment undertakings and financial derivative instruments. The first category, transferable securities, covers such securities that may be subject to trade on the capital market.

Companies not authorised to give financial advice but which sell and give advice about non-financial instrument products are not supervised by FI. However, if a company were to provide advice about financial instruments without being duly authorised, FI is able to order the company to suspend its operations.

Investment fraud

Sometimes consumers are victims of pure investment fraud, in which companies offer worthless investments or investment in companies that do not exist. FI has a warning list[46], on which it lists companies that have come to FI's attention as being associated with investment fraud as well as companies about which other national supervisory authorities have issued warnings, both in Europe and globally.

46 http://www.fi.se/Folder-EN/Startpage/Register/Investor-alerts/

Digital opportunities and challenges on the financial market

The current digitalisation has implications for society at large and affects the labour market, industry, civic institutions and infrastructure alike. There is also a clear trend on the financial market of increased digitalisation, which presents consumers and financial supervision with both opportunities and challenges.

The increasing digitalisation is a worldwide trend that is affecting all areas of society. In industry, it affects and changes value chains and purchasing processes, which also affects the conditions of both business proprietors and consumers. In turn, this leads to the emergence of new relationships; relationships which are subject to varying degrees of regulation. While this can make the consumer more influential, it also leads to new risks.[47] This is the case in particular on the financial market, where market participants, as well as the legislator and FI (in its capacity of supervisory authority), play important roles in identifying how the developments can make markets more efficient while also ensuring high consumer protection.

Investments in financial technology ("FinTech") are intensifying, signalling that the financial industry is becoming more digitalised.[48] This is particularly notable in Sweden because Stockholm is second only to London in Europe in terms of the amount of capital that has been invested in FinTech in the past five years.[49]

One of the major advantages of digitalisation is that it creates cost-efficient solutions from the point of view of both consumers and companies. Given the right conditions, this could lead to increased competition and more efficient markets. In order to ensure that the developments benefit consumers – and the economy at large – FI finds it important to address a number of issues. These issues pertain to, for example, whether regulation has been sufficiently adapted to the digital transition, whether the safety and integrity of consumers can be assured in the digital environment, and the competence that entities must possess to cope with a digital society. As the supervisory authority, FI must adapt its operations to these new conditions. The following sections describe and discuss some of the types of services enabled by digitalisation.

CROWDFUNDING

The Internet affords many opportunities for development and new business methods. In crowdfunding, capital and credit are mediated over a technical platform that connects capital-seeking parties with investors. Crowdfunding is usually broken down into four different groups: equity-based, lending-based, reward-based and donation-based. This type of financing presents an alternative to the more traditional sources of finan-

47 The Swedish Consumer Agency, "Vår omvärld 2015", report 2015:14

48 There are many different definitions of FinTech, but it is often a broad term for all technology used for operations in banks, the capital market, financial analysis, payments and personal finances.

49 See the analysis of the FinTech sector in Stockholm by the Stockholm School of Economics "Stockholm FinTech", in which it is also stated that 32% of the capital invested in Swedish limited companies was attributable to companies in the FinTech sector in 2014.

cing, i.e. credit institutions and regulated capital markets. Online platforms efficiently connect many small-scale investors with the owner of a project in need of financing. Crowdfunding therefore has the potential to create an alternative source of financing, for example if a bank has denied a loan. This is particularly relevant for small companies.

In 2015 FI was commissioned to analyse the equity-based and lending-based crowdfunding market.[50] FI's analysis shows that crowdfunding still represents a very minor part of the financial market and that it is only partially regulated.[51] One conclusion that is drawn in the report is that the risks inherent in crowdfunding could often be quite high compared with traditional types of investment such as securities or funds. Despite this relatively high level of risk, the level of consumer protection is frequently less extensive than the protection in place for regulated investments. Because its analysis shows that crowdfunding increasingly targets consumers directly, FI is of the opinion that the legislator should consider introducing consumer protection regulations for the equity-based and lending-based crowdfunding platforms. FI believes that the key issues that require further investigation include:

How should the dissemination ban be interpreted in relation to equity-based crowdfunding? The dissemination ban states that a private limited company may not disseminate shares, subscription rights, debt instruments or warrants through advertising.[52] According to the ban, private companies may not advertise or in any other way attempt to attract a large number of investors. In FI's opinion, the advertising carried out on the websites of the equity-based crowdfunding platforms offer the opportunity to invest in private limited companies and thus may be considered to be advertising and a breach of the dissemination ban. If the legislator would like to make equity-based crowdfunding possible for private limited companies, FI believes that the dissemination ban would need to be reviewed.

Another key issue is whether the platforms should require some sort of authorisation. Crowdfunding that targets the general public is still a relatively small market and individual investments are often relatively small. It therefore ought to be possible to create a regulation that is proportionate to the volume and based on principles that as a whole would increase the opportunities for the consumers to make informed decisions without unnecessarily preventing this new source of financingfrom developing. This could benefit small companies and generate growth. The regulation should consider how platforms should manage conflicts of interest and the information that platforms should provide to investors, in both equity-based and lending-based crowdfunding. Although the provisions of the Marketing Practices Act also apply to crowdfunding platforms, FI finds that there may be specific information requirements that are needed for the platforms' business.

In addition to that mentioned above, there are also specific risks linked to lending-based crowdfunding, such as a heightened risk of over-indebtedness when the borrower is a consumer. Because the platform only ser-

50 Government decision of 30 July 2015, Fi2015/3817. The report was submitted to the Government on 15 December 2015, Ref. 15–17220..

51 In its report, FI only inspected equity and lending crowdfunding because these investment types carry an expectation of return on the invested (or lent) capital.

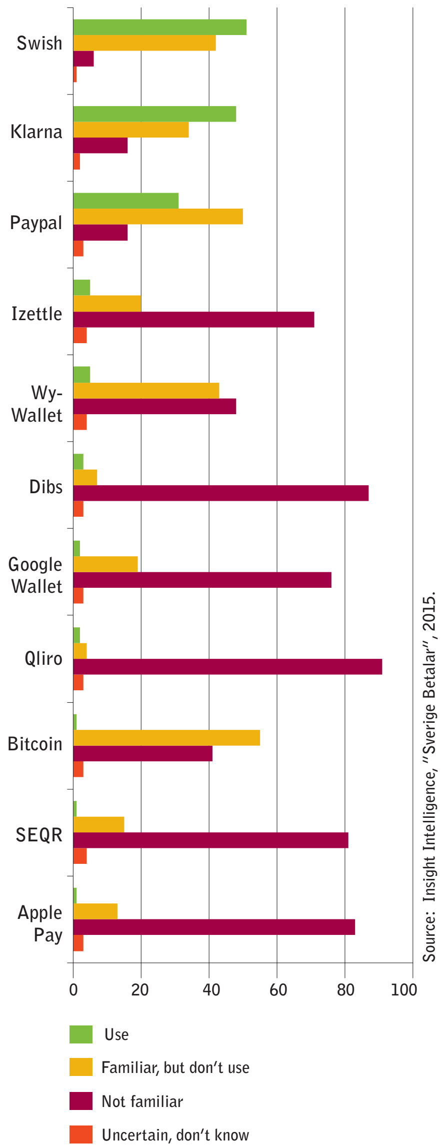
52 Chapter 1, section 7 of the Companies Act (2005:551).

ves as the credit intermediary and does not shoulder any of the credit risk, there is little or no incentive for the platform to duly perform a credit assessment. When the lender is a consumer, it is also unclear which party to the agreement is responsible for performing the credit assessment and submitting the requisite information. This gives consumers, in their capacity of borrowers, poorer protection than in other consumer loans.

DEVELOPMENT OF PAYMENT SERVICES

The Internet and development of new technology are paving the way for payment service providers to develop simpler ways of making and receiving payments. Often, it is not really a case of new infrastructure for payments, but rather of more user-friendly ways of executing payments. It can be a matter of paying bills, card payments and transfers through online banks, but also through new channels such as a phone app.

3. PAYMENT SERVICES – FAMILIARITY AND USE
(share as a percentage)



Other new methods for making or receiving payments or obtaining information about payments are offered through third-party providers. These companies offer payment initiation and account information services, which basically simplify the contact between payment service users and providers. By accessing banks or payment accounts, third-party providers, when instructed by the consumer, can facilitate payments and create an overview by compiling information. These types of service providers were not previously regulated, but they will soon be subject to the same regulation and supervision as other payment institutions through new European-level regulations.[53]

Opportunities and challenges

These types of new services increase the flexibility and accessibility to payment execution. The emergence of alternative methods for making and receiving payments could potentially put pressure on the prices of such services as well as tailor services so as to make them more attractive from a consumer perspective. However, if these services are to experience sustained growth, they need to ensure a sufficient level of consumer protection. For example, it must still be secure to make a payment. Some of the new European rules regulating payment services will therefore require all payment service providers to increase the security in online transactions by imposing greater demands than before on how they verify the customer's identity. FI finds this development to be positive.

There is still some scepticism about new technology. Many consumers prefer to use companies that have payments as their core business rather than entities that are new to the area, even if these entities are otherwise well-known. In a survey from 2015, 30% of respondents stated that they do not envisage using payment services from such entities, and 41% stated that they were doubtful or did not know.[54] Familiarity and use varies greatly between different payment services, but the majority of consumers are not familiar with many payment services (Diagram 3). The fact that there are groups of consumers that find it difficult to manage technical solutions poses a major challenge to companies developing new pay-

53 Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.

54 Insight Intelligence, "Sverige betalar" 2015.

ment methods, particularly since this development is occurring in parallel to a decline in the amount of cash that is being handled.

AUTOMATED ADVICE

Automated advice is personal advice about financial instruments that is provided, often online, with no or limited human involvement. Instead, the advice is provided, for example, after customers fill in a questionnaire that includes information about their personal identity number, other personal details, knowledge and experience, financial circumstances, objective and risk appetite. The automated advice tool then uses an algorithm, which, step by step, leads to the recommendation of one or more financial instruments based on the information provided by the customer. The algorithm relies on input information from the advisory company, such as information retrieved from a third party. Some advisory tools are fully automated, while others contain some human contact on the part of the advisory company at some stage of the process. Both of these versions are covered by the definition used here.[55]

Opportunities and challenges

One advantage of automated advice is that the cost may be lower for companies compared with traditional advisory services that include physical customer meetings. This translates into a lower price for consumers, which in turn means the advice can reach a wider circle of customers. Automated advisory services can therefore be an important element in the development of an independent advice market that is not financed by commissions.

In FI's opinion, if the advisory service meets the criteria for investment advice, then it is advice that is subject to authorisation irrespective of the means employed to deliver the advice.[56] The advice shall, in that case, follow applicable requirements for documentation, suitability assessment, managing conflicts of interest and demands on management.

The risk that automated advice introduces to consumers is basically the same risk consumers face with traditional advice, i.e. that they will receive recommendations to invest in products that are not suitable for them. However, it might be necessary to manage this risk differently since the risk of technical error might be higher while the risk of human error lower. This justifies frequent controls to verify that the advisory system functions as it should, and that the companies' control functions continuously follow up on the appropriateness of the advice provided. In turn, this requires the company to possess the right expertise for performing such quality controls.

55 Traditional advisory services can also be supported by an IT tool that generates suggested portfolio allocation and individual financial instruments. Advice supported by such internal IT tools is not covered by the definition in this report.

56 Article 52 of Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for securities companies and defined terms for the purposes of that Directive.

Glossary

The glossary "Pensionstermer för konsumenter" has been used as far as possible as a basis for the glossary.

Active share A measure of how the fund's holdings diverge from the benchmark index. If the active share is 0, the fund has the exact same holdings and portfolio weights as the index, and if the active share is 100, the fund has no holdings that are in the index.

Alternative investment fund Broad definition covering many different operations and types of fund, pursuant to the Alternative Investment Funds Act (2013:561). The funds included in this definition, however, are not funds that require authorisation according to the Investment Funds Act (2004:46).

Benchmark index Shows the aggregate growth in value for the holdings included in an index. The purpose is to provide a representative presentation of the performance of a certain market or industry.

Bond Interest-bearing security which can be issued by governments, municipalities, credit market companies, mortgage institutions and large corporations. Bonds have a maturity of at least one year and the nominal amount is repaid upon maturity. Until then, holders receive payments mainly in the form of interest. Bonds issued by corporations are called corporate bonds and are an alternative to funding through e.g. bank loans.

Cocos Bonds which, after certain predetermined events, can be impaired, i.e. they can lose all or part of their value or be converted into shares in the issuing company.

Commission Transaction-based variable remuneration on a sale. In this report the term is used in relation to the remuneration which securities companies and insurance intermediaries receive from companies whose products they recommend. A distinction is often made between trailing commission, which is a recurring commission that is often calculated as a percentage of paid-in premiums or capital under management, and upfront commission, which is commission for the entire duration in the form of a lump sum when the sale occurs.

Consumer In this context "consumer" refers to individuals who use financial products for private use.

Contribution principle Principle of law that sets out that the distribution of bonuses in traditional life insurance, to the greatest possible extent, must be based on the contribution of the individual policyholder to the insurance undertaking's total surplus.

Crowdfunding A method for financing projects or ideas by approaching a large number of, often small-scale, investors.

Derivative instruments Financial contracts that are linked to events or conditions at a specific future point in time or period of time. The value of a derivative instrument is linked to the value of the underlying asset. Examples of derivative instruments are options, futures and swaps.

Dissemination ban Rule in the Swedish Companies Act (2005:551) setting out that a private limited company may not disseminate shares, subscription rights, debt instruments or warrants through advertising.

European Banking Authority (EBA) The authority responsible for regulating and supervising banks in European supervisory system.

European Insurance and Occupational Pensions Authority (EIOPA) The authority responsible for regulating and supervising the occupational pension market in the European supervisory system.

European Securities and Markets Authority (ESMA) The authority responsible for the regulation and supervision of the securities market in the European supervisory system.

Financial markets An umbrella term for markets on which financial instruments are traded. The four most important markets are the foreign exchange market, the fixed income market, the equity market and the derivative market.

Finansinspektionen's general guidelines and regulations (FFFS) Regulations which supplement the laws and regulations that fundamentally govern financial operations. Regulations are binding while general guidelines serve as guidance.

Index management Also known as passive management. Portfolio management in which the company's own portfolio has the same composition as a selected index with the purpose of attaining the same return as the index.

Listed rate The lending rate that credit institutions use in their marketing.

Maturity The amount of time remaining until the payment of a liability or until a bond falls due.

PRIIPs Package Retail and Insurance-based Investment Products

Structured deposit Fixed-term deposits whose return often consists of a fixed interest rate and any supplemental interest rate. The supplemental interest rate is paid out, if the predetermined underlying asset performed favourably during the term of the deposit. The underlying asset can be e.g. listed shares.

Structured product Financial instrument whose return is completely or partially dependent on the performance of several other financial instruments or assets. Often consists of a bond combined with a derivative, for example an option. Examples of structured products include equity-linked bonds or commodity bonds.

Tracking error Standard deviation for the difference between the fund's return and that of the benchmark index.

Trading venue Market for trading in financial instruments, for example securities companies which organise trading, stock exchanges or MTFs. Also called marketplace.

Unlisted products Products that are not listed for trading on a regulated market or other trading venue.

Unsecured loan A loan granted without any collateral or guarantee. Also sometimes called "consumption loan" to designate that the purpose of the loan is not to make an investment in, for instance, a home.

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