S U M M A R Y

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Consumer protection in the financial markets
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Summary

Consumers are responsible for their own decisions when it comes to the purchase of financial services and products. Consumers cannot expect central government to compensate for, or protect against, losses arising from financial risk that they themselves have chosen to take.

However, central government does have responsibility to make it possible for consumers to take that responsibility. This means that central government must ensure that firms provide clear and truthful information. This allows consumers to take responsibility for their financial decisions. Consumers also have the right to expect central government to supervise the regulatory compliance of financial institutions, and that dishonest actors are kept out of the markets. Finally central government has the responsibility for ensuring that consumers have access to a dispute settlement process if problems with financial institutions do occur.

So good information is a necessary condition for a more equal relationship between producers and consumers in the financial markets. But this is not enough. Consumers also need a fundamental understanding of financial issues, including where to get information and support as an individual. Central government should take a greater responsibility for educational activities enabling consumers to obtain this awareness. FI has offered to run and coordinate such an initiative.

Today FI and the Swedish Consumer Agency share responsibility for consumer protection in the financial markets and cooperate on this. In addition to FI and the Swedish Consumer Agency, there are a number of other public authorities and organisations involved in consumer protection work to a greater or lesser extent.

FI’s consumer protection work is preventive. FI’s work aims to identify and, using general measures, counteract problems *before* they result in harm to the consumer. On the other hand FI does not intervene in the dealings of individual customers and firms. FI draws up rules which protect or empower the

consumer, and supervise the regulatory compliance of financial institutions which carry on licensed operations.

Below we summarise the report's analysis of the different types of products and services which consumers come into contact with in financial markets, and the issues and problems faced by consumers in these areas:

Savings
Swedish households have savings amounting to SEK 3,700 billion.

Financial advisors exhibit shortcomings in their advisory skills
The need for consumer protection is basically a reflection of the consumers' disadvantage in information and expertise. A well-functioning advisory sector may substantially reduce this problem. The problem is that the customer must trust in the competence of the advisor, and trust that advice is not influenced by interests other than those of the customer, e.g. sales commissions. In the opinion of FI there is a risk today that the advice which consumers are getting does not correspond to what they have the right to expect. All too often the customer is actually meeting a sales person rather than an advisor. Because of this FI is working to ensure that advisors are honest and that they follow the rules for advice-giving aimed at protecting consumers.

Saving in accounts is often low risk, but there are exceptions
Of Swedish household saving approximately 18 percent, or SEK 700 billion, is as saving in accounts. Of this the great proportion is with the largest banks. It is estimated that 90 percent of saving in accounts is covered by the deposit guarantee scheme. The ultimate risk faced by consumers saving in accounts is that the firm cannot pay back the money. FI assesses the risk of the large banks not being able to repay money as very low; this also applies to most of the smaller banks. However, FI's review for the credit market firms which accept deposits shows that there are differences in risk between the various firms. In the deposit firms – which are not under FI supervision and which are not covered by the deposit guarantee scheme – the differences in risk are probably greater. However, these firms cannot accept deposits of more than SEK 50,000 per customer. Customers should be aware to the risks when they choose a firm and assess whether a higher interest rate compensates for the greater risk.

Investment directly in equities – the choice of marketplace affects the risk and protection for the consumer
Investment directly in equities is widespread in Sweden, making up approximately 18 percent of household financial savings, which corresponds to SEK 700 billion. Equities are traded in different marketplaces with different degrees of risk and different degrees of protection for the consumer. This is not always apparent. The consumer is also dependent on intermediaries to handle the payment and administration of purchases and sales. These intermediaries can abuse the confidence of customers or damage the customer through shortcomings in their handling of the customer's business. However, FI

believes that overall, small investors have an open and fair access to the stock markets, and fair access to information.

Equity-linked bonds and warrants – firms do not give enough information
Increasing numbers of consumers save and speculate using complex financial products such as equity-linked bonds and warrants. Today Swedish consumers own such instruments to an estimated value of SEK 70 billion. In order to make balanced decisions the customer needs to evaluate a range of factors and risks over and above those found when investing in mutual funds or equities. These factors and risks are not always easy to understand and evaluate, therefore placing a heavy requirement on those who are responsible for providing information, i.e. the issuers and sellers of the securities. However, this is an area in which they often fail, and this means that customers risk investing in instruments the consequences of which they do not fully understand. Because of this, FI has tightened the review of information, and discussed how it can be improved and made easier to understand with actors in the market.

In general investment in mutual funds works well. However, it requires continued scrutiny on the part of FI
Swedish households have approximately SEK 1,000 billion invested in mutual funds, including unit-linked insurance. In addition, they have a further SEK 300 billion in premium pension authority (PPM) funds. Investment in mutual funds allows the consumer to obtain the yield potential of the stock market or bond market while spreading the risk, without having to spend the time and effort to administer their own portfolio of securities. At the same time giving the administration of one's savings to a third party means that there is a risk that the administrator will administer funds in the best interests of a party other than the customer, or that insufficient expertise or shortcomings in the necessary procedures will mean that the administrator will not be able to ensure proper protection of the invested funds. Overall FI believes that the mutual fund market is working well for consumers. Nevertheless, FI almost always finds shortcomings in a few administrators when we carry out surveys that cover several firms. Fairly often these shortcomings are serious and mean or could mean losses for customers. Given the large volume of investment in mutual funds, the large number of savers involved and the function this type of investment fulfils in allowing inexperienced investors to invest in the stock market, the FI takes a serious view of these deficiencies, and will continue to carefully scrutinise investment in mutual funds.

Savings in traditional life insurance – the highest priority in FI's consumer-related regulation.
Savings in traditional life insurance is the largest form of savings in Sweden comprising approximately SEK 1,250 billion. The regulation of savings in traditional life insurance has FI:s highest priority, not just because of its size but also because its customers are in an unusually exposed position in relation to the firms – customers have difficulty making an advance or ongoing

evaluation of this form of savings and looking after their own interests. In addition, saving takes place over a number of years and, as a rule, customers cannot transfer their savings if they are dissatisfied with the firm or, for some reason, need to change their pattern of saving. These circumstances increase the risk that firms will unintentionally or – in the worst case - intentionally ignore their customers' interests. To prevent this there is an extensive regulatory framework and supervision of firms. Certainly the debate and measures taken in recent years have improved the position of customers; however, FI has determined that the regulations, supervision and the actions of the firms need to be further improved in many areas. This applies in areas such as the opportunity for customers to transfer their savings; information about risk and returns; how the distribution of profits is carried out to and between customers; and information about this.

Payments

Payments – new risks and unclear information

There have been rapid developments and changes in how payments are made in the economy. Electronic, account-based payments have grown at the expense of cash payments. This also means that the risk and problems for the consumer involved in the use of cash have been replaced by other types of risk. These are mainly complex risks associated with electronic payments and Internet use. However, the latter is an issue that also affects services other than payments. FI is currently reviewing the security systems of the Internet banks. Another problem for consumers is the manifest lack of information about the pricing of payment services. However, the latter issue is small because the open or concealed costs of the average consumer are relatively small.

Borrowing

Consumer credit – the number of payment orders is growing fast

Borrowing in the form of consumer credit is developing relatively quickly, with a high growth in volume, new products such as SMS loans and new actors. This outstanding credit totals approximately SEK 200 billion. The number of non-performing loans under administration by the Swedish Enforcement Service has increased by 20 percent in a five-year period, despite the economic boom. The regulatory need is less a necessity for consumer information and more in areas such as marketing and the fairness of terms and conditions. In this area oversight is administered by the Swedish Consumer Agency and not FI, although the two agencies do collaborate. Important issues for FI in recent years in this area have been how firms provide information and calculate effective interest rates and the development of SMS loans. Firms offering SMS loans have been targets of fraud because the identification of customers has not been satisfactory. FI is currently investigating these firms.

Mortgages – households have increased their risk tolerance

Loans for housing is the predominant credit taken out by households in monetary terms and amount to SEK 1,400 billion, 80 percent of borrowing. Borrowing has increased by 10-15 percent over a number of years, due above all to rising property prices and low interest rates. FI has observed an increased risk tolerance in the mortgage market in that both amortisation periods and debt to equity ratios are increasing. Households are also borrowing at variable interest rates to a larger extent; this increases exposure to rising interest rates. The primary threat identified by FI in the mortgage market is that, since low interest rates have been the norm for several years, households will not take adequate account of the risk of rising interest rates. FI has therefore imposed requirements on the banks to provide information to customers about the consequences of rising interest rates on a mortgage budget.

Insurance – lack of interest and knowledge on the part of consumers
Consumers can use insurance to protect their finances from unexpected events, for example damage to property, loss of income due to illness or injury, or a liability to pay damages. The expected compensation payments to consumers from current policies amount to over SEK 200 billion. Consumers may have the wrong or poor insurance protection, either in the form of too much or too little protection. This can be due to a poor understanding of what their insurance covers, which in turn can be due to lack of interest or poor information from firms. In Sweden there is no other party – a guarantee system or central government - that steps in to compensates consumers if the firm cannot pay claims due to insolvency. However, today that risk is not such a great threat but is being followed up through FI’s ongoing supervision. However, there are many complaints about delays to the final settlement of personal injury claims. FI is actively supervising the work of firms in reducing the time taken to settle claims and in keeping policyholders informed about the progress of the process.