DG SANCO

Analysis of the Economic Impact of Directive 2002/65/EC concerning the distance marketing of consumer financial services on the conclusion of cross-border contracts for financial services between suppliers and consumers within the Internal Market

Final Report

Submitted by Civic Consulting of the Consumer Policy Evaluation Consortium (CPEC)
Framework Contract Lot 2 – DG SANCO

Date: 5 September 2008

Contact person for this project:

Dr Frank Alleweldt, Civic Consulting, Potsdamer Strasse 150, 10783 Berlin
Tel. +49 30 2196 2295, Fax: +49 30 2196 2298, email:alleweldt@civic-consulting.de

CPEC Brussels contact address:

Rue de la Sablonnière 25, B-1000 Brussels

Tel: +32 (0)2 2750100, Fax: +32 (0)2 2750109, email: petra.van.nierop@ghkint.com

Document Control

Document	*Final Report to DG SANCO – Analysis of the Economic Impact of Directive 2002/65/EC concerning the distance marketing of consumer financial services on the conclusion of cross-border contracts for financial services between suppliers and consumers within the Internal Market (DG SANCO Framework contract Lot 2)*
Proposal No.	*Request 5*
Prepared by	*Dr Frank Alleweldt (Project director), Prof Alistair Milne (Lead author economic analysis), Kristen Schubert, Sonia Gonzalo, Dr Senda Kara, Dr. Sara Buccino*
Checked by	*Dr Senda Kara, Dr Frank Alleweldt, Kristen Schubert, Dr. Sara Buccino*
Date	*5 September 2008*

CONTENTS

Acronyms

AML: Anti-money laundering

CEA: European insurance and reinsurance federation

CCD: Consumer Credit Directive

CEE: Central and Eastern European

DMD: Distance Marketing Directive

EBIC: European Banking Industry Committee

EC: European Commission

ECB: European Central Bank

EU: European Union

FFSA: Fédération Française des Sociétés d'Assurances

FPS: Freedom to provide services

FSAP: Financial Services Action Plan

M&A: Mergers and acquisitions

MFI or non-MFI: Monetary financial institutions or non-monetary financial institutions

MS: Member State(s)

SEPA: Single Euro Payments Area

VAT: Value added tax

EXECUTIVE SUMMARY

This report presents the results of an analysis of the economic impact of Directive 2002/65/EC concerning the distance marketing of consumer financial services on the conclusion of cross-border contracts for financial services between suppliers and consumers within the internal market. The study has been conducted by Civic Consulting, with support by Van Dijk Management Consultants of the Consumer Protection Evaluation Consortium (CPEC). Methodological tools employed for the study include: desk research and exploratory interviews; in-depth interviews; survey of financial service providers; survey of national associations of financial service providers;[1] case studies; and an economic analysis.

Market situation

In recent years there has been major progress towards an integrated European capital and financial services market. However, studies conducted by the European Commission indicate that the retail financial service market is among the most fragmented segment in EU financial services. Although cross-border activities have increased significantly in inter-bank and wholesale business, retail banking integration measured as cross-border activity is still limited. The insurance sector is also characterised by very limited direct cross-border provision of insurance services, especially in retail markets.

The latest data from the 2006 Eurobarometer indicates that increasing percentages of EU citizens would consider purchasing financial products cross-border. There are also indications that there is supply-side interest in increasing cross-border activity. Evidence of consolidation and integration in the banking sector, in terms of volume, can be seen from activity taking place through subsidiaries and, to a lesser extent, branches. The insurance sector is also characterized by a relatively small number of large insurance groups operating on a EU-wide basis primarily through subsidiaries; in countries where foreign companies are less prevalent, their market share is reported to be rising.

According to the research conducted for this study, the relevance of distance marketing in the banking and the insurance sector is as follows:

Banking sector

Distance marketing of consumer financial services has become relatively common in the banking sector. Of the 37 banks responding to the EU-wide survey of companies conducted in the framework of this study, 65% offer at least some of the financial services products via distance marketing. Although banks are increasingly offering alternative distribution channels for their products, all channels of distance marketing

[1] A complementary survey of consumer organisations was conducted by *iff Hamburg,* the results of which were taken into account for the present study.

typically serve as a complementary service to traditional point-of-sales banking, rather than as a substitute.

The majority of banks (67%) responding to the survey of companies provide their distance marketing customers with a combination of channels to conclude contracts: internet and telephone and in many cases, postal mail due to written signature requirements.

The most relevant financial service products offered by banks involved in distance marketing are non-mortgage loans including consumer credit (21% of the products most often offered) and savings accounts (21%), followed by stocks/shares and bonds (17%). Credit cards are the second most relevant product for banks; this product is considered to be among the most relevant products offered by 20% of banks responding to the survey of companies.

Banks are motivated to enter other EU markets for a number of reasons, including increasing saturation of the home market, large consumer bases available in other Member States, as well as significant price differentials from which banks could capture profits.

Banks have experimented with a number of different strategies to enter other EU markets, the most common of which being via mergers and acquisitions, the creation of pan-European groups or by establishing branches in the target Member State. Many banks also use intermediaries to enter EU markets cross-border; i.e. selling their product under the brand name of a well-established company already present in the target Member State. Although the cheapest means of entering cross-border markets might be via distance marketing as this is a business strategy that could easily capture economies of scale using the distance marketing platform already established in the host country, this is a business strategy that is very uncommon in the EU. Even though data on direct cross-border transactions is scarce, there is a general agreement among providers that currently only a very limited number of direct cross-border consumer credit transactions take place.

Banks that offer retail products via distance marketing, whether within a particular domestic market or as occasionally happens cross border, tend do so on specific product markets, mainly savings accounts and credit cards. The reason for this is that simple products are the easiest to sell via distance marketing as consumers do not require much advice, compared to more complex products which are most easily concluded with traditional face-to-face contracts discussed and concluded at point of sale.

For this Final Report, five case studies have been conducted in the banking sector, illustrating different approaches to entering cross-border markets and in some cases the use of cross-border distance marketing. Two case studies are of banks that operate in the EU currently using distance marketing to provide banking services cross-border from an establishment in one MS to customers in another MS. One case study bank also uses distance marketing to supply banking services to customers in other Member State, but does so out of branches or at least one single physical presence established in each MS with products provided under the law and regulation of that state. Two further case studies are of banks that provide banking services in other MS but do so after having acquired a local branch bank.

Insurance sector

The market size of distance marketing of insurance products and services is difficult to measure as there are no regular, systematic and standardised EU-level statistics issued on the proportion of sales coming from distance marketing. However, the literature and the data collected through the survey and the interviews reveal that the conclusion of insurance contracts via distance marketing in the 27 EU Member States is still not widespread among consumers and that insurance companies have not yet taken full advantage of distance distribution channels even within domestic markets. According to national associations' estimates, distance marketing accounts for only 1.8% of their members' total premium income.

Also for the insurance sector, telephone, fax and post remain the more conventional means of distance marketing even if combined with an online channel. The Internet distribution channel is mostly used for marketing purposes, or to provide additional product information. The conclusion of the contract as such is rarely done online as contractual information is most often sent by postal mail.

The most relevant insurance products offered by distance marketing are: (a) motor insurance; (b) other insurance products, primarily home properties, healthcare, travel, etc.; (c) life insurance. Home properties and motor insurance appear to be more widespread products offered through distance marketing again because they are quite simple to understand, their characteristics are easy to provide at a distance, and because they are considered to be products asked for by clients and not driven by sellers.

The EU retail insurance market remains relatively national regardless of the distribution channels used. Cross-border trade is still rather limited and the instances in which European consumers shop and chose the best insurance contract based on a pan-European comparison are extremely rare.

Local establishment is the dominant channel for market entry and integration in the EU retail financial market. Mergers and acquisitions are perceived as the most effective way to expand market share in saturated markets or acquire market share in other Member States. In fact the insurance sector is characterised by large companies operating primarily on a EU-wide basis through subsidiaries though some branch activity also takes place; the provision of services without a physical presence is rare.

For this report, seven case studies have been conducted in the insurance sector. Two case studies are of insurance companies that operate in the EU currently using distance marketing to provide retail insurance service products cross-border from an establishment in one MS to customers in another MS. In the other five case studies, insurance providers all use distance marketing; however, they have expanded their business activity to customers in other Member States with a local presence either via branches, by acquiring local insurance companies, or through partnerships with local players.

Persistent obstacles to concluding cross-border contracts for consumer financial services.

The main persistent barriers

The report considers a range of individual obstacles – both obstacles on the supply side discouraging providers from offering and concluding these same banking, insurance, or investment products directly across border *and* obstacles on the demand side discouraging consumers from considering a banking, insurance, or investment products provided directly cross-border by a non-national supplier – and assesses their importance in the light of the questionnaire and case study information collected.

While there is as yet little economically significant volume of direct cross-border marketing of retail financial services within the EU, retail financial services are instead largely being provided cross-border by other means, e.g. through local establishment or by provision to EU citizens when travelling or working in MS other than where they reside. Many of the obstacles to direct cross-border marketing and conclusion of retail financial services contracts are obstacles to cross-border marketing and distribution of any kind, whether or not the product is marketed face-to-face (through local branches or a third-party) or marketed directly cross-border.

This study identifies sixteen barriers that prevent financial institutions from supplying a product across borders. For each obstacle, the report explains the nature of the barrier, its importance, the persons or categories of persons affected, the possible developments that may affect the barrier and the economic consequences of the barrier.

The limited amount of direct cross-border provision and reluctance or inability of suppliers to discuss costs of indirect provision through establishment mean that no cost quantification can be provided, but on the basis of the response to the industry surveys and further analysis, the study catalogue the barriers into three broad categories: very significant, significant, and less significant.

The main barriers to cross border contracts for consumer financial services as identified by this study, are:

Institutional and technical barriers

1. Lack of harmonised payment systems, etc.: *less significant barrier*
2. Problems related to tax*: less significant barrier*
3. Difficulties in concluding contracts electronically*: significant barrier*
4. Need to maintain multiple channels for delivery and communication*: significant barrier*

Credit assessment and recovery problems

5. Difficulties in debt recovery*: significant barrier*
6. Absence of pan-European credit referencing system*: less significant barrier*

Differences in law and regulation

7. National anti-money laundering requirements*: very significant barrier*
8. Lack of harmonisation of relevant MS legislation or absence of EU legislation*: very significant barrier*

9. Differences in disclosure rules and withdrawal rights*: less significant barrier*
10. Inconsistency between regulation of face-to-face and distance selling*: significant barrier*

Difficulties in understanding/ penetrating local domestic market

11. Legal uncertainty regarding the applicable law*: significant barrier*
12. Lack of understanding of domestic retail financial services markets*: significant barrier*
13. Difficulties in marketing in other MS: *less significant barrier*

Demand side barriers

14. Differences in language and culture: *very significant barrier*
15. Consumer preference for own national providers: *significant barrier*
16. Absence of information: *very significant barrier*

General assessment of economic impacts of existing obstacles

Both supply-side and demand-side barriers are inhibiting cross border distance marketing. Two out of the four barriers rated as most significant are supply-side barriers. Lack of harmonisation of MS legislation or absence of pan-EU legislation is a very significant barrier for all retail financial services. Banks place particularly great weight on the barriers caused by national differences in anti-money laundering legislation. Two out of the four barriers rated as most significant are demand-side barriers. Language differences, as well as cultural differences, and consumers' lack of information about cross-border financial products, appear to be extremely relevant factors explaining the limited cross-border provision of financial services.

Operating and/or administrative costs of suppliers

The supply side barriers make it extremely difficult for suppliers to provide harmonised retail financial services on a pan-European basis or even to a group of some but not all EU Member States. Cross-border supply has to be tailored to the domestic market of an individual MS, with dedicated product description and marketing and, for the more complex problems, dedicated support systems.

Some economies of scale are exploited for simpler products, which are provided in a very similar way in bordering Member States. Suppliers could much better exploit economies of scale and achieve considerable cost reductions, if they were able to develop and market financial services products for several countries or on a pan-European scale. But this would require substantial changes in regulations, tax, and consumer law; therefore this is only a possibility in the medium to long term.

Range, prices and conditions of financial products offered at a distance

Few suppliers of retail financial services make exclusive use of distance marketing channels; rather telephone call centres and websites are complementary to physical channels such as a branch network. Our surveys and case studies uncovered *hardly any examples* of business models based exclusively on *cross-border* distance marketing. For legal and practical reasons, distance marketing of retail financial services is always tailored to a specific domestic national marketplace. Even in those few cases where the supplier is located outside the target MS, still the activity is targeted at the domestic market under the law of that MS.

Competitive position

At present a single internal market for retail financial services has not yet developed; rather retail financial services are provided in domestic national markets under the law of those individual MS. There is therefore no difference in the competitive position of European companies within the EU market or between European and non-European companies.

To the extent that barriers are reduced and companies are able to supply cross-border, either by establishment of subsidiaries or branches or by distance marketing targeted at a specific domestic market, this will encourage greater competition, with better pricing for consumers and stronger incentives for suppliers to improve cost efficiency. This impact may be relatively large in smaller MS where there has been relatively little competition in financial services.

The impact of the DMD on distance marketing of consumer financial services across borders and persistent obstacles

As the investigations of this report have demonstrated, before and after the introduction of the Directive, there has been no meaningful cross-border distance marketing of the vast majority of retail financial services cross-border within the EU – i.e. an internal market for distance marketing of consumer financial services does not yet exist and in most cases where cross-border distance marketing does take place it is on a small scale. The data show that the Directive has had little or no impact on cross-border distance marketing of most retail financial products and services. To the extent that there has been an impact it has been on distance marketing within the domestic markets of individual MS.

However, some specific retail financial services are purchased cross-border, notably investment funds (notably funds sold in Luxembourg to investors from other EU members states). Within the banking sector there are also some initial offerings of deposit accounts/credit cards marketed at a distance to consumers located in another MS.
Distance marketing of insurance products, especially general insurance, has had significant growth in recent years within a number of EU domestic markets, suggesting that there is potential for cross-border marketing of general insurance. There is some cross-border distance marketing of non-life insurance products and services (in motor insurance primarily). However, this is hardly relevant in terms of volume and therefore in insurance, just as in banking, the data suggest a virtual absence of retail cross-border distance selling.

There is evidence that the financial services sector is increasingly moving in the direction of provision of consumer financial service products cross-border, although not usually via direct marketing. Although it is true that a limited number of companies have successfully operated a business model of concluding these contracts directly cross-border, the trend seems to be that most companies will enter cross-border markets with at least one physical office and a small team of employees present in each Member State (i.e. through establishment but not with a branch network). Many of these companies will operate a small office in the Member States where they are active yet providing their financial service products through an online platform only, usually with a significant amount of back-office support located in another Member State.

The very few companies that were identified as operating with a direct cross-border strategy all stated that their business decision to provide financial service products cross-border via distance marketing was not significantly affected by the DMD. This does not mean that the Directive has had little or no overall economic impact, but any substantive economic impact has been on the existing distance marketing within the various domestic national markets for retail financial services within the various EU Member States. According to industry stakeholders, there has been some increase in compliance costs for firms engaged in distance marketing, because they have had to provide more information than previously required and because the Directive introduced a difference in the disclosure requirements and withdrawal rights for domestic products, depending upon whether they are marketed at a distance or not.

The study suggests that the DMD may have had an impact on some of the obstacles to cross-border entry by direct provision, though to a limited extent. The Directive makes little difference to the many further substantial obstacles – including differences in law and tax regimes, conflict of regulations, differences in language and culture, and other infrastructural and institutional differences – which continue to limit direct cross-border provision of consumer financial services into national domestic markets and prevent almost entirely the provision of consumer financial services at a pan-European level.

1 INTRODUCTION

Scope of the report

This report presents the results of the analysis carried out by the CPEC (Consumer Protection Evaluation Consortium) of the economic impact of Directive 2002/65/EC[2] concerning the distance marketing of consumer financial services on the conclusion of cross-border contracts for financial services between suppliers and consumers within the internal market. The study has been conducted by Civic Consulting, with support by Van Dijk Management Consultants.

Structure of the study

The structure of the report is as follows: Section 2 details the methodology employed for the analysis. Section 3 outlines details of the market situation for distance providers. This analysis is structured into the following parts for both the banking and the insurance sectors:

- Overview of the distance marketing of consumer financial services in the EU;
- Extent of distance marketing of consumer financial services cross-border; and
- Case studies on companies that are engaged in cross-border marketing or have considered doing so.

Section 4 provides an overview and an analysis of the persistent obstacles to concluding cross-border contracts for consumer financial services, their economic impact and a ranking of the severity of this impact on cross-border distance marketing as well as an analysis of the impact of the DMD. Annex I provides inputs from the legal analysis of the DMD carried out by *iff Hamburg,* which includes also views of consumer organisations in all 27 Member States. Annex II provides results from focus groups conducted in the UK, Czech Republic and Germany in the context of a study on cross-border provision of consumer credit[3] which yielded results relevant to the present study. Annex III provides a list of participating EU and national associations, as well as financial service providers participating in the survey, interviews and case studies. Annex IV presents the two questionnaires which have been circulated to business associations and to companies; Annex V gives an overview of the results of the survey of national business associations involved in financial services and Annex VI provides the results of the company survey.

The scope of Section 3, the analysis of the market situation for distance providers, is relatively broad discussing both domestic and cross-border distance marketing. The reason for this broad scope is that there is in practice still only an extremely limited volume of cross-border distance marketing. The evidence collected from industry

[2] Referred to in this report also as the "Distance Marketing Directive" or the DMD.

[3] See Civic Consulting (2007), *Broad economic analysis of the impact of the proposed directive on consumer credit*. See: http://www.europarl.europa.eu/comparl/imco/studies/0704_consumercredit_en.pdf

associations, suppliers and consumer focus groups and case studies refers to their own experience and thus naturally raised issues concerning both domestic and cross-border supply. Remaining discussion, including the analysis of the barriers to cross-border distance marketing (Section 4) and the legal analysis conducted by *iff Hamburg* (Annex I), is more narrowly focussed on cross-border distance marketing.

Acknowledgements

Civic Consulting would like to express its gratitude to all supporters; we would like to thank the European banking and insurance associations and all their members that provided valuable input though a EU-wide survey. EBIC (the European Banking Industry Committee) provided detailed and helpful comments on the interim report of this study, which was made available to its members by the European Commission. We worked intensively with more than ten banks and insurance companies for which we are very grateful for the time and efforts they dedicated to this study to provide in-depth information concerning their cross-border activities. This analysis would not have been possible without these expert opinions and advice. Finally, we thank the European Commission for the support provided throughout the study.

2 METHODOLOGY

The following methodological tools were employed to understand the impacts which the adoption of Directive 2002/65/EC has had in terms of facilitating and therefore encouraging the conclusion of cross-border financial services contracts between consumers and suppliers within the internal market:

- Desk research and exploratory interviews;
- In-depth interviews;
- Survey of financial service providers;
- Survey of national associations of financial service providers;
- Survey of consumer organisations;[4]
- Case studies;
- Economic analysis.

The main methodological tools are described in the following sections.

Interviews/meetings with key partners and stakeholders

The number of interviewed stakeholders can be found in the following table.

Table 1: Number of interviewed stakeholders

Organisation	Number of interviews
EBIC and CEA	Group meeting, interview
National financial service associations	6
Individual financial service providers	18

Surveys

It was originally foreseen that only a survey of suppliers would be circulated. However, after the exploratory interviews and discussions with EBIC and CEA, it became clear that an additional survey of national associations of financial service providers could provide additional data on how the implementation of Directive 2002/65/EC has impacted the industry.

[4] Conducted by *iff Hamburg.*

These two surveys were drafted based on feedback from stakeholders and a discussion with EBIC and CEA concerning the terminology and appropriate wording of the questions. The questionnaires were first circulated through the EU level associations (i.e. EBF, ESBG, EAPB, EACB, EMF, EFBS, Eurofinas/Leaseurope, and CEA) who distributed them further to their national associations. These national associations were encouraged to fill in the "Questionnaire of Associations" as well as target their members involved in distance marketing to fill in the "Questionnaire of Companies" for the financial service providers. Additionally, providers of financial services were identified through the Van Dijk databases[5] containing information on financial service providers who were then contacted via a direct email.

Table 2: Respondents to the survey

Respondents to Questionnaire of Associations	Questionnaires received
National Banking Associations	14
National Insurance Associations	16
Associations responding in another format than the questionnaire[6]	10
TOTAL	40
Respondents to Questionnaire of Companies	**Questionnaires received**
Banking	37
Insurance	32
Financial Advisor	1
Credit / Mortgage intermediary	1
Other	2
TOTAL	73

In parallel with the surveys of financial service providers and national associations conducted by Civic Consulting, iff Hamburg circulated questionnaires among consumer organisations, consumer complaint boards and European Consumer Centres (see Annex I). 39 consumer organisations and ECCs, covering all 27 Member States, responded to the questionnaire, as well as 7 consumer ombudsmen from France,

[5] The *Amadeus* database provides financial information on 7 millions of Pan-Euro companies from all sectors (classified upon their national industry codes, NACE code, US SIC and NAICS code) and ranked according to three different criteria (sales, number of employees, total assets). *Bankscope* provides the same kind of information but targets only the banking sector worldwide (22.000 banks covered). The *Isis* database covers 6000 Insurance companies worldwide and provides the same kind of financial information. The *Zephyr* database provides information on mergers and acquisitions deals.

[6] A number of associations formally responded to the circulation of the "Questionnaire of Associations" but did not respond using the questionnaire format. Reasons most often cited were due to the fact that they did not have any figures on this topic, Directive 2002/65/EC had only recently been transposed, or that they did not have any members to whom the Directive was thought to be relevant. However, all additional comments provided by these associations have been taken into account.

Germany, Sweden, Italy, Latvia, Portugal and Greece. Despite high participation on the demand side, the results of these surveys cannot be considered truly informative as consumer organisations unanimously report that they lack experience with complaints in the area of distance selling of financial services, and even less in cross-border sales of financial products.

Case studies

A supplementary tool for data collection was the case studies covering a broad and representative geographic area in the EU. Case studies were aimed at covering providers based and/or operating in the following 6 geographic clusters in the EU: (a) Germany/Austria; (b) UK/Ireland; (c) Benelux; (d) Southern countries; (e) Nordic countries; and (f) New Member States. Besides geographical location, special attention has been devoted to build a representative sample based on different criteria related to the: companies' size, retail selling channel used on national market, geographical cross-border markets in which they are active and type of approach implemented by those companies to enter cross-border markets.

All providers selected are involved in cross-border marketing of their financial services. Additionally they fulfil some or all of the following criteria:

- Conduct purely distance marketing;
- Conduct distance marketing cross-border;
- Conduct cross-border selling via establishment (either M&A or with branches);
- Have considered extending their operations to other European MS.

The purpose of these case studies was to collect practical experiences with distance marketing, cross-border entry, and cross-border entry via distance marketing. Where possible, quantitative data was collected. In this approach, we were able to determine the impact of the barriers to direct cross-border market entry and develop an understanding of the most severe barriers and which barriers are less problematic.

The case studies began in January and extended into May 2008. In total, 12 case studies were conducted with 5 banks[7] and 7 insurance companies. Efforts have been made to hide the identity of the financial service providers participating in the case studies.

[7] A case study of a sixth bank was conducted but not finally authorised by the bank.

3 MARKET SITUATION

3.1 Introduction

According to European Commission estimates the retail banking sector generated gross income of between 250 to 275 billion Euro in 2004, equivalent to around 2 percent of GDP in the EU. Of this figure, mortgages were the most significant source of income (generating just over 30% of gross retail income in the EU-25), followed by current accounts (28%), consumer loans (18%), deposits and savings accounts (17%) and credit cards (7%).[8] CEA estimates that the total premium income amounted to 1,110 billion Euro, while total insurance industry investments increased to 7,283 billion Euro in 2007. This figure consists of 688.3 million Euro premium income for total life premiums (with a 20% increase from the year before in the 12 new Member States) and 421.8 million Euro for non-life premiums which also experienced its strongest growth in Eastern Europe. With a 31% share of all non-life premiums, motor insurance is the largest non-life business and is particularly competitive.[9]

Integration of financial services cross-border

In recent years there has been major progress towards an integrated European capital and financial services market. According to a Commission staff working document, that integration is underway in the wholesale markets, in the capital markets and in financial market infrastructure.[10] However, studies conducted by the Commission indicate that the retail financial service market is among the most fragmented segment in EU financial services.[11] Although cross-border activities have increased significantly in inter-bank and wholesale business, retail banking integration measured as cross-border activity is still limited. In 2006, the share of Eurozone cross-border Monetary Financial Institutions (MFI) loans granted to non-MFIs was around 4% of total loans, while the share of cross-border loans in wholesale business was around 25%.[12] The insurance sector is also characterised by very limited direct cross-border provision of insurance services, especially in retail markets.[13] Clearly, there is very little cross-border provision of many consumer financial service products and only a small percentage of EU citizens are involved in cross-border financial transactions, although there seems to be some upward trend, as is indicated by recent Eurobarometer data (see Table 3):

[8] Commission of the European Communities, *European Commission, Report on the retail banking sector inquiry, January 2007*, SEC (2007) 106, p. 18, 21.

[9] CEA, *Annual report 2007-2008*, p. 6-7.

[10] SEC(2005) 1574, *Annex II White Paper Financial Services Policy (2005-2010) - Impact assessment*, p. 3

[11] Commission of the European Communities, *Commission Staff Working Document: Financial Integration Monitor 2005*, SEC (2005) 927.

[12] Vajanne, Laura (2006), *Working Paper: Integration in euro area retail banking markets – convergence of credit interest rates*, Helsinki: Bank of Finland, Markets and Statistics.

[13] Commission of the European Communities, *Commission Staff Working Document: European Financial Integration Report 2007*, SEC (2007) 1696, p. 16.

Table 3: EU citizens who have obtained financial products cross-border

Financial Product	% EU citizens who have obtained the product in another EU Member State (2004, EU-15)	% EU citizens who have obtained the product in another EU Member State (2006, EU-25)
Bank account	4 %	8 %
Credit card	2 %	n/a
A card (debit, credit, payment, bank card)	n/a	7 %
Private pension plan	1 %	3 %
Car insurance	2 %	n/a
Life insurance	1 %	4 %
Insurance (health, home, travel, care, etc.)	n/a	9 %
Mortgage	1 %	4 %
Loan for uses other than buying a house	n/a	4 %
Stocks or shares	1 %	3 %
Collective investments	1 %	2 %
Other financial product	1 %	1 %

Source: Eurobarometer 60.2 (2004), EU Public Opinion in Europe: Financial Services, Report B., Eurobarometer 252 / Wave 65.1 (2006), Consumer Protection in the Internal Market

However, the latest data from the 2006 Eurobarometer study indicates that higher percentages of EU citizens, compared to those presented in Table 3, would consider purchasing financial products cross-border.[14] In general, this is in line with an expectation that cross-border provision of retail banking and insurance services has the potential to increase substantially in the medium to long term for a number of reasons: growing consumer demand due to the gradual emergence of a "customer segment with increasingly international preferences"; the significant migration in the EU that also leads to consumers using financial services in both the country of origin and the country of residence; change in the mix of distribution channels, limited opportunities for domestic market expansion; and various regulatory initiatives at the EU level.[15]

There are also indications that there is supply-side interest in increasing cross-border activity. Evidence of consolidation and integration in the banking sector, in terms of volume, can be seen from activity taking place through subsidiaries and, to a lesser extent, branches – although in terms of numbers branches have been increasing since

[14] Eurobarometer 252 / Wave 65.1 (2006), *Consumer Protection in the Internal Market.*

[15] Deutsche Bank Research (2006), *EU retail banking – Drivers for the emergence of cross-border business*, EU monitor 34.

2002 whereas subsidiaries have not been.[16] The insurance sector is also characterized by a relatively small number of large insurance groups operating on a EU-wide basis primarily through subsidiaries; in countries where foreign companies are less prevalent, their market share is reported to be rising.[17]

The market situation for each financial service product varies according to product-specific characteristics such as the product's most propitious distribution channels, national laws for specific products, and consumer preferences; this has caused fragmentation of the market to a different extent for each financial service product. This also leads to different levels of cross-border activity for different products, see Table 4.

Table 4: Overview of integration in a selected number of retail products

	Is cross-border activity taking place?	**Are prices converging**	**What is the degree of integration?**
Savings account	Yes some	Yes	Some signs of integration
Home loans	No	Yes	Rather fragmented
Investment in securities (UCITS)	Yes	No evidence	Increasingly integrated (but scope for progress)
Consumer Credit	No evidence	No	Very fragmented

Source: European Commission, Financial Integration Monitor 2005, SEC (2005) 927.

Investment in securities has become relatively integrated compared to other financial service products and has advanced in recent years.[18] Also the convergence of interest rates and bank margins across the Eurozone in savings accounts suggests growing market integration for specific financial service products.[19] However this does not necessarily indicate that there has been any significant substantial cross-border direct marketing. Such convergence could come about simply from reduction in barriers to cross-border establishment leading to new entrants establishing on a national basis in relatively profitable high margin markets, and hence leading to convergence of margins.

Banks, when deciding to go cross-border, are increasingly entering product specific markets that do not require the high investment costs of acquiring or establishing a full service branch network in other Member States. According to the Commission's 2007 report on the retail banking sector, banks are now more often than before entering cross-border into domestic markets for products such as credit cards and savings

[16] Commission of the European Communities, *Commission Staff Working Document: European Financial Integration Report 2007*, SEC (2007) 1696, p. 15.
[17] CEIOPS (2007), *Report on Financial Conditions and Financial Stability in the European Insurance and Occupational Pension Fund Sector 2006-2007 (Risk Update)*, Frankfurt am Main. p. 16.
[18] Deutsche Bank Research. *EU retail banking*.
[19] Commission, *Financial Integration Monitor 2005*, SEC (2005) 927.

accounts which do not need a branch network enabling all operations to be carried out via internet or phone.[20] However, as confirmed by our own case studies, direct *cross-border* provision of banking products in the EU remains extremely rare, it is much more common to set up a local platform such as an internet site or call centre, for distance marketing of banking services. In the insurance sector, if products are sold cross-border, these are mainly simple products such as motor insurance because it is a relatively standard product and mandatory in many Member States. More complex products, especially those that are individually tailored to the consumer, are hardly sold cross-border at all. The distribution of these other insurance products, for example medical insurance or house insurance remains primarily nationally or locally organised.

Despite growth in cross-border entry, there still appears to be considerable opportunities to capture profits in other less competitive markets in the EU. Although prices in retail banking have been declining in the Eurozone between 2006 and 2007, the latest price indicators show significant variations across Member States in prices of payment services and other key retail financial services like consumer credit and current accounts.[21] Insurance prices are hard to measure and compare without (reliable) price-based indicator, so it is difficult to determine whether this is also occurring with insurance.[22] However, discussions with stakeholders indicate that significant price variation also exists among Member States in the insurance sector.

The appeal of distance marketing of financial service products cross-border

In order to capitalise on these price variations among MS, there is evidence that providing financial service products via distance is a cost-effective strategy, as opposed to establishing a branch network. The main economic argument for adopting the Internet as a delivery channel is based on the expected reduction in overhead expenses made possible by reducing and ultimately eliminating physical branches and their associated costs (e.g. staff and rent).[23] In the UK insurance market, face-to-face distribution models account for 38% of total operating costs.[24] An interview with a German insurance company indicated that for every 1 Euro of a traditional motor insurance premium, 20-30% is part of the agent or broker's commission.[25] Many "bricks and mortar" banks (or traditional banks) are increasingly establishing and operating distance financial service products. The survey of companies' results, indicate that 55% of responding companies operate distance marketing of financial services (either nationally or cross-border). Distance distribution channels are most often used as a complement rather than a substitute to traditional point-of-sales channels. This follows a world-wide trend in a multi-channel "clicks and mortar"

[20] Commission of the European Communities, *Commission Staff Working Document: Report on the retail banking sector*, SEC (2007) 106. P 16.

[21] Commission of the European Communities, *Commission Staff Working Document: European Financial Integration Report 2007*, SEC (2007) 1696, p. 17.

[22] Commission of the European Communities, *Commission Staff Working Document: European Financial Integration Report 2007*, SEC (2007) 1696, p. 16.

[23] Hernando, Ignacio and Maria J. Nieto (2006), *Is the Internet Delivery Channel changing Banks' Performance? The Case of Spanish Banks*, Banco de España.

[24] Deloitte & Touche. (2006). *News Release: Beyond Face to Face Insurance Distribution.*

[25] Case study interview.

approach by providers of financial service products.[26] This is likely caused by the fact that a certain amount of commission to the agent in traditional distribution channels in both the insurance and the banking sector must be calculated into the price of the final product, which will incorporate costs for advice, and conclusion and servicing the product. Research conducted in the US provides evidence that transaction costs to banks vary significantly according to the distribution channel (see table below):

Table 5: Transaction costs of various distribution channels

Channels	Dollar Unit Cost per Transaction (USD)
Full service branch	1.07
Telephone Call	0.54
ATM	0.27
Internet	0.01

Source: Booz Allen & Hamilton (1999). *Beyond Shared Services: e-Nabled Service Delivery*.

Table 5 suggests that significant savings can be had from alternative models of distribution, which indicates why many providers of financial service products have been moving in this direction often for both their existing customer base as well as a means to acquire new customers. Along the same reasoning, it would suggest that entering markets cross-border via alternative distribution models would capture the same savings.

Potential limitations to distance marketing of financial service products

However, some literature suggests that a reduction of banking branches leads to a loss of customers and consequently, a loss of market share.[27] Other sector challenges to direct cross-border provision arise additional to the barriers highlighted in the previous section; namely the <u>traditional basis for a physical establishment</u> and the difficulty in <u>customer acquisition</u>.

In interviews with the sector, financial service providers <u>traditionally operating with a physical establishment</u> have more significant challenges when trying to operate cross-border without a physical establishment in the cross-border Member State because they have a business model built on a physical establishment; alternatively, online banks have noted that they have less barriers when going cross-border because their business model is already developed on distance provision of financial service products, thereby lending itself more easily to distance provision cross-border.

Furthermore, there are reasons to assume that <u>some financial service products are intrinsically local products</u>, meaning that are difficult to conclude without some face-to-face contact. It was emphasised by financial service providers that these intrinsic

[26] Hernando, et. al.

[27] As quoted by: European Central Bank (2007). *EU Banking Structures*. Frankfurt. P. 40. Please see Eurogroup Consulting study "*La banque de détail aux Etats-Unis et en Europe*" published in French La Tribune on 13 October 2005.

characteristics of financial service products should not be underestimated and as such, hinted there are limited long-term prospects to a growth ceiling in cross-border provision of consumer financial services. One case study bank said that "there is room for significant growth in this market, however, it will never be a significant market overall vis-à-vis traditional banking."[28] Indeed, certain barriers have been recognised by the Commission as criteria for defining the geographic scope of relevant banking markets in previous merger decisions.[29] In it's inquiry into the retail-banking sector, the Commission acknowledged, "it is possible that the geographic market for some products and services may be regional or even local."[30] This was also confirmed in case studies with the insurance sector to be the case for certain markets.

Additionally, financial service providers have recognised the <u>difficulty of customer acquisition in general</u> when entering new markets and in case study interviews they stressed that it is particularly difficult to acquire customers from a distance.[31] In the 2007 Commission Staff Working Document, several comments submitted by banks in the context of the public consultation stated that entry mainly occurs by means of acquiring an existing customer base with a branch network and possibly an established brand.[32] For this reason, many providers of financial services in the context of the case studies emphasised that it made the most sense economically to acquire a local bank, which already has a consumer base, or to offer distance cross-border products through an intermediary, which allows for an easy acquisition of consumers because they are already familiar with this provider and it yields the additional benefit that the local bank or intermediary has knowledge of the local consumer population, their preferences and the local market in general. It is a common industry view in the banking sector that "green-field" entry into other Member State markets tends to be more risky and less successful than entry through merger and acquisition.[33]

However, one case study interview explained that when entering a new market, a bank has to build trust of the customers - this is most often done with marketing. But "what you can't develop, you must buy" with offers of high savings rates in order to lure the customers.[34] In fact, it appears that the strategy of most direct cross-border providers of consumer services is to offer very competitive products on the new market.

Thus, regardless of these indications that the cross-border activity is growing within the internal market and that there is a potential to offer cheaper financial service products via distance marketing for retail financial service products, the continuing separation of

---

[28] Case study interview.

[29] See Commission decision of 11 March 1997 in Case IV/M.873 – Bank Austria/Creditanstalt, OJ C 160, 27.5.1997. Referenced on 27 May 2008 from: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997M0873:DE:HTML

[30] Commission Staff Working Document (2007). *Report on the retail banking sector inquiry*. SEC(2007) 106, p. 54. See also: OECD paper (2000). *Mergers in Financial Services* DAFFE/CLP (2000)17, p. 22; and: DoJ Banking Merging Policy, US Department of Justice (1996). *Consolidation in the Banking Industry: an Antitrust Overview.* Available at: http://www.usdoj.gov/atr/public/speeches/0657.pdf

[31] Case study interview

[32] Commission Staff Working Document (2007). *Report on the retail banking sector inquiry*. SEC(2007) 106, p. 15.

[33] Commission Staff Working Document (2007). *Report on the retail banking sector inquiry*. SEC(2007) 106, p. 15.

[34] Case study interview.

the various national markets remains a policy concern, as it has been already for many years. Policy makers have endeavoured to promote greater harmonisation of national rules and regulations applied to retail financial services and to promote cross-border provision between MS. This was one of the driving forces for European legislators leading, among other pieces of legislation, to Directive 2002/65/EC concerning the distance marketing of consumer financial services. Due to the specific situation of financial services this sector had been previously excluded from the Distance Selling Directive (97/7/EC). Other regulatory initiatives have also aimed to further integrate the internal market for retail financial service products such as the Consumer Credit Directive, Third Generation of Life and Non-Life Insurance Directives, E-Commerce Directive, Insurance Mediation Directive, and others.

3.2 Banking sector

3.2.1 Overview of distance marketing of consumer financial services in the EU

Size of distance marketing of retail banking products in the EU

Distance marketing of consumer financial services has become relatively common in the banking sector since the early 1990s when products were originally offered via telephone and since 1997 when products were first offered via the internet.[35] Often consumers prefer to purchase their products via distance distribution channels, e.g. internet, telephone, fax, and direct mail, because distance marketing products are in many cases easier to access, more convenient, faster, and often cheaper than products purchased via the traditional face-to-face channel.[36]

According to the survey of national associations, all banking associations have at least some members actively engaging in offering their products through distance marketing. Of the 37 banks responding to the EU-wide survey of companies conducted in the framework of this study, 65% offer at least some of the financial services products via distance marketing. Although banks are increasingly offering alternative distribution channels for their products, all channels of distance marketing typically serve as a complementary service to traditional point-of-sales banking, rather than as a substitute. Some banks expressed the view that distance marketing served best as a form of marketing to initiate the selling process, which would later be finalised in the branch with the provision of face-to-face advice. Banking associations responding to the survey estimated that distance marketing represents only about 5% of their member companies' total business income.[37] Likewise, banks responding to the survey who operate distance distribution channels estimated their distance sales represent only 3% of their total business income. This confirms the ECB's conclusion that, in comparison to branches, the internet has only reached a limited importance so far as a sales channel.[38] It is clear that although many banks do offer their customers products via alternative distribution channels, business income from this channel is still relatively small compared to income from point-of-sales products.

Distribution channel most used

The majority of banks (67%) responding to the survey of companies provide their distance marketing customers with a combination of channels to conclude contracts, this is often a combination of internet and telephone and in many cases, this combination may include postal mail due to written signature requirements. The selection of several channels may also reflect differences in business model, with some banks using distance marketing as means of acquiring customers who are then serviced using a variety of different channels including branches. Six banks indicated that the internet was their most important distribution channel and two banks indicated

---

[35] JTL Financial Research (2000), *Direct Selling of Financial Products: Market Overview*, p. 6.

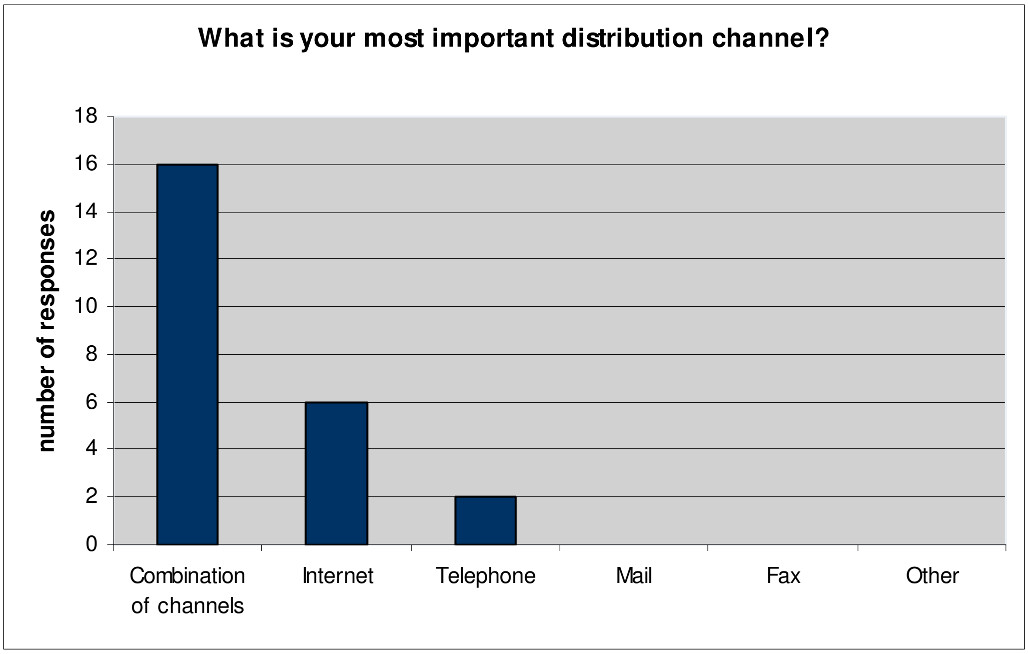
[36] JTL Financial Research (2000), *Direct Selling of Financial Products: Market Overview*, p. 3.

[37] 5% is the median average. This number is based on only 5 associations which were able to provide any estimate; many banks have asserted that data on distance marketing is simply not available as it is often not recorded in their IT system how exactly the contracts were concluded.

[38] European Central Bank (2007), *EU Banking Structures*, p. 44.

that the telephone was their most important distribution channel. The graph below illustrates that direct (postal) mail and fax are not considered as most important distribution channel by any of the responding banks.

Figure 1: Distribution channels for banks (distance marketing)

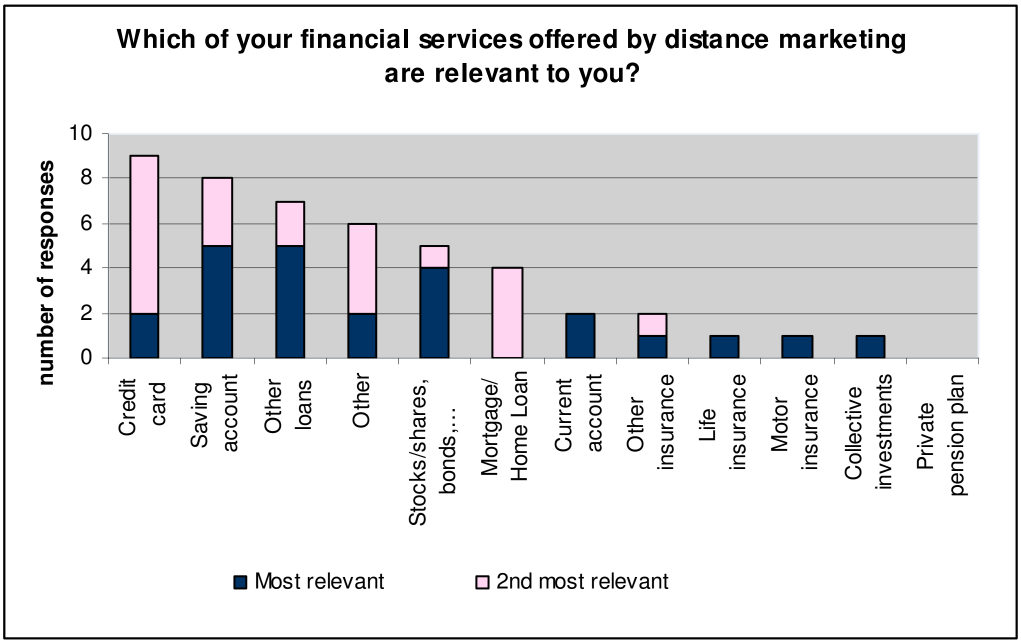


Source: Survey of Companies (banking sector responses, N= 24)

Type of products most often used

The most relevant financial service products offered by banks involved in distance marketing are other loans including consumer credit (21% of the products most often offered)[39] and savings accounts (also 21%), followed by stocks/shares and bonds (both 17%). Credit cards are the second most relevant product for banks; this product is considered to be among the most relevant products offered by 20% of banks responding to the survey of companies, see Figure 2.

Figure 2: Financial service products offered by banks



Source: Survey of Companies (only banking sector responses, N=24)

Financial services identified by banks to be “other” also included services such as electronic transfers and cash management, rather than specific financial products.

3.2.2 Extent of distance marketing of consumer financial services cross-border

Motivation to go cross-border

Banks are motivated to enter other EU markets for a number of reasons, including increasing saturation of the home market (resulting in highly competitive markets with lower potential returns), large consumer bases available in other Member States, especially those which have a relatively under-developed retail banking sector, as well as significant price differentials from which banks could capture profits. In discussions with stakeholders, the vast majority of banks recognised the potential for financial gains in other countries and said they would, in theory, be very interested to target the broad customer base in other EU Member States. Banks have experimented with a

[39] Banks did not indicate the nature of these loans.

number of different strategies to enter these markets, the most common of which being via mergers and acquisitions, the creation of pan-European groups or by establishing branches in the target Member State. Many banks also use intermediaries to enter EU markets cross-border; i.e. selling their product under the brand name of a well-established company already present in the target Member State. This is often the case because banks then do not need to invest in start-up marketing and they are also able to acquire the knowledge of the local market from the brand company with whom they are cooperating.[40]

A study of the Spanish banking sector has shown that direct banking leads to reduced overhead expenses due to a reduction of costs associated with branches (i.e. less costs for staff and rent).[41] This suggests that internet banking lowers fixed costs for certain products as well as unit costs (which fall more rapidly than those of traditional banks as this model is best able to accommodate increasing output from increasing customer acquisition without a corresponding increase in inputs).

This implies that the cheapest means of entering cross-border markets might be via distance marketing as this is a business strategy which could easily capture economies of scale using the distance marketing platform already established in the host country. However, this is a business strategy that is very uncommon in the EU. A previous study conducted by Civic Consulting on consumer credit concluded that, although data on direct cross-border transactions is scarce, there is a general agreement among providers that currently only a very limited number of direct cross-border consumer credit transactions take place. A large majority of national banking associations stated that less than 0.1% of total consumer credit transactions of member banks consisted of direct transactions with consumers resident in another EU Member State.[42]

Research conducted for the present study reaches similar conclusions for other banking products. With a comprehensive effort to identify banks active in direct cross-border marketing of consumer financial services, including the evaluation of available literature and contacting EU level and national level associations, less than 5 retail banks could be identified in the EU that actively conduct direct cross-border distance marketing as a primary business strategy (i.e. with a majority of their customers located outside of their host Member State).[43]

Furthermore, retail banks with at least some form of proactive marketing campaign in other EU Member States via distance marketing are also rather limited. Of the 14 national banking associations responding to the survey, only four indicated that they

[40] Interview case study bank 1.

[41] Hernando, Ignacio and Maria J. Nieto (2006), *Is the Internet Delivery Channel changing Banks' Performance? The Case of Spanish Banks*, Banco de España.

[42] See Civic Consulting (2007), *Broad economic analysis of the impact of the proposed directive on consumer credit*. Please visit: http://www.europarl.europa.eu/comparl/imco/studies/0704_consumercredit_en.pdf

[43] Cross-border distance marketing has been defined in the questionnaires and for the purposes of this study to be "Distance marketing of financial services directly from one EU Member State to consumers in another EU Member State (i.e. the services are not sold through local presence by branches or majority holdings in the country where the consumer is resident)."

had members conducting cross-border distance marketing;[44] of these four associations two reported that cross-border distance marketing represented less than 0.1% of their distance marketing activity (at a national level across all banks) and the other two associations reported that cross-border distance marketing represented less than 1% of their national activity.[45] Of the 37 banks responding to the survey of companies, only 7 of the 24 operating distance marketing do so on a cross-border basis (30%); however, some of these companies only passively accept consumers from abroad (for a savings account, most commonly) rather than maintain a proactive cross-border operation. Three of these 7 banks provided estimates of the percentage cross-border distance marketing represented of their total sales of consumer financial services; for one bank direct cross-border sales represented less than 0.1%, for another bank it was less than 1% and the last bank marked direct cross-border sales represented less than 5% of their total sales of consumer financial services. Quite clearly, this is a business strategy that is not actively pursued by the vast majority of retail banks.

Characteristics of products offered cross-border via distance marketing

Banks which do offer retail products via distance marketing, whether cross border or within a particular domestic market, tend do so on specific product markets, mainly savings accounts and credit cards. The reasoning behind this, according to interviews with the industry, is that simple products are the easiest to sell via distance marketing as consumers do not require much advice, compared to more complex point-of-sales products which are most easily concluded with traditional face-to-face contracts. It also appears that products with a large degree of credit risk (e.g. consumer credit) are particularly unsuitable for cross-border sale because banks are unsure whether they will have the means to pursue, if required, normal bad-debt collection activities and recover their loans.

The future of cross-border distance marketing

National banking associations do not foresee any change in the next five years for this market segment; the majority of banking associations (36%) believe that sales of financial service contracts concluded cross-border by their member companies will remain the same if there is no legislative change.[46] Similarly, 29% of banks responding to this question in the survey of companies also agreed that sales in the next 5 years would remain the same (54% answered “Don’t Know”, see Figure 3).

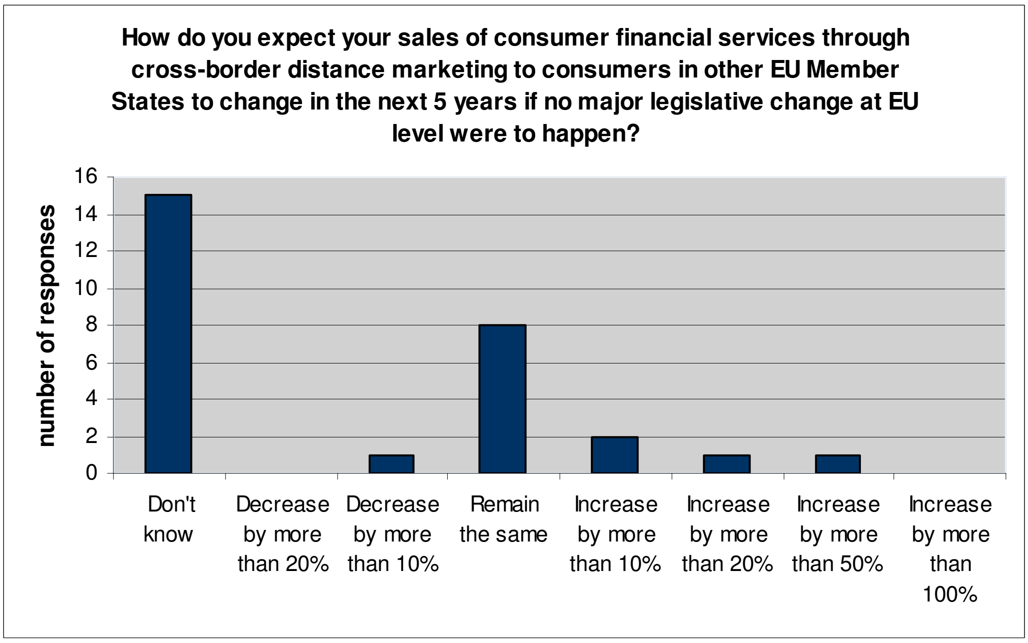
---

[44] 5 indicated they had no members conducting cross-border distance marketing and 5 indicated “Don’t Know”.

[45] Also, it is not entirely clear that associations always understood cross-border distance marketing to mean that the contract was concluded without face-to-face services; a number of responses suggest that cross-border distance marketing may also mean cross-border clients accessing their financial information and servicing transactions via the internet.

[46] 36% of national banking associations responding to the Survey of Associations answered “Don’t know”, 14% of respondents answered “Increase by more than 10%” and 14% of respondents answered “Increase by more than 20%.

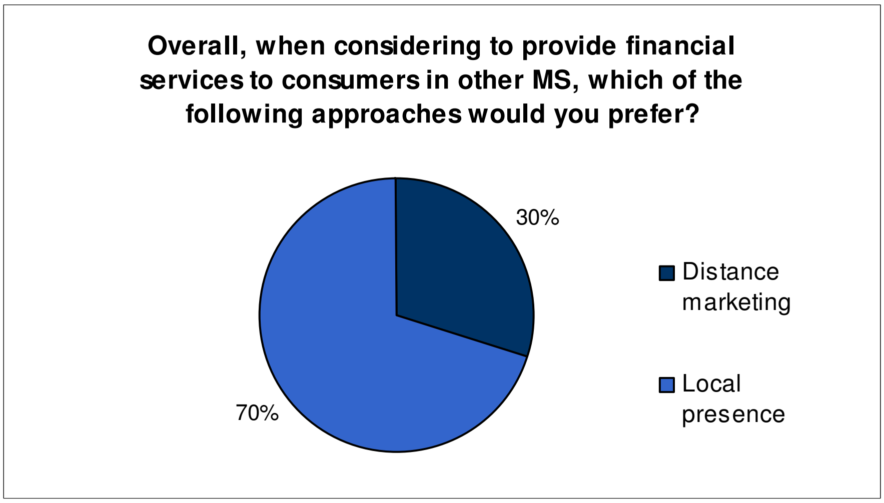
Figure 3: Future change in cross-border distance marketing sales



Source: Survey of Companies (only banking sector responses, N=28)

Several banks responded that future cross-border sales will remain the same regardless of legislative change simply because the market demand is not yet there; one banking association said that the DMD was "ahead of its time" because distance marketing as a primary tool for retail banking sales is not yet a well-established approach of banks, even on national markets. Similarly, a majority of banks (70%) responding to the survey of companies indicated that they would most likely to enter cross-border markets via a local presence (see Figure 4).

Figure 4: Bankers likely approach to entering cross-border markets



Source: Survey of Companies (only banking sector responses, N=30)

These results confirm the Commission's findings in the sector inquiry that banks tend to agree that a widespread branch network remains a critical factor in expansion and accruing significant market share in full service retail banking.[47]

3.2.3 *Case studies on banks*

For this report, five case studies have been conducted in the banking sector; illustrating different approaches to entering cross-border markets and in some cases the use of cross-border distance marketing.

Despite extensive enquiries, we have been able to provide only two case studies of banks operating in the EU currently using distance marketing to provide banking services cross-border from an establishment in one MS to customers in another MS:

- First banking case study: this provides the clearest example of cross-border distance marketing, a bank which uses distance marketing from single internet platforms of credit card and deposit accounts in two EU Member States. It also accepts deposits from consumers in other EU Member States, although is does not actively market to them. This bank has its registered office in the Benelux area. It should be underlined that this company has not participated in the survey but has cooperated with the study through an interview.

- Second banking case study: a traditional Irish bank that provides a credit card cross-border via distance marketing into the UK market, but using the services of a UK based intermediary for marketing and distributing the credit card to its particular target market segment.

One case study bank also used distance marketing to supply banking services to customers in other Member States, but does so out of branches or at least one single physical presence established in each MS with products provided under the law and regulation of that state:

- Third banking case study: a subsidiary of a large Benelux bank (whose parent has an extensive branch network in three MS). This subsidiary is an internet bank with branches in six other MS, each branch using an internet platform to provide savings accounts and other products within each of these markets.

Two further case studies were of banks that provide banking services in other MS but have done so by acquiring a local branch bank (a strategy also pursued by the Irish bank in the second case study for entering other EU Member States):

- Fourth banking case study: a large company located in Northern Europe with a presence in an Eastern European Member State. They are primarily based on traditional branch banking although they operate an online credit card through an intermediary in another Member State.

[47] Commission of the European Communities, *Report on the retail banking sector inquiry, January 2007*, SEC (2007) 106, p. 16.

- Fifth banking case study: a large cross-border company located in the Nordic region. They are operating via subsidiaries or branches in the UK/Ireland regions, Northern Europe and in the New Member States. They do not use distance marketing for cross-border provision of any of their services.

First bank – Benelux

The first bank located in the Benelux region (Luxembourg) is a distance provider of financial service products, operating without any branches; it accepted the first clients in May 2006. The bank actively markets a credit card and a deposit account to consumers in their headquarter MS as well as another large MS (Germany). It also accepts consumers from 5 MS for their deposit accounts (though not for their credit card), without actively marketing their services in these countries. Though the bank is based in Luxembourg, a majority (99.5%) of their at the time of the interview approximately 100,000 customers are located in Germany. This bank offers the same products to consumers in the two MS in which it is active. The bank indicated it is competitive in Germany because it reportedly was the only provider offering a credit card without any fees, even for all purchases outside the home country.

The bank expressed that it offered its credit card for the same price in both MS as they have similar laws regarding interest rates that allow them to do so; however, should it decide to actively enter France, Belgium and the Netherlands for example, the bank would necessarily need to adapt the rates because these countries had different national provisions in place regarding the determination of interest rates. This was not necessarily identified to be a barrier to entry but rather as a cost consideration because this lack of harmonisation requires them to conduct research in each country regarding the legal requirements concerning financial service products.

In the moment, the bank does not offer its credit card to consumers outside of their two countries of operation, because credit cards are a more complicated product than deposit accounts as it requires credit checks and other information; additionally, offering credit cards involves a certain inherent degree of risk for the banks which is more complicated to assess cross-border. The major barrier here is the access to credit databases which are all different at the national level. Even with the new Consumer Credit Directive[48] which will permit access to all public and private credit databases, the bank would still have to deal with different credit agencies in each country meaning they would have to adapt their IT systems to interface with each credit reporting company. Additionally, accepting payments from consumers has traditionally been a barrier as payment systems were not harmonised and the IT system would have to be adapted for each Member State; though the bank recognised that this is likely to improve with SEPA.[49]

Another barrier indicated by the bank, though not recognised to be a prohibitive obstacle to market entry, is the fact that legislation on electronic contracts has not been implemented similarly in each Member State. For example, some countries (such as

[48] The Consumer Credit Directive was adopted by the European Commission in May 2008. OJ L133/66, 22 May 2008.
[49] The interview was conducted before the official start of SEPA on 28 January 2008.

the UK) allow an electronic contract to be a valid substitute for a written contract; however, in Germany consumers need to conclude their contract by mailing in a hard copy.

Generally, the lack of harmonisation of legislation is considered a barrier to the expansion across borders. This bank stated that a significant amount of research is needed when considering whether to expand into a country, which takes time and effort. The bank also stressed that this limits the likelihood to enter a small country; research to enter each Member State is the same, however larger countries have more potential consumers which will diffuse the fixed costs associated with research across a wider number of consumers, thereby lowering the per unit cost of market entry research; whereas in smaller countries the pay-off is less likely to compensate the costs for research as there is a lower number of potential consumers. Additionally, this bank, when thinking to expand, does not consider countries outside the Eurozone because that would require even more additional research.

Second bank – UK/Ireland

An alternative approach to cross-border distance marketing is using an intermediary. This is illustrated by a second bank, an Irish bank involved to a very limited extent in direct cross-border distance marketing; typically the bank has favoured entering cross-border markets either via branches, as it has done in one MS, or via mergers and acquisitions, as in another MS. However, the bank offers one product cross-border via distance selling, although this is done through an intermediary. This bank offers a credit card from Ireland via an intermediary in the UK. Although this bank also has a physical presence in the UK, they choose to go with an intermediary who had a proven track record in providing services of this nature with other providers. When considering direct provision cross-border, this bank asserted that entering a market with a well-known brand name, such as the intermediary they have selected, is of importance because it reduces the high marketing costs. The second advantage of the intermediary approach was the ability to take advantage of their knowledge of the local market as well as their contact with the relevant customer base. The bank representative asserted that this product launch was expensive but that these costs were mostly start-up expenses; should the bank decide to offer another product in the UK, it would expected to be a considerably cheaper venture.

The bank noted the difficulty in determining relevant legislation in cross-border situations. On examination, many pieces of legislation are ambiguous as to their scope in relation to entities which are not authorised within the jurisdiction to which the legislation applies. This is compounded by the lack of clarity and consistency in definitions of entity and institution types, across jurisdictions. While in some instances this can be attributed to the fact that legislation was written before the advent of cross-border activity, the bank also noted that more recent EU legislation can also be deficient in this regard. The bank in question spent significant time and financial resources obtaining legal advice in relation to the above.

In addition to the above of particular concern to this bank from a legislative perspective was the issue of compliance with the Irish Consumer Credit Act 1995. This act contains a section that requires certain charges for financial products to be approved by the public financial authority. While the entire act did not apply to the cross-border activity the wording of the aforementioned section meant that it was applicable. The bank was required to provide the public financial authority with data on their fees and charges and also conducted a significant amount of research of the cross-border market to indicate how the proposed prices compared to those in the host market. This bank stressed that this puts them at a competitive disadvantage as they cannot open their prices to the market pressures without the delay of seeking approval which may or may not be granted. In addition the authority is not familiar with the prices charged in markets outside Ireland.

The bank has also entered cross-border into another European country but has chosen to do so through acquisition rather than distance marketing. This acquisition was a strategic commitment to geographic diversification and a long-term investment in a solid growing economy. The nature of the services that the bank wished to offer in this market which included both money transmission capability and the sales of advice based products, necessitated an on-the-ground physical presence in the country.

A distance marketing approach to this endeavour would have required the creation of a new IT system to support the banking operation while managing the complexity of language and currency differences. An acquisition minimises the impact of such complexity at an operational level.

Third bank – Benelux

This bank is one of six business lines of a larger group, which is also involved in investment banking, commercial banking, and asset management. The internet banking subsidiary operates in six European markets, namely the UK, France, Spain, Italy, Germany and Austria. In all cases it operates via local establishment, so while its business model is based around direct marketing, it does not engage in cross-border selling via distance marketing. It does not operate this business model in Benelux because this would cannibalise their own established customer base; there the bank operates internet and telephone banking as additional channels alongside its branch network.

Their business model is to offer standard banking products (especially savings accounts and mortgages) using a low-cost direct marketing platform and seeking to capture business from incumbent banks pursuing a more traditional branch based strategy.

Products provided are purely country based. Savings products and mortgages are the two main products provided and a similar range of products are provided in each of the countries in which they are present. The entry strategy is always based on savings products. Local demand then dictates additional products provided, e.g. mortgages, mutual funds etc, which are developed on an organic basis. The number and type of products provided is a purely local decision. It is often driven by specific national features, for example in France life insurance has a strong tax advantage and therefore they offer life insurance products; in the UK they offer the cash ISA (a savings account with tax benefits).

The two most important barriers to market entry they have faced have been a) the misuse of dominant positions; and b) state aid. With regard to the misuse of the dominant position, this does not relate to the ease with which one can obtain a license that is guaranteed by EU rules, but rather to the problems posed by the incumbent players in the market. This can include for example barriers of entry into the ATM network, as well as little/no cooperation with the processing of corporate and interbank payments (so for example it can be difficult to fulfil their stated promise of providing access to money within 24 hours). These problems are cited as existing in several of the EU countries in which they operate.

The problem of state aid is illustrated by the case of a MS, where a special savings account benefits from a tax subsidy (officially this subsidy is to help support social housing). Only this MS's banks are allowed to market this account leading in the view of this case study bank to unfair competition between savings account providers. This however is changing and in the near future, all banks should be able to distribute this product. These barriers to entry into new markets do not completely prevent entry to new markets. There is always a way around these problems either, for example through cooperation with smaller players that have access to the ATM network. These barriers add to the costs of their business rather than prevent them entering the larger European markets at all.

Many national rules and regulations exist that prevent the possibility of creating a product and offering it cross-border. According to this bank, the main barriers still preventing cross-border selling can be summarised as follows: a) large and fundamental differences in national laws and regulations, for example differences in the legal requirements for a mortgage or a different process required to complete a contract, or different rules about the crediting of interest to bank accounts; b) heterogeneity in anti-money laundering requirements, requiring quite different processes for account opening; c) different conventions for example about writing addresses which are written in many ways in different countries (e.g. whether the number comes before or after the street); d) differences in language and business culture; e) absence of harmonisation of tax systems -- no two countries have a comparable system.

For their business model it is key to provide customers with a simple and straightforward interface that will not discourage customers. If they meet a problem, for example a language problem, an address that cannot be easily input in a web-dialog, or confusing or unfamiliar instructions in order to confirm their identity, then they are likely to give up entirely and the customer is lost. In order to provide this simplicity, as well as to comply with local tax and other regulations, it is essential to provide each product specifically for each market.

Even apparently small departures from customer expectations can create problems, for example Austrian customers objected strongly to their calls being dealt with by a German overflow call centre, since they were aware from the accent that they were not longer talking with an Austrian employee. Anti-money laundering requirements and customer protection rules can place additional obstacles in the way of direct marketing which do not affect a sales person in a bank branch. Thus in a face-to-face situation it is possible to skip through a long list of questions; but this cannot be done on a website. Then there are additional costs of providing proof of identification, in a face-to-face situation it is easy to compare an identity document such as a passport with an individual, but difficult to do this online (webcams do not count).

Directive 2002/65/EC has had little impact on their business since they did not attempt cross-border distance marketing either before or after the Directive. They are aware that the introduction of the Directive had some impact on domestic rules, but has not eliminated the heterogeneity of rules and practice in different markets that prevent cross-border selling.

Fourth bank – Nordic countries

The business model adopted by the fourth bank is not cross-border product provision, but rather the acquisition of existing banks, either as branches or subsidiaries, that can then be used as a platform for entering new markets. Through subsidiaries, they are able to enter a new market, accessing a larger customer base, while still benefiting from the local knowledge and branding built up by the acquired bank. By acquiring new branches and subsidiaries that are already in existence, this bank is able to side-step several obstacles that are associated with entry to a new market since the acquired bank is already fully established in the market of interest. Around 90% of the banks' business is conducted using the same model whereby a set of homogeneous products are provided across countries. Until 2005, they were active only in Scandinavia; since 2005 however, they have entered new markets, namely Finland, the UK and the Baltic States. At present, more than half of their business is conducted internationally.

There are some barriers when pursuing their business model in new markets. Due to the homogeneity of the products offered across markets, there are very few barriers to pursue the business model outlined above. The majority of business comes from the provision of bundled products (e.g. online banking, credit cards etc.) in each of market. Small legal differences however do exist that need to be overcome in this regard. For example, in the UK, it is not possible to bundle products to be sold on to the consumer, rather, in this case, the products need to be unbundled before they are sold separately. Similarly, in relation to credit card usage, this depends on what is accepted locally, which card provider works etc. Several such national differences exist that need to be considered.

Regarding constraints to accessing new markets in Northern Europe, this bank currently has offices in 3 MS conducting small amounts of business but in which they are not currently pursuing entry with a wide retail model. Entry into these markets is not however restricted by barriers, but are rather limited by their own capacity to develop business further in these countries.

Cost and pricing issues are not relevant in this regard since the bank is not directly delivering cross-border products. Rather, they have developed a business model which is strong in each market in which they have a presence. Despite the homogeneity of products being offered in markets however, pricing is still dependent on local competition. One recent innovation in this regard is the introduction of fee-free banking in Norway and Denmark.

When considering cross-border selling, some collaboration between the Swedish and Danish markets (and even Ireland and Northern Ireland) seems relevant due to the high movement of people between these countries. There may be some necessity in the near future for more flexible account opening opportunities. One major concern however still remains the issue of money laundering, particularly relating to the identification of new customers in a wide branch network. In particular, cross-border identification is a clear obstacle. At present, in Norway, the bank makes use of the post office to identify new customers, while in other markets the branch is used for identification purposes. There is however a need to develop a customer friendly alternative.

All relevant bank products (e.g. deposits, credit cards, mortgages, loans, insurance etc.) are important for business operations. As far as possible, the same products are provided across markets, however there is some need for local collaboration. For example, in the case of insurance, they have no local insurance markets. Few products are tailored to the local market, but bundled products are homogeneous. In essence, where necessary a single product is provided across markets, however for some products there is some need for local solutions. For example, for certain investment products, tax rules may differ from country to country.

Finally, for terms and conditions (e.g. information disclosure, withdrawal rights etc) for products that can go across markets the terms and conditions attached are consistent as far as possible. One exemption might be local regulations placed on product marketing (e.g. price) that may differ from country to country.

Fifth bank – Germany/Austria

This banking group is based in Austria and is additionally active in four Eastern European markets within the EU through local presence established in each of these Member States (MS). They do offer products via distance marketing, though this is also done on a national basis in each market in which they are active. They offer savings accounts, credit cards and consumer loans through their online distribution channel. This bank estimates that their online sales activity is only a very small part of their overall marketing operations. They do not conduct cross-border distance marketing and do not plan to do so.

This bank enters other markets by acquiring local banks, which have the local language skills and the market know-how. They foresee a number of barriers that would hinder their ability to enter cross-border markets via distance marketing; namely two institutional barriers, "National anti-money laundering requirements" and "Difficulties to conclude contracts electronically"; as well as a significant challenge resulting from intrinsic characteristics of the local populations within MS, "Consumer preference for national providers".

Other barriers emphasised by this bank include:

National anti-money laundering requirements. There is a difference between whether it is legally possible and whether it is actually possible to enter cross-border markets via distance marketing. On the one hand, anti-money laundering legislation (AML) results in a relatively cumbersome process for consumers to prove their identity: for example, local officials (such as a postal officer) would need to have a copy of the bank's registration papers and make the copies of the customer's ID card and identify the customer, fill in the registration sheet, perform a cross-check of the documents and send it off. As a result, this procedure is not permitted by their national AML officers because it is not absolutely sure that this identification procedure actually provides proof of identity, despite the fact that this procedure is in line with EU legislation. Although it is legally possible to go cross-border, AML legislation makes it impossible to sell financial service products cross-border.

Difficulties to conclude contracts electronically. The Austrian Banking Act specifies that only a distance contract is valid if a customer signs with an electronic signature. However, the problem here is that only a limited number of people have electronic signatures so this already significantly restricts the consumer base relevant for direct selling of consumer financial services. If a consumer does not have an electronic signature, they are able to fill in the contract and send it by post with a copy of their ID card/passport, etc. This however, does not encourage large numbers of direct customers, because this is not necessarily easier than going to the local bank. Additionally, this might be even less possible in other countries where there is even less take-up of electronic signatures within the population.

Furthermore, certain consumer products simply require a written signature such as opening a current account or a consumer mortgage loan under the Austrian Banking Act. This is for security reasons and consumer protection laws aiming to ensure that all consumers have received the relevant advice and documents, and that the consumers demonstrate an understanding of the financial service product. This is a considerable amount of information that cannot be provided over a distance means and therefore must be delivered in person. As a final example, high consumer protection laws make it difficult for married couples to conclude contracts online for certain services because the law requires the presence and identification of both parties involved.

Consumer preference for national providers. This is not so much a barrier as it is “just a fact”. Consumers prefer having a bank on the corner (regardless if they are a national provider or a local provider with a foreign ownership). This has to do with factors including the following: (1) Language: even in Austria, language is important to their customers and even regional accents are unwelcome to Austrian consumers; and (2) Consumer redress: consumers are uncomfortable that they are not sure what happens if there is a problem nor do not know which courts or consumer organisations would be available to them nor whether they could solve any problems in their own language. Even performing the research on this is a natural barrier for the consumers when deciding between a foreign or local provider.

Their strategy of acquiring local banks avoids some significant and expensive problems that would be experienced by banks attempting to enter cross-border markets without the assistance of a local institution (either via establishment or direct marketing) such as technical changes to IT systems, translating texts into the local language and translating the laws into the native language of the bank experts, implementing legal differences into the bank’s business strategy and approach, different consumer demand and the handling/consumer centres (also related to language).

This case study bank expressed that Directive 2002/65/EC has had no significant impact on their operations. For the future of their expansion activities, their approach will always be with local presence. They claim this has successfully been their approach in the past and how they expect their business to remain successful. Although they expect direct sales of financial service products to develop perhaps 1%

to 5% in the future (because of increasing online security technology and acceptance/awareness of distance cross-border marketing), direct sales are currently only "minor for business sectors" and will likely remain that way (due to the natural barriers mentioned above, such as that consumers will always prefer the banker around the corner). Their distance channels serve simply to compliment their branch network.

Overall assessment of banking case studies

<u>Barriers to cross-border market entry:</u> Many of the banks were clear to differentiate between legislative barriers and barriers that reflect intrinsic differences between EU MS, such as language and business culture. The most significant barriers were related to: complications to conclude distance contracts at all (due primarily to anti-money laundering legislation as well as requirements for a high level of advice and consultation to be given on more complicated products which is difficult to provide via distance channels); language differences; consumers' preference for local providers or a physical establishment; large and significant differences in national legislation, for instance on electronic contracts, determination of interest rates, requirements for a mortgage etc. A few banks insisted these barriers were extremely prohibitive and therefore, direct cross-border provision of financial services was simply, in practice, an impossible business strategy. However, many banks considered that these barriers were not impossible to overcome, only that they were restrictive and implied a significant cost factor which may or may not impact their desire to pursue a business strategy of direct cross-border market entry. All banks considered that the barriers prohibited any kind of pan-European platform and that, at the moment, these barriers did not make it appealing to enter many EU Member States with this strategy.

<u>Strategies to overcome barriers:</u> The case study banks with cross-border business operations had a number of different approaches to overcome the barriers. The only bank case study with strictly direct cross-border market activity was able to do so by offering a limited number of relatively simple products. Another bank attempted to enter markets via direct cross-border provision of a single product, rather than as a systematic bank entry, but has done so via a partnership with a local provider (intermediary) to avoid a number of the barriers. An online bank entered cross-border MS with at least one physical establishment with a limited number of staff members and then operated a strictly online platform while trying to centralise as much of their European back-office operations as possible. Other case study banks are traditional banks that have entered cross-border markets via branches or mergers and acquisitions in order to have a physical establishment and offer their products through this channel.

<u>Variation in prices, terms and conditions and range of products offered:</u> Regardless of the case study banks' approaches, all companies perceive that is very difficult to overcome and circumvent all local requirements coming from the structure of the market and the specific legal requirements or practices impacting product definition and prices. As such, even standard products offered by the banks in each of their different MS operations varied significantly in the terms and conditions as well as the products themselves differed (as far as product add-ons, withholding taxes, etc.). Products rates/prices were always priced to compete within the economic conditions of the local market and always varied; many banks insisted they were not comparable.

The range of products was in all cases of distance marketing, severely restricted to simple products at least at the time of market entry. Only the traditional banks with a physical presence could offer more complex products.

Costs: Many of these banks specified that a majority of the barriers they experienced did imply significant financial impacts on their business activity when entering cross-border markets (either direct or via establishment) but they specified that a majority of the financial consequences of the barriers impacted primarily implementation costs rather than on-going costs. Banks specified that these high implementation costs from cross-border market entry could, in some cases, be prohibitively high impacting:

- Their ability to enter certain markets as the implementation costs would need to be passed onto consumers in order to make a profit, thereby prohibiting their ability to effectively compete with the local competition; and

- Their desire to enter certain MS markets that are not large or technologically advanced enough; as such, these MS do not have a sufficiently large consumer base to compensate for the implementation costs necessary to enter these markets.

However, it is very difficult to measure implementation or on-going costs resulting from these barriers as most companies were reluctant to provide any information on cost related issues. There was a general consensus from the banks that online companies were more strategically positioned to enter cross-border markets economically (as opposed to via establishment) because of their specific business models, which are centralised and built on a uniform IT platform. Such a model allows economies of scale and lower processing costs. Establishment banks emphasised, on the other hand, that their success was traditionally derived from their physical presence and their expansion into cross-border markets would follow this strategy.

Overall assessment of the impact of the DMD on the banking case studies

Impact of the DMD: No banks were able to identify any significant impact from the DMD. Even the online banks expressed that this Directive is not relevant for their business activity and when considering to enter cross-border markets via direct distribution channels, this Directive is not influential in their decision nor has there been a difference since before the Directive was implemented. Obviously, for banks that prefer the establishment approach, they have not been affected by the DMD; however, one bank did specify that the pre-contractual information needed to be changed for contracts concluded via direct channels, this information now differs from the pre-contractual information they provide for the same product purchased in a branch. In fact, several traditional banks did note that as a result of the DMD they supply information required by all relevant legislation (to include both distance contracts and contracts concluded in banks) potentially resulting in information overload for consumers. It was recognised that any kind of harmonisation of national legislation is a necessary step towards integration of the financial internal market and to this end, the DMD has been welcome; however according to their view the DMD did not go far enough to eliminate the heterogeneity of national legislation among EU Member States.

3.3 Insurance sector

3.3.1 Overview of distance marketing of consumer financial services in the EU

Size of the distance marketing of insurance in the EU

The market size of distance marketing of insurance products and services seems difficult to measure as there are no regular, systematic and standardised EU-level statistics issued on the proportion of sales coming from distance marketing.

However, the literature and the data collected through the survey and the interviews reveal that the conclusion of insurance contracts via distance marketing in the 27 EU Member States is still not widespread among consumers and that insurance companies have not yet taken full advantage of distance distribution channels even within domestic markets. This is illustrated by the fact that in the year 2000, insurance transactions via the internet were amounting to merely 0.02% of total European premiums.[50] On the other hand, in 2005, more than a quarter of surveyed consumers in the EU (26%) answered in a Eurobarometer survey that they had purchased financial services by distance in their country,[51] indicating a growing acceptance of this marketing channel. To update the figures on the “extent of national distance selling in the insurance field”, both national federations and insurance companies were asked in the framework of this study to provide:

- Their total sales or members’ total sales of consumer financial services by means of distance marketing in 2006 at a national level;
- The percentage of the total business income represented by distance marketing at a national level.

While considering the figures provided by both stakeholders, it must be noted that, in general, they are “pure” illustrative estimations. It also should be underlined that:

- Two associations noted that they do not have members providing distance marketing of insurance products at national level (i.e. Denmark and Luxembourg);
- Insurance Federations of Ireland, Malta and Slovakia did not feel able to participate in the survey due to data unavailability.

The table below refers to the results of the survey of associations for the “income generated by distance marketing at national level”. Based on the inputs of 10 associations, distance marketing income represented 57.6 billion Euro in 2006. According to national associations’ estimates, distance marketing accounts for only 1.8% of their members’ total premium income.

---

[50] Swiss Re (2000b), *The impact of e-business on the insurance industry: Pressure to adapt - chance to reinvent*, sigma No. 5/2000.

[51] Eurobarometer 230 (2005), *Public Opinion in Europe on Financial Services.*

Table 6: Income from distance marketing national and/or cross-border (2006)

Number of insurance companies represented	Total premium income	Distance marketing share of total premium income (median)
1157	57.6 billion Euro	1.8%

Source: Survey of Associations (only insurance sector responses, N=10 2nd column, N=11 3rd column)

If we look more in-depth at the share of distance marketing compared to total premium income, we can see that distance selling amounts to less than 5% except in Sweden, Estonia and UK (see Table 7 below). For UK and Sweden, this could be correlated to the fact that in both countries consumers conduct online shopping at a higher rate than the European average.[52] Except for Estonia, the other new Member States responding to the survey do have weak income from distance marketing. This may due to low level of financial awareness of consumers and to low maturity level of the market. As said by one association: "In our view the 'organic' development of a market cannot be replaced by legislative acts at EU-level. The consumers in the New Member States still need time for adapting themselves to the relatively new circumstances".

A CEA report states, as also concluded by Cyprus' response to the Survey of Association, that telephone sales are increasing but are not a dynamic distribution source while internet sales remain low.[53] Although the Spanish Association did not respond to the Survey of Associations, the CEA report indicates that for motor insurance, electronic commerce amounts to 1.57% of the total motor insurance premium, while telephone sales represent 14.9%.[54]

It shall be noted that Austria, Belgium, and Greece were not able to estimate this percentage. However, these associations provided the following comments:

The Belgian insurance association said that "a fair share of the Belgian insurance market is offered to customers through direct marketing…Websites, emails, telephone and letters are important sales instruments for direct insurers…It is worth noticing that insurance companies with other distribution strategies have found distance marketing to be helpful as well…to support local brokers for example, thereby centralising specific activities and reducing costs".

On the contrary, the Austrian Insurance Association emphasized that despite increasing popularity of online retail banking, online insurance products have not experienced a similar significant increase in provision. This statement is confirmed by the CEA report on 'The European motor insurance market" where it is explicitly mentioned that in Austria the "share of distribution via the internet or the telephone is negligible".[55]

---

[52] Extract from New Media Review (February 2008) available at:
http://www.etcnewmedia.com/review/default.asp?SectionID=10&CountryID=50

[53] CEA (2007), *The European Motor Insurance Market*, CEA Statistics N°32, p. 58.

[54] CEA (2007), *The European Motor Insurance Market*, CEA Statistics N°32, p. 71.

[55] CEA (2007), *The European Motor Insurance Market*, CEA Statistics N°32, p. 49.

The Greek Federation simply commented that distance marketing is at an initial stage in their country.

Table 7: Market share of distance marketing at national level (in % of total premium income)

Countries	% of market share generated by distance selling
Hungary, Italy, Poland, Portugal, Slovenia	Less than 1%
Cyprus	Less than 2%
France	2%
Czech Republic	Less than 5%
Sweden	8%
Estonia	25%
UK	45%

Source: Survey of Associations (only insurance sector responses, N=16). Associations from Austria, Denmark, Finland, Germany and Greece did not provide estimates.

When comparing data received from associations and from companies, we can see that, based on inputs from 12 companies, we get a total premium income for distance marketing at a national and/or cross-border level of 122.8 million Euro. This represents a median of 1.5% of companies' total premium income; it should be underlined that this encompasses 2 companies that declared they received 95% or more of its premium income by distance marketing.

Even if insurance premiums written directly by distance are still low with the exception of the UK, Germany and Spain[56], distance marketing is currently expanding and will continue to do so as confirmed by the insurance associations. For example, the Association of Hungarian Insurance Companies commented that "even if market share of distance selling was rather low in 2006, this does not reflect anymore the current situation as several insurance companies started internet-selling in 2007, notably in the motor third-party liability system which is considered as a propulsive business line".

Reasons underlying the future growth of distance selling are notably:

- An increasing demand from consumers (market-driven process). The propensity to use the internet depends much on "generations" and will only slowly expand owing to demographic factors. In fact, elderly customers change their established habits of purchasing financial products to a far lesser extent than the "internet generation";

[56] Extract from Zurich website: http://www.zurich.com/main/mediarelations/mediareleases/2007/english/2007_0821_01_article.htm

- The development of new electronic technologies that will significantly facilitate more reliable electronic signatures.[57]

Main characteristics of distance marketing

For providing the characteristics of the distance marketing for insurance products at the EU level, we consider:

- The distribution channel mostly used by insurance companies when conducting distance marketing;

- The types of products or services that are most relevant for companies to offer by distance marketing.

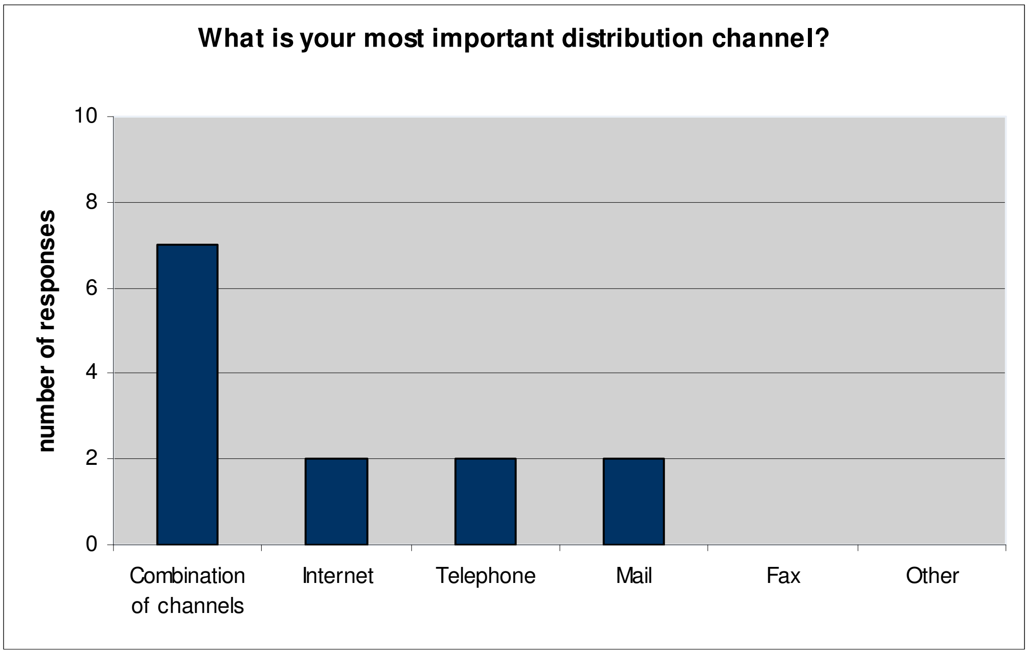
Inputs come mainly from the companies' surveys and exploratory interviews.

Distribution channel most used

For presenting this item, we firstly refer to survey results of insurance companies (see Figure 5 below). Of the 13 companies responding to this question, the most important distribution channel is combination of channels according to 7 respondents (i.e. a mix between internet, phone, e-mail and postal mail). Pure online distance marketing has been indicated by 2 companies, 2 companies indicated they used most often telephone distribution, and 2 insurance companies indicated that they find mail to be their most important distribution channel. These results have also been confirmed by the interviews conducted.[58]

[57] It seems that signing contracts on the internet remains a practical problem because neither companies nor customers are used to it.
[58] Exploratory interviews were conducted with 7 insurance companies and 2 insurance federations.

Figure 5: Distribution channel most used to offer services through distance marketing



Source: Survey of Companies (only insurance sector responses, N=13)

The internet distribution channel is mostly used for marketing purposes through the website, or to provide additional product information (e.g. by email). The conclusion of the contract as such is rarely done online as contractual information is most often sent by postal mail (e.g. signature of the contract needed, sending of written information imposed by the law to consumers, and other administrative requirements such as a copy of identity card, etc.). One company stated that in 50% of the purchases which begin on the internet, the transactions end through a phone conversation during which payments details are addressed and more specific questions are raised by the consumers to know for example when exactly their insurance cover is starting. It seems as such that telephone, fax and post remain the more conventional means of distance marketing of financial services even if combined with an online channel.

Type of products most often offered by distance

For this question, insurance service providers were asked to assess the two most relevant insurance products offered by distance marketing (Figure 6 below shows how companies have ranked 3 different insurance products. Overall, the most often mentioned products were (by descending order):

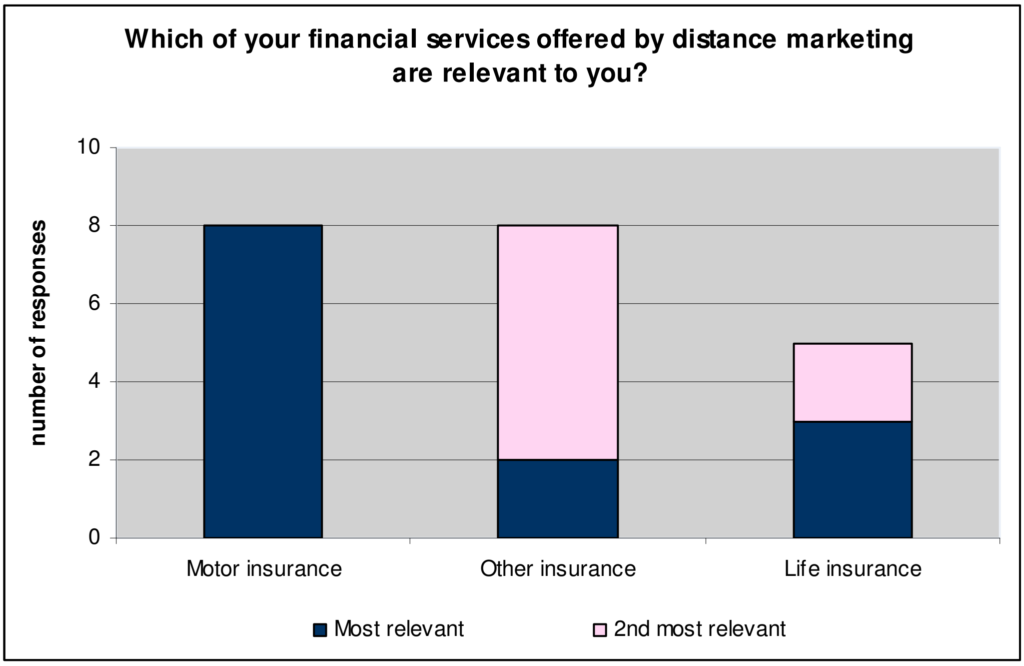
- Motor insurance (N=8);
- Other insurance products, primarily home properties, healthcare, travel, etc. (N=8); and
- Life insurance (N=5).

The suitability of insurance products for internet distribution varies, depending mainly on how much individual advice is needed by the consumer. Products requiring little information are therefore better suited for internet distribution than products requiring much information. This is confirmed in this case by data collected through the survey and through interviews. As such, home properties and motor insurance appear to be more widespread products offered through distance marketing because:

- They are quite simple to understand and their characteristics are easy to provide by distance;

- They are considered to be products asked for by clients and not driven by sellers (pull products) – this is the case for motor insurance in Italy, or homeowner insurance in UK.

Figure 6: First and second most relevant insurance products for distance marketing



Source: Survey of Companies (only insurance sector responses, N=13)

3.3.2 *Extent of distance marketing of consumer financial services cross-border*

Size of distance marketing of insurance cross-border

The EU retail insurance market remains relatively national regardless of the distribution channels used. Cross-border trade is therefore still rather limited and the instances in which European consumers shop and chose the best insurance contract based on a pan-European comparison are extremely rare. Figures from CEA indicate that cross-border transactions throughout EU generally vary between 0.001% of the total turnover of some national markets to 1 - 2% for others.[59]

The Eurobarometer demonstrates that there is, at present, virtually no appetite amongst consumers to shop cross-border for financial services. 94% of consumers in Europe have not even considered taking out an insurance policy in another EU Member State, while only 3% have indicated that taking those products in another MS has been an option.[60]

If we consider in particular the sales through cross-border distance marketing, they are obviously more limited than cross-border sales or even nonexistent as they rarely exceed a few percentage points of annual premium income. This is confirmed by the feedback from insurance associations and companies through the survey.

Feedback from national insurance associations

According to 16 insurance associations participating in the survey, 7 declare that cross-border distance marketing of insurance products is non-existent (i.e. Cyprus, Czech Republic, Denmark, Estonia, Hungary, Poland, and Portugal).

Austria, Germany, Greece and Italy were not able to assess this market. Nevertheless the German Insurance Federation did comment that the size of cross-border distance marketing is very small.

Lastly, France, Slovenia and UK mentioned that such activity amounts to less than 0.1% of the total premium income of their members in 2006. In France, for example, the figure provided by FFSA is confirmed by literature: The income of insurance companies brought by freedom of establishment amounts to 2%.[61]

Feedback from Insurance companies:

Of the 13 companies that offer their products via distance marketing on their national markets, only 2 also operate on a cross-border basis and for both of them, income generated amounts to less than 0.1% of their total premium income. For illustrative purposes, Table 8 indicates which insurance companies are conducting cross-border distance marketing, for which products, and their comments.

[59] Comité Européen des Assurances “position on the Green Paper on Retail Financial Services” 2007.

[60] Eurobarometer 254 / Wave 65.1 (2006), *Internal Market: Opinions and experiences of Citizens in EU-25*

[61] Extract from federation française des sociétés d’assurance – 24 mars 2006 – l’évolution du droit de l’assurance dans sa relation avec le droit commun français et européen) – Intervention de Gérard de La Martinière, président de la FFSA).

Table 8: Products/services sold by distance marketing in other EU-level MS

	Type of products distributed abroad	Comments raised by respondents
Delta Lloyd Life	Life insurance	Insurance for foreign residents from neighbour countries, available upon direct demand from consumers (no proactive marketing)
If Skadeförsäkring AB	Motor insurance and other insurance	Insurance for foreign residents where the risk insured is located in Sweden. Risks not located in Sweden are not marketed or insured cross-border by distance

Source: Survey of Companies (only insurance sector responses)

The lack of cross-border sales via distance marketing is not specific only to the insurance sector; local establishment has been identified as the dominant channel for market entry and integration in the context of the EU retail financial market. In fact the insurance sector is characterised by large companies operating primarily on a EU-wide basis through subsidiaries though some branch activity also takes place; free provision of services (FPS) without a physical presence is rare.[62]

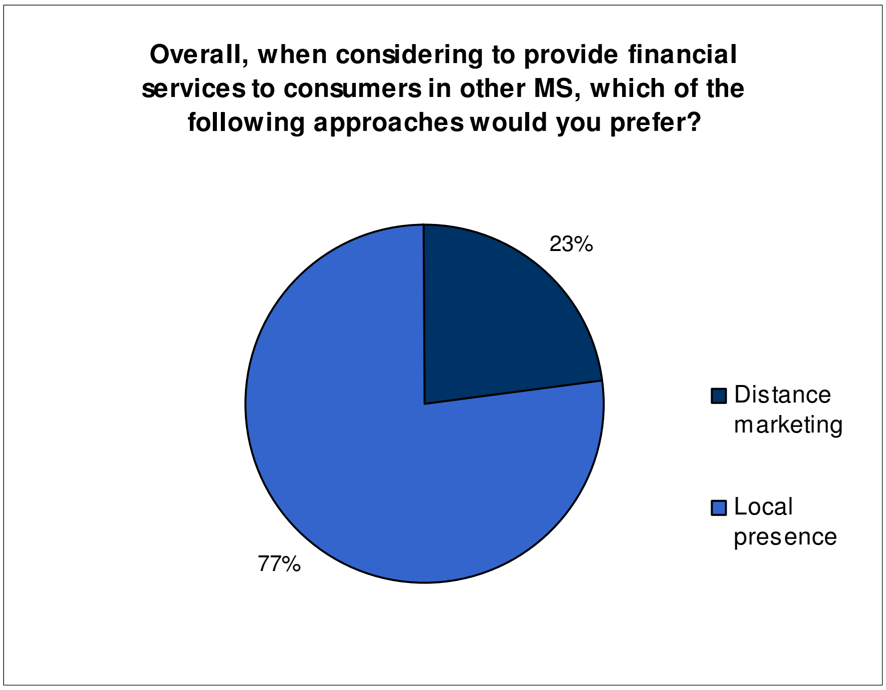
Mergers and acquisitions are perceived as the most effective way to expand market share in saturated markets or acquire market share in foreign markets. This is especially true in the retail insurance market where proximity to the consumer and an established reputation are important factors for acquisition of new customers. In the period between 1999 and 2006, cross-border M&A in the insurance industry accounted for 30% of the value of all M&A, while for banks this was 11%.[63] As such European insurance is mainly organised in a multi-domestic market structure.

When asked whether insurance companies planned to expand their activities of distance marketing abroad, 23 respondents (77%) clearly stated that they have no such intention and if they had, it would be more through local branches (local presence/establishment) rather than by distance marketing (see figure below).

[62] CEIOPS (2007), *Report on Financial Conditions and Financial Stability in the European Insurance and Occupational Pension Fund Sector 2006-2007 (Risk Update)*, Frankfurt am Main, p. 17.

[63] Commission of the European Communities, *Commission Staff Working Document: European Financial Integration Report 2007*, SEC (2007) 1696.

Figure 7: Approach preferred to offer insurance products in another MS



Source: Survey of Companies (only insurance sector responses, N=26)

Mains reasons underlying such business strategies or positions are:

- The preference of insurers to be established close to their customers in order to accurately assess the risks involved and to provide post-sales services such as claims handling;
- The insurers' willingness to firstly strengthen their activity and their position through distance marketing on their national market before expanding abroad;
- The relative significant degree of competition: it seems that insurance companies deciding to sell cross-border have to cope with considerable competitive disadvantages compared to local service providers.[64]
- The different sociological contexts that characterise the markets; and
- The necessary resources required for developing free provision of services due to specificities of national legal contexts and laws governing insurance contracts.

[64] According to CEA, the number of companies that do sell retail insurance products or services varies to several hundreds on the large European insurance markets (extract from CEA report on the European retail insurance market – 2004).

The last two reasons (i.e. sociological context and specificities of national legal contexts) are particularly important and are further explained in the section related to barriers to cross-border distance marketing (see section 4).

Characteristics of the supply of insurance products and services through cross-border marketing

In order to assess whether "cross-border distance marketing" contributes to a Pan-European insurance market, it is necessary to consider the convergence of insurance product types and prices as well as the geographical distribution of these products.

<u>Convergence of insurance products characteristics and prices offered by cross-border distance marketing</u>

The comparison of insurance products' characteristics and prices offered in the various European markets is difficult as little data are available. However it seems that there is no real standardisation of such products and that insurers have to adapt their offer accordingly to the structure of the market. Indeed, the conditions linked to the products must be in accordance with local regulations and traditions which may require changes in the terms and coverage of the insurance (e.g. the motor liability package offer in a given country can include specific guarantees that do not exist in neighbouring markets; the no-claims bonus system is calculated differently from one country to another, even from one region to another; natural catastrophes can be excluded from coverage of household insurance or not).

Pricing of products is also dependent on some factors or elements, which vary substantially from one country to another and even from one region to another. Insurers set premiums according to their analysis of the likelihood that the policyholder will make a claim and the probable cost of such claims. The premium level is also affected by different national taxes, levies and other country-specific legislation.

Considering specifically motor insurance, there are large disparities among and within countries in the liability premiums. Reasons are that premiums reflect:

1) The risk exposure level: in the motor insurance field there are no homogenous collectives and individual risks differ considerably according to driver habits, climate, road safety, traffic conditions, number of accidents, frequency of claims, etc.;

2) The indemnity level that refers to the average level of claims (price of repair, medical costs, etc.);

3) The different national taxes (which vary from 0% in most new MS to over 55% on the premium price in a Nordic country); and

4) The national insurance related legislation: the content of motor third party liability insurance policies is defined by the legislation of the country of registration of the vehicle. The policies of EU Member States provide different amounts of cover: some provide an unlimited cover, some apply the no-fault

compensation scheme,[65] others apply the rule of the vulnerable road user which goes beyond the common general liability rules and increases the cost born by insurers, etc.

All these specificities explain why the companies operating cross-border often have different websites for presenting their different range of products (in terms of prices and characteristics). The following expression, issued by one insurance association in the survey, illustrates the convergence level of prices and products and then indirectly the market integration level: "Range, prices and conditions follow one guiding principle: 'insurance business is local business'".

<u>Countries in which cross-border distance marketing is carried out</u>

No statistics were found on the geographical distribution of insurance products sold by cross-border distance marketing. However, limited results were obtained from the surveys circulated for the purposes of this study; as discussed before, only 2 insurance companies have indicated that they conduct cross-border distance marketing. Both of them distribute their products in selected MS to foreign residents living in the country where they are established. This as such is not really pure "cross-border distance marketing". Even so, it seems that companies that expand their distance marketing abroad choose specific EU Member States (e.g. Spain, Germany, Italy, France or UK) either because:

- They have good internet market penetration (in terms of consumers habits); or
- They have a tradition of direct insurance or at least the markets are mature enough for direct distance selling.

Based on the evidence presented above, it seems that it is very difficult to offer a pan-European product in the insurance field as companies have to tailor them to the specific market where they plan to distribute it.

3.3.3 Case studies on insurance companies

For this report, seven case studies have been conducted in the insurance sector; illustrating different approaches to entering cross-border markets and in some cases the use of cross-border distance marketing.

Despite extensive enquiries, we have been able to provide only two case studies of insurance companies operating in the EU currently using distance marketing to provide retail insurance service products cross-border from an establishment in one MS to customers in another MS:

- First insurance case study: this provides the clearest example of cross-border distance marketing, a strictly online insurance provider which uses distance

[65] This scheme requires drivers to carry insurance for their own protection and limits their ability to sue other drivers for damages. In an accident under a no-fault system, the insurance company pay for the damages up to the policy limits, no matter who was at fault for the accident. This means that other drivers involved in the accident are covered by their own automobile insurance policies.

marketing through cross-border distance marketing. This insurance company has its registered office in the Netherlands and operates in other parts of Western Europe. It should be underlined that this company has not participated in the survey but has cooperated with the study through an interview.

- Second insurance case study: an Irish insurance provider which primarily operates via distance marketing but also uses other traditional approaches, mainly brokers. When operating cross-border they do so with distance marketing but also through a branch network.

The following five case studies of insurance providers all use distance marketing; however, they have expanded their business activity to customers in other Member States with a local presence either via branches, acquiring local insurance companies, or through partnerships with local players:

- Third insurance case study: a large, multi-national Austrian company operating with a combination of brokers, bank insurance and distance marketing. They are present mainly in Central and Eastern Europe but also operate in Western Europe mainly through the acquisition of national insurance companies and partnerships with other financial institutions.

- Fourth insurance case study: a small to medium sized company operating only with distance marketing in Belgium. They have entered a neighbouring country via partnerships with local players and have plans to expand to another country.

- Fifth insurance case study: a large multinational company based in Germany operating with brokers, affinity groups as well as distance marketing. They have entered other markets via mergers and acquisitions.

- Sixth insurance case study: a large multinational company based in Hungary operating through banks, brokers, independent and tied agents as well as distance marketing. They have entered Central and Eastern European markets via establishment, acquisition of national companies and partnerships with financial institutions.

- Seventh insurance case study: a large company based in Sweden operating with banks, partnerships with car dealers and other companies as well as distance marketing. They have expanded throughout the Nordic and Baltic countries as well as Russia via branches and partnerships with a limited number of cross-border distance marketing customers.

First insurance company – Benelux

This company launched its activities in 1996 have since then carried out their activities by distance selling (internet), while focusing on a pan-European approach.

They began expanding their activities first in Germany (in 1999) through the freedom to provide services set up by the third non-life insurance Directive. This principle is at the basis of their whole EU-activities as the company has been able to operate on a cross-border basis without intermediaries and under the supervision of a unique authority (home country). They are currently present in other countries such as France, UK and Spain via distance marketing, even though in the UK they operate through a joint venture with a British partner (products are offered under a separate brand).

Their business model is entirely based upon “online marketing and selling” and they operate on a uniform standard interface. More specifically, the core competence of the company is the design and the structuring of products. This includes full transactions from selecting the type of cover, to policy insurance and premiums payment. This business model is effective even at a cross-border level as 100% of their total sales income is brought by distance marketing.

The core product of this online supplier is motor insurance (due to the large size of the product market as motor insurance is the largest sector in non-life insurance business), which is distributed online in the five mentioned countries. They also offer other insurance products in France such as home insurance, travel insurance, real personal line, and health insurance.

The impact of the Directive 2002/65/EC has been, and continues to be, rather limited on the company’s business activity. Although the company indicated that the Directive may have slightly facilitated their activities by providing a legal framework the more obvious beneficial impact has resulted from the third non-life insurance Directive, as discussed above.

The main problem to operate by distance marketing is the fact that each market is different and has a different level of complexity and the various interpretations of the applicable law implemented by the MS (e.g. concerning internet selling, freedom to provide services). However, to address the differing structure of each market, the company works with local partners (e.g. national insurance associations, research market companies, etc.) in order to correctly survey and know the insurance market and this has proved to be efficient from a cost perspective and from a customer perspective.

Second insurance company – UK/Ireland

This company, operating both in business and retail insurance, was created in 1996 in the Republic of Ireland. It began by offering financial services to consumers by distance marketing and, in 2006, 55% of their retail activities income was by means of distance marketing.

They also operate in two other EU countries/regions (i.e. Northern Ireland and UK) by distance marketing respectively since 1996 and 2003. The products offered in these cross border markets are motor insurance (UK and Northern Ireland) and home insurance (Northern Ireland). They also sell, via the traditional channel and distance marketing, health insurance in the Republic of Ireland, which is a new product line, resulting from an acquisition of another company. This product will not be developed elsewhere due to specificities of the market (health insurance are community rated in Ireland, which means that everyone pays the same insurance premium level. In the UK, this insurance product is not so common as less than 10% of population takes health insurance and is considered as risk insurance).

Due to a different market structure, the company adapts its distribution channel to each country and uses mostly telephone in Ireland and Northern Ireland, and internet in the UK. In Ireland, internet usage and broadband connections are less frequent as in the UK. Additionally, there are less than 10 insurance companies selling motor insurance in Ireland, which makes it easy to compare offers and give a call, reducing the need for the internet. In the UK, this is different due to the fact there are many players on the market, and that the company is not yet widely known. It has only started operating in the UK since the end of 2003 and currently has a market share of less than 1% (as opposed to 20% in North Ireland). As a newcomer, the company has no brand recognition yet in the UK although it advertises mainly through aggregators, who offer comparison services to customers. Aggregators themselves advertise through television or other direct channels. Therefore, in the UK, initial contact is mainly done over the internet. There is no requirement for further phone contact, though some customers do take advantage of this distribution channel as well.

For the company, the main barriers to access other markets are 1) brand advertising and the difficulty to make customers aware of the existence of the products; 2) the different market characteristics and claims assessment; and 3) differences in language and culture which are a significant disincentive. Regarding regulation, no real barriers are perceived. Because of the above described barriers, the company justifies its expansion strategy in the UK and Northern Ireland because of the similarity of the markets (e.g. products in the UK are 90% identical and the brand is the same while Northern Ireland is completely assimilated to the Irish market). As a matter of fact, language, terms and conditions and policies offered are almost the same due to the fact that under Irish and UK law a very similar level of cover is required. Slight differences may come from payment plans through instalments and from claim costs (i.e. claim costs are higher in Ireland due to higher personal injury awards whereas claims frequency is higher in the UK due to higher density of population and cars). This latter issue has repercussions on the prices charged to the consumers.

Lastly, they operated under the freedom to provide services well before the implementation of the DMD and preferred this approach as they were able to develop a business model based on cost efficiency (IT systems and development costs are considered to be not substantial, and operational/administrative costs are similar when doing distance marketing cross-border or within the national market).

Third insurance company – Germany/Austria

The third company is a holding group that was founded in 1999 through the merger of two national insurance companies. The company is a composite insurer that sells non-life products (i.e. property and casualty insurance and health insurance) and life insurance products.[66] It offers its products and services through own employees, brokers, banks and direct sales. This latter channel (i.e. distance marketing) is in the hands of a specific holding company operating only on national market and concentrating on the selling of accident, life and health insurance.

The company is active in about 15 countries from Central and Eastern Europe and also in some Western European countries (Italy, Germany, Switzerland and Liechtenstein). Local presence has been considered by the holding group as more appropriate to enter those cross-border markets, either by buying national companies or through partnerships with other players in the financial services field. However there is an exception to this approach as they sell some life insurance products on the German market through distance marketing by the intermediary of another subsidiary company of the holding group. The distance selling has in this case been possible as the German market is more easily accessible due to the use of same language (this facilitates procedures and allows better understanding of the market) and because distance marketing involves less infrastructure and administration when business is conducted in the same language.

However the selling of life insurance products by distance in Germany is facing some critical challenges due to the new German insurance contract law applicable since the beginning of 2008. These changes in the German legal framework mean that the company has to face significant adjustments and challenges regarding their terms and conditions but also their IT infrastructure, workflows, etc.

In fact, the lack of appropriate EU legislation leading to some convergence or harmonisation in the national insurance contract law has been underlined by the company as a severe barrier to cross border activities. The fact that insurance contract law is regulated differently and often quite heavily in each MS; as a consequence, products have to be adapted and reshaped to national rules and policies, which is a considerable burden requiring permanent counselling and legal screening by companies.

The differences in language are also perceived as an important obstacle. To enter other markets, it seems more efficient to the company to establish some form a permanent presence (through local staff) in the country of activity. This helps to translate and get an in-depth knowledge of the market from a legal and economic perspective.

The attitude of consumers towards distance marketing is another important obstacle as there is a need to build a structure bringing high level of confidence of consumers. The company considers that gaining trust through email or internet is significantly more difficult to achieve than by personal contact and the provision of advice with brokers or tied agents.

[66] 32% of their national market share and 41% of their global market share (including EU countries and other countries) comes from life insurance products.

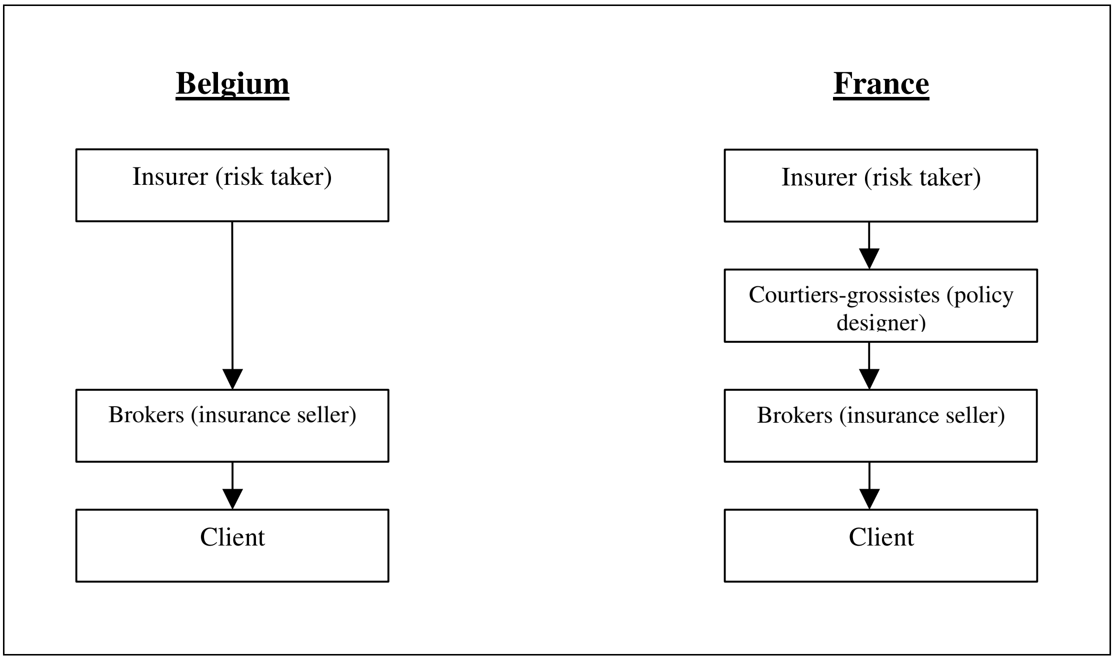
Finally, establishing a strong brand on external markets simply through advertising alone does not guarantee success and is extremely expensive. To increase the visibility of the company, some partnerships with other companies or with brokers are considered necessary to attract customers and enter into sales processes.

Fourth insurance company – Benelux

This fourth company, founded about 75 years ago, worked first as a broker company. Main products sold are car insurance and insurance for funeral expenses. The company also offers other insurance products to existing customers such as civil liability and hospitalisation. It started direct marketing operations in the early 70s and is fully distant marketing since about 15 years ago. Of car insurance sales, 20% is done over the internet and the other 80% is through direct mail or phone.

The company is operating in Luxembourg and will, in the coming future, start to set up non-life insurance (i.e. only car insurance) in France. In their experience, the main barriers to direct provision of cross-border insurance products relates to the differing legal environments, consequently resulting in a lack of standardisation of operations and, more significantly, resulting in a lack of knowledge of the structure and habits of the market and the repercussions it may have on the company's distribution model. As an example, when the company screened the French insurance market, they learned about the intervention of an additional intermediary (i.e. Courtiers-grossistes (policy designer)) which differs from the typical market structure in Belgium as illustrated in the following scheme:

Figure 8: Insurance companies' distribution models in two different MS



Source: Case study

Based on that scheme, the company will have to adapt its selling process in order to integrate the additional layer. This means that the company will bear the risk (i.e. risk taker) from Belgium and establish partnerships with a “courtier-grossiste” (policy designer) operating in France to be able to market insurance. This model has been perceived as the best by the company to address the above mentioned barriers and differences stemming from the market. In Luxembourg they also partner with a local car dealer (insurance seller) but the risk is covered to 100% by the Belgian company.

The company has no plans to expand to other countries. They prefer to see first how it works in France with their car insurance products before broadening the offer and targeting other markets.

Fifth insurance company – Germany/Austria

This company is a large multi-national company operating in several EU markets. They have expanded abroad through mergers and acquisitions and each of their units operate relatively independently of one another in each MS and do not provide any insurance products cross-border.

The company has recently launched online operation to provide motor insurance to German customers and their distance marketing activities are rapidly growing (15% each year). The company estimates that the significance of this business will increase in the future for several reasons: consumers are increasingly more comfortable with concluding a contract online, the strong competitiveness of the motor insurance market and the high price sensitivity of consumers. The company is able to offer online products at a less expensive rate notably because different underwriting rules, depending on the risks, can cause a 15-30% price decrease as compared to traditional distribution channels.

However there are significant barriers to direct cross-border provision of insurance products namely: (1) the huge differences in the legal framework of MS (the company particularly referred to the different tax regimes applicable in the EU); (2) the tariff settings that vary according to local characteristics of the market, local risks and customer specificities - the company representative cites that for their motor insurance product offered via distance marketing on the national market, there are about 20 different tariffs offered depending on about 25-30 different tariff elements (e.g. car model, year, mileage, etc.) specific to each customer. This implies that there are a huge number of different sales combinations available for one tariff and to recreate this for distance markets would be a complicated and significant undertaking for their actuaries; (3) the cost of processing claims abroad which is considered as unreasonably expensive; and (4) problems related to language including the difficulties to monitor legal texts of a MS and translate the legislation into their business practices or hiring agents trained in the local language in order to process claims in another language. To address these barriers would require a significant number of people likely rendering it to be an expensive means of expanding their business operations cross-border.

Additionally, the representative does not imagine that this product would ever be highly demanded by consumers because “insurance is a local business”. This company noted that even on a national level, the market is very much regionalised (this company estimates that each regional office has less than 10% of their customers from the other German Länder). They have conducted their own in-house studies, which indicated that there is a significantly higher cancellation rate of retail contracts when the customer lives more than 10 km from the insurance agent.

Sixth insurance company – New Member States

The sixth company is mainly active in the life insurance sector which represents 60% of their total sales in their host country, Hungary. The company also sells some non-life products such as health, accident, household, third party liability, etc.

Very little distance marketing is done by the company, even at national level, and only for motor insurance and home properties. This is partially a result of obstacles related to the Hungarian legal framework such as:

- The national anti-money laundering requirements which requires face-to-face contact between a representative of the company and the client for life insurance contracts; and

- The former legal obligation[67] to have face-to face contact for premiums above a certain price level for household and casco[68] insurance products.

Other obstacles to distance marketing at the national level are related to the readiness of the market for distance marketing such as:

- Limited usage of electronic signatures at a national level because the national civil code requires a written signature of both parties which implies mail contact; and

- Lack of penetration of the internet among the population.

The company is operating in other European countries (i.e. Czech Republic, Slovakia and Poland) mainly through establishment and only for life insurance as this is their main product in terms of sales. Moreover they consider that it is very hard to access market related data (claims statistics, price of repairs, etc.) for non-life insurance contracts. Establishments in Czech Republic and Slovakia were green field operations and the company entered Poland through acquisition of a national company specialising in life insurance and pensions.

The company does not intend to expand their business activity cross-border via distance marketing in the coming years, although they may see a possibility to expand their distance marketing products to Hungarians living near the border.

This insurance company assesses the entrance to other EU markets (by establishment) as very difficult due to differing national legal requirements (variations of terms and conditions, information requirements, capital requirements, etc.) as well as resulting from the administrative burden imposed by EU legislation.

[67] This legal obligation seems to have been modified in 2007.
[68] Insurance including third party liability and covering the damages to the vehicle.

They were not really able to identify whether costs to enter other markets in the EU via establishment are more significant than through distance marketing but underlined that major costs to enter other EU markets, regardless of the company's approach, are due to solvency requirements and legal expertise. Regarding the Directive 2002/65/EC, no opinion was provided.

Seventh insurance company – Nordic countries

This last company has been created through a joint venture of a Swedish and a Norwegian company in 1999 and since then offers its products through national distance marketing while offering some insurance products to foreign residents as long as the risk is located in Sweden. The company operates in different countries (i.e. Denmark, Finland, Norway, Baltic countries and even Russia) exclusively through establishment. The company has just started to offer to consumers of Nordic countries products for risks abroad, e.g. a holiday house in Spain, but through partnerships with companies situated in the targeted countries.

The insurance products they distribute are motor insurance (including third party liability) and additionally property insurance (including home), travel and health insurance (pregnancy, accidents). Most of these products are offered in all MS where they are active. Exceptions may be due to prioritisation issues for example when a product is marketed first in one country and then broadened upon success (the same is true for the fifth company with its market in France), or for lack of profitability due to, for example, a lack of demand.

Developing and implementing business for retail insurance products cross-border is difficult due to: 1) the evaluation of the risks and claims to cover, which are important to set the insurance product prices in a profitable way; 2) the local variation of rules applicable to insurance contracts which imply adapting the terms and conditions to the country's regulation (e.g. concerning the signature of insurance contracts, in Sweden, there is no need for a written form of contracts arranged over the phone or through electronic means, while on the contrary in Finland a signed contract is required); 3) the variations specific to each market in terms of consumers needs (e.g. there is no market for travel insurance in Sweden as state insurance already covers consumers for travelling inside the country – on the contrary in Norway there is a need for such a product line); and 4) marketing costs to make the company known. Finally, the company considers the insurance market to be typically national and this main feature necessitates having a physical presence to know the market and legislation.

According to the Swedish company, Directive 2002/65/EC did not bring any change due to their perspective that the Directive does not tackle important barriers coming from differences in regulation.

General considerations concerning barriers and costs

Barriers to cross-border market entry: As far as barriers to cross-border distance marketing are concerned, it seems that the most important barrier comes from the fact that it is not possible to offer at the EU level a unique product as the insurance market has been identified as an exclusively national market. Other difficulties underlined are related to language obstacles, administrative burden linked to EU legislation, or marketing strategies.

Variation in prices, terms and conditions and range of products offered: Nearly all companies perceive that is very difficult to overcome and circumvent all local requirements coming from the structure of the market and the specific legal requirements or practices impacting product definition and prices. As such, even if based on the same type of insurance products their offer is not standardised in terms of content (type of coverage, terms and conditions) or premium level.

Strategies to overcome barriers: In order to overcome the existing barriers, the companies have adopted different business strategies: three of them through establishment (branches), partnerships or acquisitions, another by targeting very similar markets to their national one and offering products with some standardised policies, and the last by outsourcing the market research and analysis of consumers' behaviour to local companies.

Costs: As far as costs are concerned, it seems that the main costs deriving from the existing barriers are related to:

- The organisation of the selling process (as specific economic and legal skills are necessary to adjust products to the local market and regulation);

- Marketing campaigns which demand huge efforts in new markets.

It is however, very difficult to measure the impact of such costs on their operating structure and on their decision to market cross-border as most companies were reluctant to provide any information on cost related issues. The two online companies simply argued that financial implications of the barriers have a smaller impact than if they had to operate under freedom of establishment. This is due to their specific business models, which are built on a unique IT platform. Such a model allows economies of scale and lower processing costs. This situation could be very different for big insurance companies that consider internet as only supplementary to traditional distribution channels rather than fully integrating the internet in their business processes. As such, all those expenses would have to be passed onto the customer and the company would be in a weak position to face local competition.

Overall assessment of the impact of the DMD on the insurance case studies

Impact of the DMD: The impact of the Directive 2002/65/EC on the three companies engaged in or considering using cross-border distance marketing has been and is still rather limited. The first company indicated that the Directive may have slightly facilitated their activities by providing a legal framework but the more obvious positive impact comes from the third non-life insurance Directive. For the remaining four companies that do not engage in cross-border distance marketing the impact of the DMD is negligible.

4 PERSISTENT OBSTACLES TO CONCLUDING CROSS-BORDER CONTRACTS FOR CONSUMER FINANCIAL SERVICES

4.1 Introduction

This section discusses the various obstacles to the direct offering and conclusion of cross-border consumer financial services contracts and the wider economic impact of these obstacles on competition, pricing, and efficiency of provision of consumer financial services in the European Union. It considers a range of individual obstacles – both obstacles on the supply side discouraging providers from offering and concluding these same banking, insurance, or investment products directly across border *and* obstacles on the demand side discouraging consumers from considering a banking, insurance, or investment products provided directly cross-border by a non-national supplier – and assesses their importance in the light of the questionnaire and case study information collected for this report.

Note that the very low level of direct cross-border marketing and conclusion of retail financial services contracts, means that there is very little data available to analyse the obstacles to direct cross-border provision. The analysis of this section takes as much information as possible from available public domain reports and statistics, as well as from the various surveys and case studies conducted for the present study; but hard factual evidence remains limited. The analysis provided in this section suggests that the DMD may have had an impact on some of the obstacles to cross-border entry by direct provision, though to a limited extent. Furthermore, it also finds that the Directive makes little difference to the many further substantial obstacles – including differences in law and tax regimes, conflict of regulations, differences in language and culture, and other infrastructural and institutional differences – which continue to limit direct cross-border provision of consumer financial services into national domestic markets and prevent almost entirely the provision of consumer financial services at a pan-European level.

While there is as yet little economically significant volume of direct cross-border marketing and conclusion of retail financial services within the EU, retail financial services are instead largely being provided cross-border by other means e.g. through local establishment or by provision to EU citizens when travelling or working in MS other than where they reside. Section 4.2 therefore presents an overview of the different possible arrangements of and obstacles to cross-border supply (whether by direct cross-border marketing or other means). The key conclusion of this section is that many of the obstacles to direct cross-border marketing and conclusion of retail financial services contracts are obstacles to cross-border marketing and distribution of any kind, whether or not the product is marketed face-to-face (through local branches or a third-party) or marketed directly cross-border.

Section 4.3 provides a short overview of the various barriers to cross-border supply and completion of retail financial services contracts. Section 4.4 discusses the supply side barriers that prevent providers of retail financial services selling (whether at distance or face-to-face; and whether through direct cross-border provision or through establishment) the same financial services contract into a number of different domestic national market places. Section 4.5 discusses the corresponding demand side obstacles, i.e. obstacles faced by consumers that prevent or discourage them from buying consumer financial services that are provided cross-border, either through establishment or through direct cross-border provision.

4.2 Overview of different arrangements for cross-border supply of retail services

This section provides an overview of the cross-border supply of retail financial services and obstacles to their cross-border supply whether by distance marketing or through traditional face-to-face channels, and whether marketing and conclusion is conducted cross-border or within the target EU Member States. The key conclusion of this section is that many of the obstacles to cross-border distance marketing are those that prevent cross-border marketing of any kind, whether face-to-face (e.g. through local branches or a third-party) or marketed directly cross-border.

The main evidence on cross-border retail financial services activity is Eurobarometer data reported in Table 3 of Section 3 (above). This table reveals that cross-border purchase of retail financial services is becoming increasingly common in the EU. But it must be pointed out that survey data of this kind provides a very incomplete picture of cross-border supply. First, a financial service may be marketed and distributed using a domestic brand; thus the consumer can be unaware that the service is supplied cross-border. Such cases are then likely to be reported in survey data as a "domestic purchase" when in fact they are a form of cross-border supply. Second, this particular survey data provides no information on whether a transaction is face-to-face or by distance. The surveys and case studies conducted for this study reveal that direct cross-border distance marketing of retail financial services is extremely rare, especially in banking and general insurance. It is therefore likely that much of the cross-border purchase reported in Table 3 is face-to-face contact, with the marketing and conclusion of the contract taking place when customers are visiting another MS from where they are resident.

A proper understanding of the obstacles to cross-border supply needs to take account of:

- *The location of the value-chain for the provision of retail financial services*. The value chain has several different component links: the provision of various inputs (labour, equity capital, other financial inputs such as funding); the origination and assembly of the service; marketing; and finally distribution to customers. This implies that there are several different ways in which financial services can be supplied cross-border, depending upon which links of the value-chain are located in which Member State.

- *Different possible arrangements for marketing and distribution.* When the origination and assembly of a retail financial service takes place in a different EU Member State from that of the consumer of the service, the obstacles to supply then vary according to how marketing and distribution is conducted. *Four possible arrangements are considered*, according to whether the marketing channel is distance or face-to-face and whether the service is regulated under the law of the state where the customer or where the service provider is located.

- *Variation between one retail financial services product and another.* Cross-border supply of even relatively simple products is hampered by institutional fragmentation and differences in national law and regulation. Cross-border supply of the more complex financial products, where the provider is exposed to significant credit or other risks and where contractual uncertainty play an important role, are further inhibited by differences in language and culture and preferences for familiar domestic national suppliers.

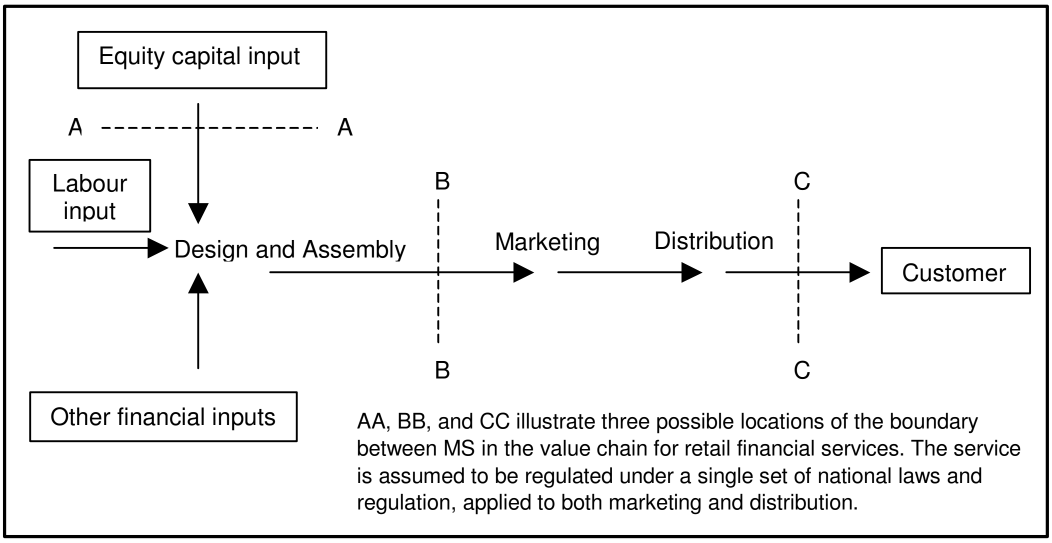
- *The distinction between* provision of financial services into domestic national markets and the provision of harmonised products at a pan-European level. This distinction is discussed for the sake of completeness, since current law and regulation, even when harmonised, is specific to individual Member States. It is not yet possible in practice to market retail financial services products at a pan-European level.

As already observed current cross-border provision is overwhelmingly by establishment within domestic retail financial services markets, not through direct cross-border provision; and when direct provision takes place this often seems to be primarily through face-to-face contact (e.g. when an EU resident visits another MS) not by distance marketing. As we have noted, this means that only extremely limited evidence is available on the nature and impact of obstacles to distance marketing of cross-border retail financial services.

The value chain and cross-border supply

The following figure illustrates the value chain in the supply of financial services, distinguishing three possible locations (AA, BB and CC) of the boundary between domestic activity in the customer's Member State and cross-border activity in another Member State.

Figure 9: The financial services value chain and MS borders



Source: Civic Consulting

Boundary AA in this figure is the case of cross-border ownership but domestic supply. This is now a common situation in many EU Member States when shareholders in another Member State own a financial institution operating inside the Member State of the customer. This boundary is observed within several large banks and insurance groups in the European Union (for example the German HypoVereinsbank subsidiary of the Italian Unicredito Bank and the many subsidiaries of large European financial institutions located in the New Member States). Several of our banking and insurance case studies illustrate this arrangement.

Boundary BB in this figure is the case of cross-border supply, either via establishment or via direct marketing targeted at the consumer's domestic market. In this case a financial institution assembles a single financial service, such as a bank account or insurance product, in one MS, but uses domestic channels (such as branches, telephone call centres, or web-sites) to market and distribute this service to customers in another Member State. The business case for such cross-border supply is that it allows the supplier to exploit economies of scale in product design and assembly, for example using a single computer system of processing.

Such cross-border supply is not common, but we have found examples in the preparation of this report. For example, a bank in a Nordic country uses a single design for its bank deposit services, which are marketed and distributed through branches in Denmark, Norway, Sweden, Finland, the Baltic States, and Northern Ireland; and a Luxembourg based bank with a similar business model targeting customers in both Luxembourg and Germany. Another example are investment funds designed and assembled in Luxembourg but marketed and distributed through branches in neighbouring European Member States, notably Germany and Belgium. Note that consumers are not necessarily aware that a financial service is being supplied cross-border in this way, since it is common for such distribution channels to use a local domestic brand.

Boundary CC is the different situation, where a customer resident in one EU Member State purchases a retail financial service from an establishment serving the domestic market in another MS. At present such purchase mostly takes place through face-to-face contact, when the customer is visiting the MS of the supplier for example as a commuter, seasonal worker, or holiday maker.

Figure 9 does not illustrate all possible cross-border boundaries. As a single European market in retail financial services develops, other locations of the boundaries of activities between members states in the supply and consumption might be expected to be observed. To give one example, an insurance contract might be assembled in and *distributed* from one MS (with premiums paid and claims processed in a different MS than that of the customer); while the contracts are marketed and concluded through a third-party agent or a branch or subsidiary in the MS of the customer. As far as we aware this possibility, with marketing and distribution in different Member States, does not currently take place anywhere in the EU; an indication that obstacles to cross-border supply in retail financial services remain substantial.

Another possibility, one which does frequently takes place but which for simplicity of exposition has been omitted from Figure 1, is when either labour or other financial inputs are supplied from a different Member State. An insurance or banking service might be supported by a call centre in a different MS from the customer, so that there is a MS boundary between labour input and distribution (or indeed might be supplied from a call centre outside the EU altogether e.g. in India). Other financial inputs (funding, risk transfer) are traded on wholesale financial markets which nowadays increasingly operate across the borders of EU Member States and in some cases (e.g. financial derivative contracts) are purchased in global rather than national markets.

Four possible arrangements for cross-border supply

This discussion of the value chain makes clear that cross-border supply of retail financial services *does not require* the use of a distance channel (such as telephone or internet) in order to reach customers located in a different country. As already discussed most cross-border supply of financial services within the EU is by establishment (through either a local branch or a subsidiary), under the legal and regulatory jurisdiction of the host MS of the customer purchasing the service, rather than that of the home MS of the company providing the service. There is also an increasing amount of cross-border population movements within the European Union, making it possible for a customer to have face-to-face contact with a supplier in another MS from that in which they are resident; i.e. in those relatively few occasions where cross-border supply takes place directly from the MS of the supplier to a customer resident in a different MS, rather than indirectly through local branch or subsidiary. This supply typically makes use of a face-to-face channel rather than relying solely on a remote distance channel for the marketing and conclusion of the contract.

The following table represents some of the different possibilities for supply of a retail financial service:

Table 9: Different possibilities for domestic and cross-border supply

	***Domestic supply*:** supplier and customer from same EU Member State	***Cross-border supply*:** the product is originated from a different EU Member State than the customer	
		Service provided under the law of the customer's Member State (BB in Figure 9)	Service provided under the law of the supplier's Member State (CC in Figure 9)
Marketing and conclusion of contract involves face-to-face contact	Case F1	Case F2E	Case F2D
Marketing and conclusion of contract is conducted exclusively at a distance	Case D1	Case D2E	Case D2D

This table distinguishes two possible arrangements for domestic supply (Face-to-Face Case F1 and Distance Case D1) and four possible arrangements for cross-border supply. These are two cases (face-to-face supply F2E and distance marketing D2E), where the service is provided under the law of the customer's Member State, and two further cases (face-to-face supply F2D and distance marketing D2D), where the service is provided under the law applicable in the supplier's own Member State.

For the further analysis we will use the following terminology:

- *Direct cross-border provision (or supply)* describes the situation where a retail financial service contract is concluded cross-border at a distance (cases D2E and D2D). It also includes the case where customers have face-to-face contact with a supplier in another MS from that in which they are resident (case F2D).

- *Indirect provision through establishment* describes the situation where a retail financial service is sold by a supplier from another MS through local presence by branches or majority holdings in the country where the consumer is resident (case F2E).[69]

---

[69] Indirect provision through establishment also includes a situation where some national distance marketing is conducted by the branches or majority holdings in the country where the consumer is resident – this operation is, however, for the aim of this study not significantly different from the face-to-face operation of the establishment and is therefore not explicitly considered in the further analysis.

For cross-border distance marketing in most cases the law of the consumer's Member State applies (case D2E).

The case F2D requires a little further explanation. How can a financial service be provided cross-border face-to-face, under the law of the supplier's Member State? The most obvious reason is because of the short-term cross-border population movements between EU Member States, for example residents of Germany or Belgium commuting to work in Luxembourg; or residents of southern Sweden working in Denmark buying a financial service product there. These are prominent examples, but such cross-border commuting takes place across many borders in the EU. There are also cases of longer term population movements, such as weekly or season commuting; although these cases face less obstacles to cross-border supply since the customers then usually have an address in the country they visit, and are treated as domestic customers.

The main point made by this table is that while the DMD affects cases D1, D2E, and D2D; these are not the only cases of cross-border supply of retail financial services; a full discussion of the obstacles to cross-border supply must also take account of cases F2E (cross-border, face-to-face supply, via an establishment in the consumer's MS) and F2D (direct cross-border face-to-face supply via a branch in the supplier's MS). Moreover, as will become clear in the subsequent discussion, many of obstacles to cross-border provision are differences in national law and regulation that make it difficult or impossible to provide a harmonised retail financial services product to several EU Member States i.e. obstacles to all of cases D2E, D2D, F2E and F2D

It should also be realised that in practice there is at present very little cross-border supply of retail financial services at all. F2D appears to take place a little more often when there is substantial cross-border population movement. Cases F2E and D2E (where there is active cross-border marketing under the law and usually also the regulation of the consumer's home state) also occur infrequently – we identify only a small few examples in our own case studies. The great majority of transactions are still either distance or face-to-face marketing within a national domestic market (cases D1 or F1)

This table does not cover all possibilities concerning the applicable law. It is also possible that the law and regulation of two Member States, both that of the consumer and the supplier, are applied to a single transaction, creating legal uncertainty and additional obstacles to cross-border supply. This is a particular concern with cross-border distance marketing since the Distance Marketing Directive does not make clear which jurisdiction is responsible for applying the Directive to a particular transaction. Potentially – in case of inconsistencies in national implementation – two different sets of conflicting rules might be applied to the same transaction; one by the financial regulators of the supplier's Member State and the other by the financial regulators of the consumer's Member State.[70]

---

[70] The FFSA in France reported to us that "One barrier is the applicability of the law - The Directive contains no explicit provision as to whether it is the competent enforcement authorities of the supplier's or consumer's state that should be responsible for enforcing its provisions in respect of transactions involving more than one Member State. Some countries (for example UK) have clearly considered that the Directive is intended to operate on a "country of origin basis" (in light of article 16 of the Directive) while others have

An illustrative example: the savings deposit account. The discussion so far has shown that there are several different ways in which retail financial services can be supplied cross-border. To illustrate these different possibilities, it is worth considering a relatively straightforward example, that of a savings deposit account. Although the service itself is relatively simple (accepting deposits and crediting interest), the supplying bank must still undertake a large number of different tasks.

First, the terms on which deposits are taken must be defined, including features such as the rates of interest offered; the terms of withdrawal; and the allowable methods for payment in and out of the account. Alongside this, the bank must ensure that the underlying systems are in place to support the various deposit services, including: the acceptance of payments, whether cash, electronic or paper; the recording of account balances; the crediting of interest; the collection of withholding tax; the execution of payment instructions; the preparation and communication of account statements; and the various channels (such as branch access, telephone call centre, internet banking, postal banking, or cell phone banking) used for customer information and communication.

In practice, this description is somewhat oversimplified – a deposit account need not be provided on a standalone basis, but is instead often accompanied by offers of a range of other retail financial services, e.g. short term credit, debit card, credit card, and each of these services must also be defined and supported. Also it is common to provide a bundled package, in which several such services are provided together with attractive pricing for obtaining the whole bundle of services from a single provider. This implies that, in order to compete effectively cross-border, even in such a simple product space as savings deposits, it may be necessary to provide a wide range of banking products.

In addition, the supplier must offer the deposit within a particular legal and regulatory jurisdiction, and ensure that the operation of the service complies with all the relevant rules, regulations, and laws. At present within the European Union these jurisdictions are defined at a national level.

A deposit account can be provided cross-border under any of the four arrangements distinguished in Table 9. F2E is when a bank offers accounts via branches or a subsidiary in another country (so the service falls under the law and regulation applicable to the customer's Member State) and there is an element of face-to-face contact in either the marketing or conclusion of the contract to open the account. Typically this would be part of a multi-channel offering, so the customer has a choice of accessing a physical branch, a telephone call centre, or via an internet website. In the case of deposit accounts, this is convenient because the various identity documents required by anti-money laundering regulations can be brought to a branch, even if the account application is handled at a distance via telephone or internet. At the same time the provider may seek to exploit economies of scale by spreading the fixed costs of account design and servicing of support systems over deposit products made in several different MS.

interpreted that on the contrary the Directive should be implemented on a host state basis. This creates inconsistencies very difficult to resolve."

D2E is very similar to F2E, the only difference is that there is no face-to-face contact (for example if identity documents required for anti-money laundering purposes are submitted and returned by mail). If the DMD has been implemented correctly in the customer's Member State then this service will however be subject to slightly different regulations than F2E, with different disclosure rights and with the customer having rights of withdrawal in addition to those provided under any national legislation (e.g. from the deposit contract).

Alternatively, the deposit account might be provided under the law of a different Member State than that of the consumer making the deposit. In Table 9 this seems to concern mainly the case F2D (with face-to-face contact). As already discussed, the provision of deposit accounts to residents of other MS is a relatively common occurrence, as a result of the population movements between Member States, whether daily commuting, or other short term visits. Cross-border distance provision of deposits appears, as yet, to be relatively uncommon.

<u>Other products.</u> We have discussed the example of the savings deposit in detail. Obstacles to the direct offering and conclusion of consumer financial services contracts vary substantially from one product to another. At one extreme are the simplest products in which there is little risk to the provider and in which services to be provided are clearly defined with no contractual uncertainty, for example the simple deposit product (already explored as an illustration of the difference cases of cross-border supply); or a clearly defined short-term non-life insurance contract such as motor or travel insurance. At the other extreme are contracts in which there are implicit promises about the quality, pricing and delivery of the service; or in which the supplier is exposed to significant financial and business risks. Examples here would include both secured and unsecured credit products and long-term life insurance. Bundled service offerings, where the customer obtains a range of different services from a "one stop shop", are another example of a complex product in which trust and transparency play an important role.

This section considers the entire range of obstacles to cross-border provision and conclusion of financial contracts. In the case of the simplest products the main obstacles seem to be specific institutional and regulatory arrangements, for example the lack of integration of retail payments across Europe or lack of regulatory harmonisation which prevent or at least substantially hamper direct cross-border provision. For the more complex products the range of obstacles are much greater, including differences in language and culture, and this may inhibit most forms of cross-border provision.

<u>Domestic national versus pan-European competition.</u> For completeness we note that in order to understand the economic impact of these obstacles, and the effect of measures such as the DMD upon them, it is necessary also to distinguish two forms of competition: competition within national domestic markets and competition at pan-European level. Despite the various legal and regulatory changes introduced by the Financial Services Action Plan (FSAP), European consumer financial services continue overwhelmingly to be sold and purchased within national *domestic* market places. This does not mean that the various FSAP measures, and the DMD in particular, have had no competitive impact; but it is important to distinguish their impact on competition

within domestic financial markets from their effects on still nascent competition at pan-European level.

This implies that we must consider separately:

(a) Obstacles to cross-border entry by suppliers into existing domestic markets for consumer financial services (under any of the four arrangements F2E, F2D, D2E, D2D discussed above); and

(b) Those additional obstacles which prevent suppliers offering and consumer purchasing consumer financial service contracts which are marketed and concluded at a pan-European level i.e. providing a standard contract serving a number of different European national markets.

It is notable that the efforts to promote a pan-European market in retail financial services have not, to date, included the development of a comprehensive Euro-level regime of product and customer protection regulation allowing banking, insurance, or investment products to be sold across the EU under either domestic regulations of other Member States (through the passporting principle applied to product and consumer protection regulations) or through consistent harmonisation of standards (although there are efforts in this direction, as has been indicated by the new Consumer Credit Directive). As a result, with few if any exceptions, retail financial services continue to be bought and sold in domestic national rather than pan-European markets. The discussion here thus focuses on the obstacles to providing retail financial services cross-border into different domestic markets of other MS.

4.3 Overview of main persistent barriers

This subsection provides an overview of the various obstacles or barriers that prevent financial institutions supplying a product across borders, whether this is by direct cross-border provision or face-to-face through a local establishment or local agent. Sixteen such obstacles are discussed, under five broad headings:

Institutional and technical barriers

1. Lack of harmonised payment systems, etc.
2. Problems related to tax
3. Difficulties in concluding contracts electronically
4. Need to maintain multiple channels for delivery and communication

Credit assessment and recovery problems

5. Difficulties in debt recovery
6. Absence of pan-European credit referencing system

Differences in law and regulation

7. National anti-money laundering requirements
8. Lack of harmonisation of relevant MS legislation or absence of EU legislation
9. Differences in disclosure rules and withdrawal rights
10. Inconsistency between regulation of face-to-face and distance selling

Difficulties in understanding/ penetrating local domestic market

11. Legal uncertainty regarding the applicable law
12. Lack of understanding of domestic retail financial services markets
13. Difficulties in marketing in other MS

Demand side barriers

14. Differences in language and culture
15. Consumer preference for own national providers
16. Absence of information

This list distinguishes thirteen supply side barriers and three demand side barriers. This relatively larger number of supply side barriers does *not* imply that supply side barriers are overall of greater importance than demand side barriers in discouraging cross-border supply of retail financial services. This discrepancy in number of barriers is simply because the complexity of the barriers seems to be higher on the supply side than on the demand side.

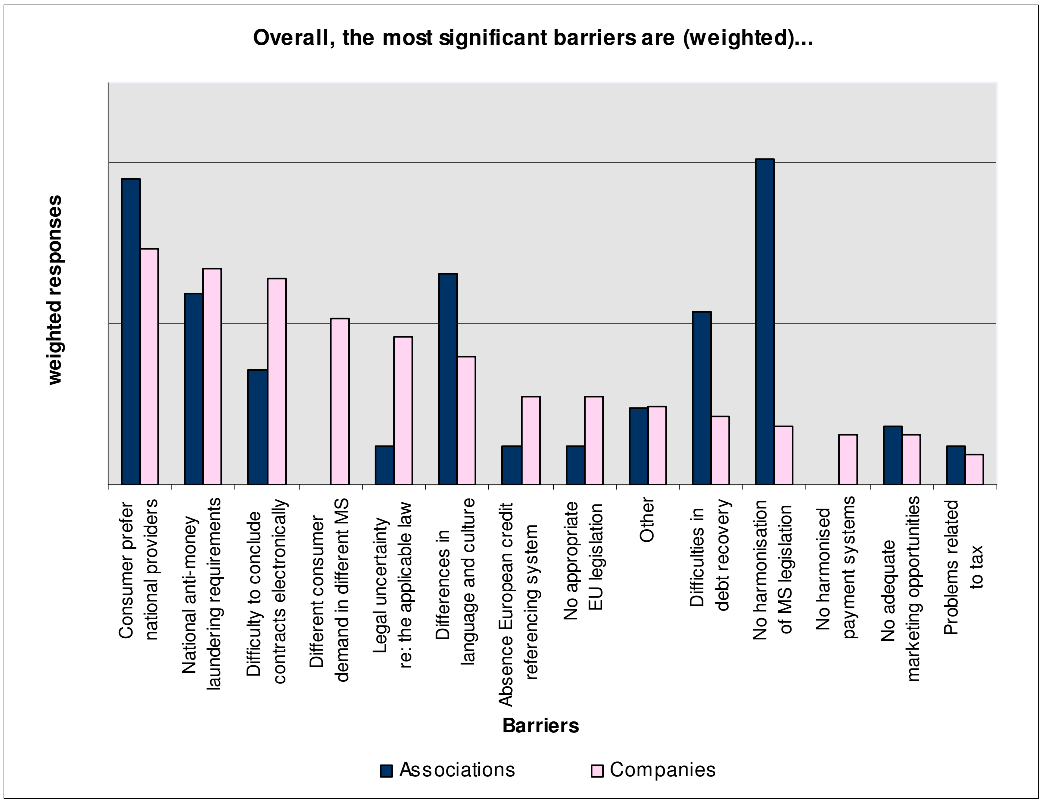
4.3.1 Main barriers as perceived by the banking sector

The questionnaires conducted for the present study asked the opinions of both national industry associations and individual companies on the importance of these barriers (note that several of the barriers were not included in the questionnaires including: (4)

Need to maintain multiple channels for delivery and communication; (9) Differences in disclosure rules and withdrawal rights; (10) Inconsistency between regulation of face-to-face and distance selling; (12) Lack of understanding of domestic retail financial services markets; and (16) Absence of information. They are mentioned here because these emerged in association interviews case studies as potentially significant barriers).

Figure 10 below summarises the responses by both bank associations and banks, to questions about the significance of various barriers to cross-border distance marketing. The list of barriers included in the survey questionnaire did not cover all sixteen identified barriers, but the option of "other barrier" allowed respondents to give a complete picture. Since the different barriers are open to wide variations in interpretation, it is more sensible to discuss these results in the context of the five broad areas, not the sixteen specified barriers. Note also that this survey refers specifically to marketing financial services at a distance to consumers in other MS, not to the other possibilities of cross-border provision discussed in Table 9 above.

Figure 10: Major problems/barriers as perceived by banking sector



Source: Surveys of Associations and Companies (only banking sector responses, N=43)

A first conclusion from these survey results is that banking associations and individual companies alike, view both the demand side barriers (consumer preference for national providers, differences in language and culture) as important barriers to cross-border distance marketing, as well as the supply side barriers which directly inhibit their operations.

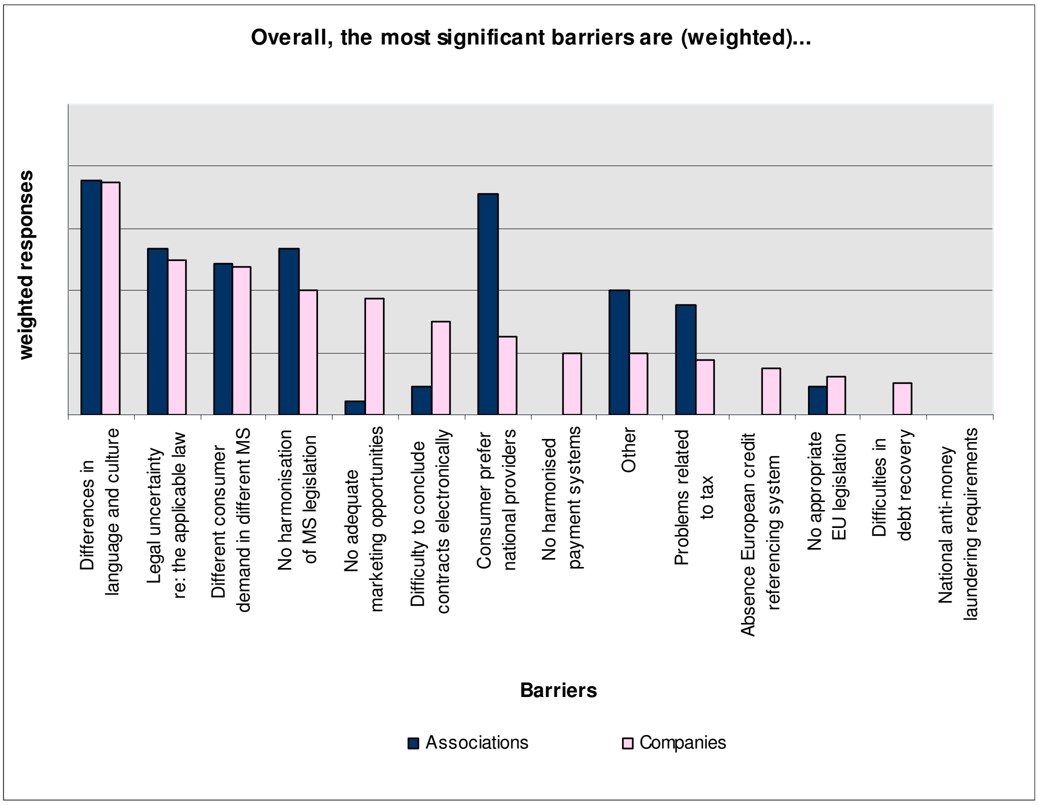
A second conclusion from these survey results is that barriers falling under the general heading of differences in national law and regulation are regarded as being of particular importance, especially by banking associations. Some specific institutional barriers are emphasised, for example banks and banking associations emphasised the difficulties arising from national anti-money laundering requirements, which likely explains why banks also ranked “difficulty to conclude contracts electronically” highly. Some weight is placed on credit assessment, but not as much as on some other general headings. Debt recovery is however, seen as a more relevant barrier to the banking sector. Lack of harmonised payment systems, problems related to tax, and the absence of a pan-European credit referencing system seem to matter less.

There are some differences between the views of associations and individual companies, but these seem to reflect differences in responsibility rather than fundamental divergence. For example the associations, who are directly involved in lobbying on EU legislation, emphasise the divergence in national laws; while the companies emphasise more the difficulties of legal compliance in terms of legal uncertainty of the applicable law. Any deviation between the answers of associations and companies is possibly also related to the previously mentioned limitation of factual evidence: Cross-border provision of consumer financial services is currently rare and most respondents therefore cannot base their assessment on their own experience, but rather have to base it on general considerations.

4.3.2 Main barriers as perceived by the insurance sector

Figure 11 below reports the equivalent survey findings for the insurance sector.

Figure 11: Major problems/barriers as perceived by insurance sector



Source: Surveys of Associations and Companies (only insurance sector responses, N=44)

The survey results for the insurance sector, at least with respect to the five broad headings, are fairly consistent with those for the banking sector. Once again demand side barriers differences of language and culture and consumer preferences for national providers are perceived as major barriers by both the associations and the companies. Differences in law and regulation are again emphasised although given somewhat less prominence than the replies to the banking sector survey. Unsurprisingly the insurance respondents make few references to difficulties in credit assessment or recovery.

Across both banking and insurance, individual companies emphasise “lack of marketing opportunities” but this is rarely mentioned by associations. Tax, while never the most significant barrier, is mentioned more frequently by the insurance sector than by the banking sector.

4.4 Analysis of supply side barriers

The next two subsections provide some further discussion of the barriers, distinguishing between supply side barriers (in this subsection) and demand side barriers (in the next subsection).

Thirteen of the sixteen identified barriers are on the supply side, hindering companies from providing retail financial services on a cross-border basis. These affect all arrangements for cross-border supply presented in Table 9 above, be it sometimes to a differing degree. Where relevant, the importance of a barrier for the different arrangements for cross-border supply is highlighted in the analysis.

When reviewing the economic consequences of these barriers we distinguish: (a) their impact on cross-border supply into existing MS domestic markets; (b) their impact on cross-border marketing into other MS (i.e. on the specific aspect of cross-border supply addressed by this study); and (c) on the obstacles they present to the marketing of harmonised retail financial products on a pan-European basis.

4.4.1 Institutional and technical barriers

Main barrier 1: Lack of harmonised payment systems, etc

<u>Description of the barrier</u>

- <u>Nature:</u> All financial contracts involve regular payments, either from customer to supplier or from supplier to customer. While the 2001 Regulation on Cross-Border Payments in Euro[71] ensures that cross-border payments are charged on the same basis as domestic payments, cross-border payments have continued to be handled on a different basis than domestic payments, using inefficient manual processing and separate systems with relatively high fixed costs and low usage volumes.[72] The costs to banks of receiving and making cross-border payments have thus continued to be very much higher than for domestic payments.

- <u>Scale of problem/barrier:</u> This is a major barrier to most forms of cross-border financial contracts. It is a particular concern with recurrent payments made using a direct debt or recurring credit transfer. One-off payments can be handled more easily across Europe using e.g. a credit card.

- <u>Persons or categories of persons affected:</u> Affects the supplier and to lesser extent the customer. In the case of the supplier it directly raises the costs of direct distance cross-border supply; it also limits the extent to which economies of scale can be exploited in indirect cross-border supply through establishment. It also may discourage customers.

[71] Regulation (EC) No 2560/2001 of 19 December 2001.
[72] The Eurozone large value payments systems, such as Target and its successor Target 2, have only limited impact on retail payments because these handle only bank to bank payments. Retail payments, i.e. small value payments from one bank customer to the customer of a different bank, or from a bank customer to a different bank, have until now been handled by a variety of different national payment systems.

- Possible developments that may affect barrier: The introduction of the Single Euro Payments Area (SEPA) that started in January 2008, will remove or at least substantially reduce this barrier for the Eurozone, allowing payments to be routed through pan-European automated clearing houses throughout Europe and ensuring acceptability of both credit and debit card payments on a standardised basis across the EU. However, the full implementation of SEPA will take some time and therefore some cost differences between domestic and cross-border payments can be expected to remain in the near term.

Economic consequences of barrier

This barrier inhibits cross-border supply of retail financial services products, such as many insurance products or a credit card, involving regular small payments from customer to supplier; it has also directly prevented the provision of transactions products such as a current account which provide payments services on a pan-European basis.

It is also a major barrier to any future development of the marketing of harmonised retail financial services, offered on a pan-European basis across several EU Member States; although we would anticipate that by the time such developments become a commercial possibility, a single framework for EU or at least Eurozone retail payments will be in place and this will no longer be a significant barrier.

Main barrier 2: Problems related to tax

Description of the barrier

- Nature: Each retail financial service product falls within a distinct national tax regime, requiring its own particular processing procedures. Examples include withholding tax on bank accounts, the specific taxes applied to general insurance products; and the widely differing tax exemptions available on pension and life-insurance and other investment products.

- Scale of problem/barrier: This is a fundamental obstacle to the development of pan-European supply of retail financial services, for two distinct reasons:

  1. First, the differing national systems for tax collection mean that a supplier must develop separate systems of transaction processing within each national jurisdiction in order to comply with tax legislation. This limits the possibilities for suppliers for exploiting economies of scale in indirect provision through establishment and may cause some additional costs to customers in direct cross-border provision.

  2. Second, many savings, investment and pension products are specifically tailored to take advantage of particular national tax exemptions.

- Persons or categories of persons affected: Both suppliers and customers are affected, with substantial increases in supplier costs because products and processing must be specific to national markets; and some inconvenience to customers dealing with different regimes for tax reporting and assessment.

- Possible developments that may affect barrier: To our knowledge there are no prospective developments in EU law and tax arrangements that will reduce these tax barriers. We note that reduction in these barriers does *not* require that every EU Member State apply the same rates of tax and offer the same tax exemptions on financial services products. What appears to be required is harmonisation at the EU level of the systems for assessing and processing tax payments, so that suppliers can then use the same internal systems for meeting the tax payment and reporting requirements wherever a financial product is sold across the EU i.e. much in the way that VAT assessment and processing is already harmonised across the EU even while VAT rates can be determined at the national level.

Economic consequences of barrier

This barrier is a major inhibitor of direct cross-border supply in two cases:

1. Any savings or investment product, including savings accounts, life insurance, investment funds, and pensions.

2. Any other retail financial services where product taxes other than VAT are imposed; for example stamp duties on mortgages or some general insurance taxes.

This barrier prevents firms fully exploiting economies of scale when supplying different domestic MS markets (because a separate tax processing system is required for each MS) and is also a major barrier to marketing and distributing retail financial services on a standardised pan-European basis.

Main barrier 3: Difficulties in concluding contracts electronically

Description of the barrier

- Nature: This barrier overlaps with several of the other legal and institutional barriers identified and discussed in this report. But it involves sufficient distinct issues to make it worthwhile to discuss and address it as a separate barrier. For various reasons, both of regulation and of business practice, contracts for financial services are often not concluded electronically, even when the initial application is electronic. The reasons vary considerably from product to product. A deposit account or an investment product must comply with the relevant "know your customer" requirements of anti-money laundering legislation (discussed further below) and this requires physical documentation of address and identity. Credit products cannot be processed without identification of the customer for credit referencing purposes and this again may require paper documentation. A life insurance product must often be supported by a medical examination or at least a medical report, which again may require paper processing and/or follow-up via telephone.

- Scale of problem/barrier: Once other related barriers (such as national differences in anti-money laundering legislation) are removed, then this barrier has a relatively small impact on cross-border supply. It does however inhibit cross-border distance marketing being used instead of cross-border supply by establishment and thus in those cases where distance marketing is relatively cost effective reduces the overall amount of cross-border supply.

- Persons or categories of persons affected: Affects mainly suppliers because they must use multiple channels for marketing and distribution; which in turn may inhibit cross-border supply into some smaller MS.

- Possible developments that may affect barrier: An in-depth analysis of this issue was out of the scope of this study, but it is possible that developments in on-line identification at EU level may help reduce this barrier.

Economic consequences of barrier

This is not primarily a barrier to cross-border supply but rather a barrier to the use of distance marketing (D2E and D2D) as an alternative to face-to-face marketing (F2E and F2D). The main consequence of this barrier is that many retail financial services products require a multi-channel system of distribution. They cannot be supported by a website alone but must also have a telephone sales processing team (to follow up application details) and/or a branch network (to facilitate processing of paper documents). Only in specific cases – credit cards and some types of general insurance are examples – can retail financial services products be supplied purely at a distance on a significant scale.

Difficulties of concluding contracts electronically inhibit cross-border supply only to the extent that distance marketing and conclusions of contracts, by telephone or by website, can allow financial services firms to achieve relatively greater economies of scale than when using face-to-face channels; therefore a reduction in this barrier would make a stronger business case for supplying some financial services products cross-border, especially into the smaller MS.

This is also a barrier to the supply of harmonised retail financial services on a pan-European basis across several MS; the necessity of using face-to-face contact suggests that providers will be forced to supply such harmonised products to only a subset of MS – those in which they have already have a branch network or a subsidiary, or where they can arrange cost-effective arrangements for agency distribution (i.e. having their product supported by the branch network of another institution such as a bank or national post-office).

Main barrier 4: Need to maintain multiple channels for delivery and communication

Description of the barrier

- Nature: This is closely related to barrier 3. There are further reasons why some products cannot be supplied using a single distribution channel. This is most obvious in the case of bank transaction accounts where most customers have a clear preference for multiple channel delivery, requiring access to branches as well as to call centres or internet banking.[73]

- Scale of problem/barrier: In our judgement this is again a relatively less important barrier to cross-border supply. As with barrier 3 above and 5 below it does however, inhibit cross-border distance marketing being used instead of cross-border supply by establishment and thus in those cases where distance marketing is relatively cost effective reduces the overall amount of cross-border supply. The point here is that cross-border distance marketing is more suited to the sub-set of retail financial services (e.g. savings deposits, credit cards, motor insurance) that do not need multiple channels for delivery. While the initiation of other retail financial services needing multiple channels for complete delivery can be undertaken through distance marketing, the complete service itself cannot itself be supplied cross border. Therefore local presence is required even when conducting distance marketing.

- Persons or categories of persons affected: Affects mainly suppliers because they must use multiple channels for marketing and distribution; which in turn may inhibit cross-border supply into some smaller national MS.

- Possible developments that may affect barrier: There are no indications for ongoing developments affecting this barrier.

Economic consequences of barrier

This is again not primarily a barrier to cross-border supply but rather a barrier to the use of distance marketing (D2E and D2D) as an alternative to face-to-face marketing (F2E and F2D). The main consequence of this barrier is that many retail financial services products require a multi-channel system of distribution, with the exception of specific cases such as credit cards and some types of general insurance.

The need to use branches when supplying retail financial services products cross-border will reduce the scope for exploiting economies of scale especially when supplying smaller MS.

As with main barrier 3, this is also a barrier to the eventual emergence of harmonised retail financial services supplied on a pan-European basis across a large number of EU Member States; since providers will be forced to supply such harmonised products to only a subset of EU Member States where they have access to a branch network, at least regarding those products where customers have a clear preference for multiple channel delivery.

[73] For some evidence in support of this point see the Euro-Group consulting report which found that in Spain banks that most reduced their branch networks also lost market share (described in the October 2007 ECB report "EU Banking Structures", section 3.1).

4.4.2 Credit assessment and recovery problems

Main barrier 5: Difficulties in debt recovery

Description of the barrier

- Nature: Legal systems and the operation and efficiency of the courts can add substantially to the costs arising in the event of default of a retail credit product, such as a mortgage, credit card, or unsecured loan. This is not directly a barrier to cross-border supply so much as a barrier to any form of supply. However it does mean, first that the expected losses and variability of losses in such credit products will vary considerably from one MS to another, and second, that the pricing and credit assessment rules must be set on a national rather than EU basis.

- Scale of problem/barrier: This poses a substantial barrier to new cross-border market entry, especially through distance marketing or through a "de novo" establishment i.e. setting up an entirely new branch or subsidiary rather than acquiring an existing branch or subsidiary. Limited opportunities for acquisition of existing domestic financial institutions then constrain total cross-border supply.

- Persons or categories of persons affected: Both domestic and competing cross-border suppliers.

- Possible developments that may affect barrier: To the extent that the operation and efficiency of court operations have and continue to improve in several EU Member States and that pan-European legal mechanisms are developed, this barrier is being reduced. However, national differences in legal system may remain, e.g. regarding creditor rights, etc.

Economic consequences of barrier

The consequence of this barrier is to reduce the supply of credit products into domestic markets in EU Member States, both from domestic financial institutions and cross-border. The market specific skills needed to assess risk and respond to default inhibit new entry and discourage the growth of cross-border supply.

This barrier can be expected to effectively prevent the development and marketing of harmonised credit products on a pan-European basis across several EU Member States. Each MS will require its own pricing and risk assessment. For this reason credit products can be expected to be among the last retail financial services products to be offered at a pan-European level.

Main barrier 6: Absence of pan-European credit referencing system

Description of the barrier

- Nature: This particular barrier is clearly perceived by banks as a substantial barrier to cross-border supply of credit products. While in each country databases of customer credit performance are used to trace past behaviour and assess credit worthiness, these credit referencing arrangements operate very differently across the EU. Different companies maintain and provide access to these databases. The time periods for which data has been systematically collected vary (these arrangements are very recent in many of the New Member States). Moreover the nature of the information recorded in these databases varies from one country to another. Finally, there is no pan-European system of personal identification, presumably making it impossible to collate credit referencing information across different MS.

- Scale of problem/barrier: Like main barrier 5, this poses a substantial barrier to new cross-border entry into credit markets, especially through distance marketing or through a "de novo" establishment i.e. setting up an entirely new branch or subsidiary rather than acquiring an existing branch or subsidiary. Limited opportunities for acquisition of existing domestic financial institutions then constrain total cross-border supply.

- Persons or categories of persons affected: Suppliers.

- Possible developments that may affect barrier: The new Directive on Consumer Credit is expected to reduce the relevance of this barrier as it establishes that Member States should ensure access for creditors from other Member States to databases used in that Member State for assessing the creditworthiness of consumers. In the medium to long term we anticipate harmonisation of the information collected in credit databases; increasing cross-border competition in the supply of credit referencing services, with a few leading firms providing this service in most countries; and developments in systems for personal identification across the EU allowing greater constancy.

Economic consequences of barrier

The consequence of this barrier is to reduce the cross-border supply of credit products into domestic markets in EU Member States.

This barrier can be expected to effectively prevent the development and marketing of harmonised credit products on a pan-European basis across several EU Members States. Until such time as pan-European or at least multiple MS credit referencing can be offered these products will have to be developed on a single country basis. This is a further reason why credit products can be expected to be among the last retail financial services products to be offered at a pan-European level.

4.4.3 Differences in law and regulation

Main barrier 7: National anti-money laundering requirements

Description of the barrier

- Nature: In order to combat both terrorism and organised crime, anti-money laundering legislation imposes quite burdensome requirements on banks, insurance companies, and other financial institutions. Detailed rules, differing in their precise detail from one MS to another, prescribe how financial institutions should confirm the address and identity of a customer. Further rules, again differing from one jurisdiction to another, also impose requirements to report suspicious transactions so that each financial institution must monitor transaction databases and frequently pass on transaction details to the relevant authorities.

- Scale of problem/barrier: This barrier is mentioned prominently in all our surveys and cases. It does not prevent indirect cross-border supply through establishment but it is one of the major reasons why there is such limited direct cross-border supply.

- Persons or categories of persons affected: Suppliers.

- Possible developments that may affect barrier: We are aware of no prospective developments. We believe that suppliers would welcome standardisation of requirements and a reduction in the level of reporting requirements, both of which would facilitate cross-border supply and the provision of harmonised products to several European Union MS.

Economic consequences of barrier

This barrier strongly limits distance marketing, since it is very difficult to comply with the legislation, especially when conducted cross-border, without some face-to-face interaction with the customer; e.g. to examine bills or identify documents. Postal examination can be substituted but this is especially problematic for a cross-border supplier. While we have not specifically investigated the point, it has been suggested to us that there are similar requirements in some MS for physical presentation of documents other than for prevention of terrorism or organised crime e.g. for reasons of tax enforcement. Any such requirements discourage distance marketing, especially if they differ from one MS to another. It also limits the extent to which economies of scale can be realised from the marketing and distribution of retail financial services into domestic markets in several MS.

This barrier is a major obstacle to the supply of harmonised retail financial service products into several EU Member States.

Main barrier 8: Lack of harmonisation of relevant MS legislation or absence of EU legislation

Description of the barrier

- Nature: A variety of further laws and regulations are imposed on banks, insurance companies, and other financial institutions and on their products and services. While prudential regulations (such as capital requirements) are now generally harmonised through the various European Directives, laws and regulations for consumer protection and product design continue to vary substantially from one MS to another.

- Scale of problem/barrier: This barrier is also mentioned prominently in all our surveys and cases. It does not prevent indirect cross-border supply through establishment but it appears to be one of the major reasons why there is such limited direct cross-border supply. The surveys conducted by *iff Hamburg* report an apparently conflicting finding: consumer organisations report no evidence that differences in the regulation of financial services are an obstacle to cross border sales. However, this does not really conflict at all. It may be true that differences in national regulation are of little concern to consumers, i.e. are not a demand side barrier, but they can still be a major concern to suppliers, ie. a major supply side barrier. In any case consumers have limited experience because of the insignificant amount of cross-border transactions. As the *iff Hamburg* report acknowledges, "consumer organisations do not show much experience of complaint-handling in this area".

- Persons or categories of persons affected: Suppliers.
- Possible developments that may affect barrier: Many of the Directives of the FSAP address these barriers. The emphasis given by European policy makers, post FSAP, to promoting cross-border and pan-European retail financial services is expected to lead to further legislative efforts to reduce these barriers.

Economic consequences of barrier

This is a further barrier limiting cross-border distance marketing, since retail financial service products must be tailored to each individual national domestic market. This barrier thus, limits the extent to which economies of scale can be realised from the marketing and distribution of retail financial services into domestic markets in several MS.

This barrier is also a formidable obstacle to the supply of harmonised retail financial service products into several EU Member States.

Main barrier 9: Differences in disclosure and withdrawal rights

Description of the barrier

- Nature: This barrier is really a subset of barrier 8 (differences in national law and regulation) but since these rights are substantially affected by the DMD, they merit further discussion.
- Scale of problem/barrier: Our survey results and case studies do not suggest that this is a major barrier to cross-border supply, whether indirectly via establishment or directly. In the case of direct marketing these barriers require some additional marketing materials to be supplied on a MS specific basis, adding some additional cost to suppliers. In case that there is a lack of clarity regarding the applicable law, this may create uncertainty for the supplier whether disclosure rules and withdrawal rights apply that are required under the law and regulation of the consumer's MS, or that of the MS where the service is marketed and concluded. The study conducted by *iff Hamburg* confirms these results. Legal experts deem that the more relevant differences are in tax law and money laundering law. Within consumer law, differences in

product-specific rules are considered more important than differences in pure information requirements[74].

- Persons or categories of persons affected: Suppliers (because documentation must be prepared on a MS by MS basis.)

- Possible developments that may affect barrier: Further legislative efforts may reduce these barriers.

Economic consequences of barrier

Although diversity of information and withdrawal rights are not yet seen as a significant problem for cross-border distance marketing, different rules are likely to contribute to limiting the provision of cross-border financial services. The insecurity as to whether different information requirements or withdrawal rights exist in targeted Member States may force suppliers to offer products tailored to each individual national domestic market. This barrier is also likely to limit the extent to which economies of scale can be realised from the marketing and distribution of retail financial services into domestic markets in several MS.

This barrier is also an obstacle to the supply of harmonised retail financial service products into several EU Member States.

Main barrier 10: Inconsistency between regulation of face-to-face and distance selling

Description of the barrier

- Nature: Again this is really a subset of main barrier 8. One effect of the Distance Marketing Directive, commented on by a number of survey respondents (especially industry associations), is that it has introduced differences in disclosure requirements and withdrawal rights, between products involving face-to-face marketing and those marketed and concluded purely on a distance basis.

- Scale of problem/barrier: According to industry associations this is a substantial problem. For example, as reported by several of the industry associations, the withdrawal rights of the Directive are considered inappropriate for general insurance products, since they could be interpreted as allowing a consumer to claim on a policy and subsequently withdraw from the contract[75]. Another example is provided by the information requirements: insurance companies claim that, under the DMD, they do not know how they should provide pre-contractual information to consumers, how long they should keep proof of it, and what happens if they fail to comply with information

[74] The study of *iff Hamburg* reveals a great variety of information rights specific to certain financial products across Member States. When asked to name potential risks to cross-border selling of financial services, some ECC mention differences in the legal protection with respect of credit card payments. See Annex I.

[75] On the other hand our supplier interviews suggest that differences in withdrawal rights have no major practical impact on loan or deposit products or life insurance.

requirements[76]; banks mention that they have to provide different amount of information depending on how product is sold and they are not always sure on the rules to apply (DMD or face-to-face regulations).

- Persons or categories of persons affected: Suppliers
- Possible developments that may affect barrier: Further legislation to remove these discrepancies.

Economic consequences of barrier

The inconsistency between regulation face-to-face and distant selling is one possible factor (among others) discouraging institutions from conducting distance selling. The cost of printing and providing different type of information, as well as the legal advice needed to distinguish the rules applicable in the two cases, might act as a deterrent for financial institutions to engage in distant selling. The surveys reveal that the overall impact of this barrier seems to be small, although it may have some effects on the provision of general insurance products, as the withdrawal right provided by the DMD is not suitable to insurance products where risk coverage is granted instantaneously., , ,

[76] The Distance Marketing Directive does not regulate these aspects, e.g. materialisation of the proof.

Barriers relating to difficulties in marketing or understanding local market conditions

Main barrier 11: Legal uncertainty regarding the applicable law

Description of the barrier

- Nature: A critical issue for companies seeking to supply retail financial services into other MS is that they must fully understand the relevant national state law and regulation. When product documentation is translated from one MS language to another, the outcome of the translation exercise can generate legal uncertainly. Moreover, different sets of national rules applicable to financial services make it difficult for suppliers to offer products by distance marketing abroad. Terms and conditions of the products have to be adapted in each country, and this adaptation exercise is usually most effectively achieved by local establishment.

- Scale of problem/barrier: This is a significant barrier and one of the main reasons why suppliers almost always need local presence in order to supply retail financial services into a particular MS.

- Persons or categories of persons affected: Suppliers.

- Possible developments that may affect barrier: While there are ongoing efforts to harmonise EU law and regulation of retail financial services this is almost always undertaken through the use of Directives which must be transposed into MS national law. Since national implementation varies, a good deal of legal uncertainty remains. Possible developments that might reduce this barrier, but not yet under serious consideration, might be either passporting of retail financial products from one MS to another, so any product regulated in one MS could be sold in any other MS; or the creation of EU level law and regulation of retail financial products, allowing such “Euro” products to be sold across the EU. A possible development that might influence this barrier (although it was not mentioned in any surveys, interviews, or case studies) is the introduction of Rome I regulation, which will make contracts subject to the law of a consumers ‘habitual residence’, something which may not always be easy for a distance seller to determine.

Economic consequences of barrier

This barrier effectively precludes the marketing and distribution of most retail financial services cross-border into other MS, especially the more complex products. Even in the case of the simplest products great care must be taken to ensure that they comply with the relevant national law and regulation and this induces most providers to offer such services through local presence, even if they distribute either directly or through third parties and do not operate their own local branch network. It also makes it impossible to market and distribute harmonised products on a pan-European basis. One example is provided by the insurance sector: the three generations of life and non-life insurance directives established that, in many cases, the law of the country in which the consumer has its residence should apply. This means that insurance companies who want to sell abroad must propose contracts which comply with the insurance law of each targeted country. This is reported by insurers as a significant barrier to entry in other national markets. Also banks mention additional costs when considering entering other national markets, e.g. the costs of legal advice or administrative costs to set up branches in the targeted markets.

Main barrier 12: Lack of understanding of domestic retail financial services markets

Description of the barrier

- Nature: There are considerable institutional and legal differences between MS for many retail financial services. Also the competitive conditions in different markets vary. Cross-border suppliers need to be fully informed about the local market before supply cross-border.

- Scale of problem/barrier: This barrier adds a considerable fixed cost to the cross-border supply of retail financial services, using any method other than acquisition of a local provider who is already familiar with the market. This barrier is easier to overcome in the largest MS because the potential gains from entry are relatively large, compared to the fixed costs of understanding the market. The scale of the barrier is especially large for the smaller MS.

- Persons or categories of persons affected: Suppliers.

- Possible developments that may affect barrier: Until effective pan-European markets emerge these national differences are likely to persist.

Economic consequences of barrier

This barrier adds considerable additional fixed costs and discourages cross-border supply into smaller MS except through the acquisition of local providers. It therefore tends to discourage competition within local markets, since it leads to only a limited about of new entrants.

Main barrier 13: Difficulties in marketing in other MS

Description of the barrier

- Nature: Differences in language and culture require tailored marketing campaigns. Moreover, the high fixed costs of marketing in relatively small MS can create an additional barrier to cross-border supply.

- Scale of problem/barrier: This is not an insuperable barrier but adds to the costs of entry, whether this is conducted through local presence or through cross-border marketing and distribution.

- Persons or categories of persons affected: Suppliers.

- Possible developments that may affect barrier: Within certain regions of the EU greater integration of culture and media, including greater use of the internet, can be expected to reduce this barrier, albeit slowly. This barrier will persist for some considerable time.

Economic consequences of barrier

The costs of overcoming differences in language and culture may be large and are one reason for preferring local presence to cross-border distance marketing. These additional marketing costs increase both the fixed and variable costs of entry, and discourage the distribution of harmonised products on a pan-European basis.

4.5 Demand side barriers

Eurobarometer results indicate that consumers are increasingly interested in looking cross-border for the financial service products (see Table 3 in section 3 above). However, several concerns are reflected in the Eurobarometer surveys.[77] In a 2006 Eurobarometer, the most serious concern for consumers was *only having to communicate in another language* with 31% of the respondents mentioning this as a barrier preventing them from purchasing or signing up for financial services in another European Union country compared to their own. Similar to the focus group results (see Annex II), other barriers are: *lack of personal contact when purchasing or signing up at a distance* (26%), i*nsufficient / inaccurate information* (25%), *risk of fraud* (23%), *misleading / deceptive information* (14%) and *lower level of consumer protection in other EU countries*, *excessive / incomprehensible information* and *extra costs related to purchasing financial services in other EU countries*, all with 11% of the responses. Another obstacle frequently mentioned in focus groups, namely the insufficient knowledge about cross-border redress mechanisms/support, was highlighted by the Eurobarometer survey as well. Only 2% of respondents have heard of FIN-NET, 11% of the European Consumer Centres.

Despite the fact that banks ranked anti-money laundering legislation as the second highest barrier to providing direct cross-border financial services (see Figure 10)[78], only 9% of responses to the Eurobarometer survey listed *issues related to proof of identity when purchasing/signing up for financial services in other EU countries (residence permit, utility bills, etc.)*. This is likely related to the fact that only a small proportion of Europeans have practical experience of the cross-border purchase of financial services; the study found that only 1% of EU consumers have used distance means to buy financial services from sellers/providers based in other EU member states.[79]

These trends indicated in the 2006 Eurobarometer are fairly consistent with the Eurobarometer monitoring of the issue since 2002,[80] where *lack of information*, *language problems*, *too risky* and *difficulties due to the distance* were among the top five barriers identified by respondents. Interestingly though, there was a noticeable change in percentages from 2002 to 2005, indicating an increased level of comfort with cross-border consumer credit arrangements. For example, the percentage of EU15 citizens surveyed that felt there were no obstacles to cross-border trade in financial services was 24% in 2002 and 31% in 2005. Likewise, only 23% of respondents identified *lack of information* as a barrier in 2005, while 30% did so in 2002. Another noticeable change was perceived with the *too risky* barrier, which went from 3rd rank with 22% in 2002, to 4th rank with only 14% in 2005.

---

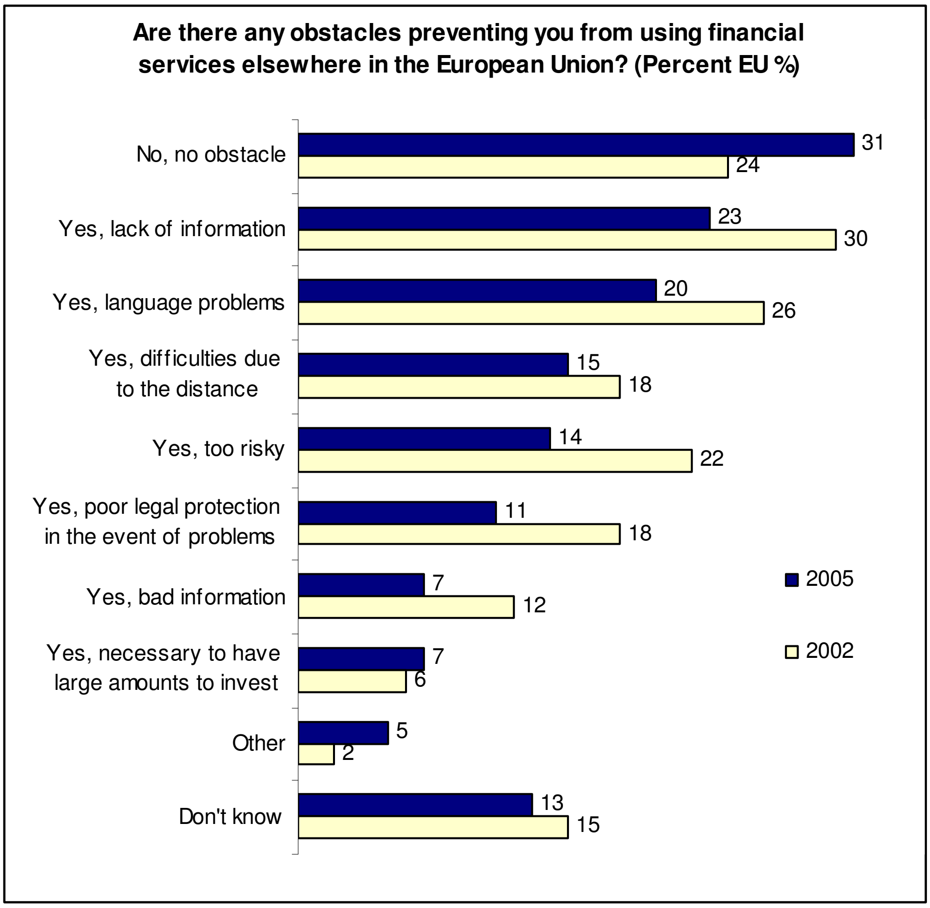
[77] The following Eurobarometers were used for statistics: Eurobarometer 58.1, Public Opinion in Europe: Views on Financial Services, February 2003, p.57; Eurobarometer 60.2, Public Opinion in Europe: Financial Services, January 2004, p.74; Eurobarometer 63.2, Public Opinion in Europe on Financial Services (Summary), September 2005, p.11; Eurobarometer 65.1, Consumer protection in the internal market, September 2006, p. 109.

[78] Discussions with bankers indicated this resulted in sometimes elaborate administrative procedures for customers' proof of identity.

[79] Eurobarometer 65.1. *Consumer protection in the internal market.* September 2006, pp. 110 – 112.

[80] All Eurobarometer surveys before 2006 refer to the EU 15 only.

Figure 12: Trends in Eurobarometer data on consumer perception of barriers to cross-border financial services (2002 and 2005)



Source: Eurobarometer (2002). Public Opinion in Europe: Views on Financial Services. EB58.1 December 2001, p. 57. and Eurobarometer (2005). Public Opinion in Europe on Financial Services. EB63.2 August 2005, p. 45. Please note: the 2002 results include only the EU15 Member States whereas the 2005 results include the EU25 Member States.

The results of the surveys conducted by *iff Hamburg* confirm Eurobarometer data. Consumer organisations state that factors such as language and culture are far more relevant barriers to the demand for cross-border financial services than differences in national legal provisions.

Many of these barriers, such as *lack of information, language problems, too risky* and *poor legal protection in the event of problems* relate primarily to intrinsic differences between MS and consumers' discomfort with these differences vis-à-vis conducting their financial activity in their own MS. As such, these differences translate into barriers related principally to the market for directly produced services where the financial service is provided under the law of the supplier's MS. They matter less to the marketing of financial services cross-border under the law of the customer's MS. In this latter case suppliers may adopt local branding and use locally targeted advertising and disclosure information. The consumer is not even necessarily aware that they are purchasing from a non-domestic supplier and the principal impact is to add somewhat to the costs of developing products for any particular domestic market.

As we have already discussed there are virtually no examples today of pan-European retail financial service products, almost all cross-border provision is *either* into individual MS under the law of that state *or* it takes place when the consumer is travelling on short or long term basis to another Member State. We can only speculate about the medium- to long-term, at such a time when supply side barriers such as differences in national law and regulation have been largely overcome, that financial institutions will then seek to market and distribute harmonised retail financial services products on a pan-European basis. In this case we suppose that demand side barriers such as language and culture will affect the take up of these pan-European products in different EU Member States.

Main barrier 14: Differences in language and culture

Description of the barrier

- Nature: consumers unable or unwilling to purchase products marketed in a foreign language. Aside from language there may also be cultural differences, for example some methods of marketing may not work so well in some cultural milieu, e.g. customers may have a cultural distrust of an internet site or a telephone sales centre, preferring face-to-face contact.

- Scale of problem/barrier: This is certainly not the only barrier to cross-border purchase of retail financial services: some neighbouring countries share a common language and there are many cases where speakers of a language are on both sides of a border, yet still in most of these cases there is little cross-border provision of retail financial services. There are a few examples (some Scandinavian countries, Spain/Portugal, and Belgium/Netherlands/ Luxembourg) where there are language differences but financial services marketed within one MS are purchased by customers from the neighbouring MS. There are also several examples of more than one language being used within a single MS, where suppliers of retail financial services use multiple languages for marketing. We can conclude that language differences discourage but do not entirely prevent cross-border purchase of retail financial services.

- Persons or categories of persons affected: Consumers unaware or untrusting of potential products; additional costs of translating marketing and other materials to suppliers providing financial services cross-border.

- Possible developments that may affect barrier: Greater population movement and cultural interaction between MS.

Economic consequences of barrier

At present there are many other barriers (local laws on disclosure of information, local taxation regimes, variation in consumer credit laws, continuing differences in payment systems) preventing retail financial services products to being marketed and delivered on a pan-European basis across many countries. Thus active marketing is always tailored to individual domestic national markets. Differences in language are then one of many factors, and not the most important one, contributing to the costs of cross-border provision. Differences in language are especially relevant for cross-border provision where the customer decides to take a financial service prepared for the domestic market of another MS; thus these relatively small amounts of cross-border provision may grow over time if barriers of language erode.

Main barrier 15: Consumer preferences towards national domestic providers

Description of the barrier

- Nature: Consumers unwilling to purchase products perceived as being produced by a foreign supplier. Evidence from the focus group discussions (see Annex II) suggests that consumers have a preference for local providers and obtain a sense of security with a physical presence of the bank nearby.[81]

- Scale of problem/barrier: Financial institutions almost always adopt local branding when supplying into domestic national markets for retail financial services, suggesting that there is a strong consumer preference towards what is perceived to be a local product. The need to use a domestic brand adds to the costs of entering a local market. For the simplest retail financial products, e.g. a savings deposit, such preferences may also play a significant role in preventing consumers from acquiring directly from suppliers in other MS (F2D and D2D), although other barriers such as national payment systems continue also to discourage such acquisitions.

- Persons or categories of persons affected: Consumers unwilling to purchase retail financial services that could be acquired from other MS; additional costs of translating marketing and other materials to suppliers providing financial services cross-border into domestic markets.

- Possible developments that may affect barrier: Greater population movement and cultural interaction between MS.

Economic consequences of barrier

At present there many other barriers (local laws on disclosure of information, local taxation regimes, variation in consumer credit laws, continuing differences in payment systems) preventing retail financial services products to being marketed and delivered on a pan-European basis across many countries. Thus active marketing is always tailored to individual domestic national markets. The cost of adopting a domestic branding, is then one of many factors, and probably not the most important one, contributing to the costs of cross-border provision. National preferences also inhibit cross-border provision where the customer decides to take a financial service

[81] From the interviews it seems that the most relevant issue here is the "local" provision, rather than "national". In other words, consumers tend to prefer a provider that has a local presence, which not necessarily means a national provider.

prepared for the domestic market of another MS; thus these relatively small amounts of cross-border provision may grow over time with greater interaction and cultural interchange between populations of different MS.

Main barrier 16: Absence of information

Description of the barrier

- Nature: For a direct cross-border transaction to be attractive for consumers, the benefit needs to compensate for the time and energy it costs to find and research these products (including the effort to operate in another language and do the additional background research it requires to ensure that they are not exposing themselves to a significant amount of risk).[82] This additional effort by consumers to purchase cross-border financial products, their additional transaction costs, is a cost consideration when consumers make purchasing decisions.

- Scale of problem/barrier: It appears as if consumers in only a few Member States have information on cross-border products available to them. In a survey of EU consumer organisations[83], the vast majority (90%) had not compiled information specifically for consumers on cross-border financial services and 76% of consumer organisations had not produced any articles, market reviews or comparative tests on financial services, that reviewed or included financial services sold across the border from a foreign supplier.[84] Furthermore, in the focus groups (see Annex II) no participants indicated an awareness of information on cross-border providers.

- Persons or categories of persons affected: Consumers unaware of potential products or needing to commit significant transaction costs to find these products and/or determine whether the products are relevant to cross-border consumers.

- Possible developments that may affect barrier: A number of actions could facilitate consumer mobility across borders. Information on any price or product yielding economic benefits to consumers could be made available in order to diminish consumers' transaction costs to learn of these products themselves. Providing information on the prices and products available to consumers within each Member State may encourage interest and/or demand of cross-border products by consumers. Furthermore, in line with the Commission's White Paper on the Integration of EU Mortgage Credit Markets, price transparency, through the provision of clear and comparable information, has an important role to play in facilitating customer mobility.[85]

---

[82] Evidence from external focus groups, see ANNEX II: Focus group results.
[83] Conducted by *iff Hamburg.*
[84] *iff Hamburg*, Survey of consumer organisations. (n=21).
[85] European Commission. *White Paper on the Integration of EU Mortgage Credit Markets*. White Paper, COM(2007) 807 final. Brussels, 2007, p. 6.

Economic consequences of barrier

Transaction costs to consumer increase when they spend energy to find and research the availability and price advantages of cross-border products, thus reducing any potential price benefits they could gain vis-a-vis products offered by local providers. Reducing the transaction costs of cross-border purchases of financial service products is likely to render price advantages of cross-border products more economically profitable for consumers. Transparency is a key method to reduce the transaction costs for consumers. Product and price transparency would facilitate consumers' awareness of cross-border products, and thereby encourage consumer demand in this market niche. Similarly, when there is little customer interest in purchasing goods and services directly cross-border, then little information is available; it may well be that as other barriers are reduced this information barrier may also decline.

4.6 General assessment of economic impacts of existing obstacles

This subsection provides a brief summary of the economic impacts of the various obstacles to cross-border supply analysed in sub-sections 4.4 and 4.5 – both for distance marketing and where the provision involves some face-to-face interaction. The limited amount of direct cross-border provision and reluctance or inability of suppliers to discuss costs of indirect provision through establishment mean that no cost quantification can be provided, but a broad ranking (very significant, significant, less significant) is attempted.

4.6.1 Operating and/or administrative costs of suppliers

The supply side barriers discussed in sub-section 4.3 make it extremely difficult for suppliers to provide harmonised retail financial services on a pan-European basis or even to a group of some but not all EU Member States. Cross-border supply has to be tailored to the domestic market of an individual MS, with dedicated product description and marketing and, for the more complex problems, dedicated support systems.

Some economies of scale can be exploited for simpler products, allowing cost reductions. As our study of a Nordic bank illustrates, there are cases where suppliers of retail financial services can spread some of the fixed costs of product design and processing across several domestic markets; in their case a relatively simple integrated deposit product and credit card offering which is provided in a very similar way in the smaller Scandinavian and northern European states in which they are active.

Suppliers could much better exploit economies of scale and achieve considerable cost reductions, if they were able to develop and market financial services products for several countries or on a pan-European scale. But this will require substantial changes in regulations, tax, and consumer law so this is only a possibility in the medium to long term.

4.6.2 Range, prices and conditions of financial products offered at a distance

Few suppliers of retail financial services make exclusive use of distance marketing channels, rather telephone call centres and websites are complementary to physical channels such as a branch network. Our surveys and case studies uncovered *hardly any examples* of business models based exclusively on *cross-border* distance marketing. For legal and practical reasons, distance marketing of retail financial services is always tailored to a specific domestic national marketplace. Even in those few cases where the supplier is located outside the target MS, still the activity is targeted at the domestic market under the law of that MS.

Our study has not compared the prices and other features of financial products offered at a distance e.g. via telephone or website, with the prices and other features of financial products available through face-to-face channels such as a branch network or via agents or brokers. In many cases, the distance channel is a complement to an existing branch network so the distinction between financial products offered at a distance and face-to-face is not very meaningful. We are aware of some examples of suppliers within particular domestic markets who focus on distance marketing. It could be informative to examine the range and price competitiveness of the products provided by these pure distance suppliers, in particular to examine to what extent their relatively low costs allow them to set prices lower than their competitors using multiple channels, but such comparisons fall outside the scope of the present study.

4.6.3 Competitive position

At present, as already discussed, a single internal market for retail financial services has not yet developed. Rather, retail financial services are provided in domestic national markets under the law of those individual MS. There is therefore no difference in the competitive position of European companies within the EU market or between European and non-European companies.

Some of the obstacles to cross-border supply are being reduced, for example the introduction of the Single Euro Payments Area (SEPA) will largely remove in the Eurozone the barrier of the lack of a single European retail payment system, although it may still be some years before single internal systems are used for processing payments across the EU or even the Eurozone. To the extent that barriers are reduced and companies are able to supply cross-border, either by establishment of subsidiaries or branches or by distance marketing targeted at a specific domestic market, then this will encourage greater competition, with better pricing for consumers and stronger incentives for improving cost efficiency. This impact may be relatively large in smaller MS where there has been relatively little competition in financial services.

4.6.4 Ranking of barriers

On the basis of the response to the surveys and case studies as well as further analysis we group the barriers into three broad categories: very significant, significant, and less significant.

<u>Institutional and technical barriers</u>

1. Lack of harmonised payment systems, etc.: *less significant barrier*
2. Problems related to tax*: less significant barrier*
3. Difficulties in concluding contracts electronically*: significant barrier*
4. Need to maintain multiple channels for delivery and communication*: significant barrier*

<u>Credit assessment and recovery problems</u>

5. Difficulties in debt recovery*: significant barrier*
6. Absence of pan-European credit referencing system*: less significant barrier*

<u>Differences in law and regulation</u>

7. National anti-money laundering requirements: *very significant barrier*
8. Lack of harmonisation of relevant MS legislation or absence of EU legislation: *very significant barrier*
9. Differences in disclosure rules and withdrawal rights: *less significant barrier*
10. Inconsistency between regulation of face-to-face and distance selling: *significant barrier*

<u>Difficulties in understanding/ penetrating local domestic market</u>

11. Legal uncertainty regarding the applicable law*: significant barrier*
12. Lack of understanding of domestic retail financial services markets*: significant barrier*
13. Difficulties in marketing in other MS: *less significant barrier*

<u>Demand side barriers</u>

14. Differences in language and culture: *very significant barrier*
15. Consumer preference for own national providers: *significant barrier*
16. Absence of information: *very significant barrier*

It is clear that both supply-side and demand-side barriers are inhibiting cross border distance marketing. Two out of the four barriers rated as most significant are supply-side barriers. Lack of harmonisation of MS legislation or absence of pan-EU legislation is a very significant barrier for all retail financial services. We note from our survey results that banks, but not insurance companies, placed particularly great weight on the barriers caused by national differences in anti-money laundering legislation. Some of the other barriers are very significant for particular products, most obviously barrier 5: Difficulties in debt recovery, which is a very significant barrier for cross-border provision of consumer credit.

Two out of the four barriers rated as most significant are demand-side barriers. Language differences, as well as cultural differences, and consumers' lack of information about cross-border financial products, appear to be very relevant factors explaining the limited cross-border provision of financial services.

4.7 The impact of the DMD on distance marketing of consumer financial services across borders and persistent obstacles

As the investigations of this report have demonstrated, there is no meaningful cross-border distance marketing of the vast majority of retail financial services cross-border within the EU – i.e. an internal market for distance marketing of consumer financial services does not yet exist and in most cases where cross-border distance marketing does take place it is on a small scale. This was the situation both before the Distance Marketing Directive and remains the situation today more than five years after it was adopted. Thus the data – the absence of such activities both before and after the implementation of the Directive – shows that the Directive has had little or no impact on cross-border distance marketing of most retail financial products and services. To the extent that there has been an impact it has been on distance marketing within the domestic markets of individual MS. Are there any exceptions? Some specific retail financial services are purchased cross-border, notably investment funds (notably funds sold in Luxembourg to investors from other EU members states). Within the banking sector there are also some initial offerings of deposit accounts/credit cards marketed at a distance to consumers located in another MS (see section 3.2).

Distance marketing of insurance products, especially general insurance, has had significant growth in recent years within a number of EU domestic markets, suggesting that there is potential for cross-border marketing of general insurance. There is some cross-border distance marketing of non-life insurance products and services (again in motor insurance primarily, see section 3.3.2). However, this is hardly relevant in terms of volume and therefore in insurance, just as in banking, the data suggest a virtual absence of retail cross-border distance selling.

Additionally, there is evidence that the financial services sector is increasingly moving in the direction of provision of consumer financial service products cross-border, although not usually via direct marketing. Although it is true that a limited number of companies have successfully operated a business model of concluding these contracts directly cross-border, the trend seems to be that most companies will enter cross-border markets with at least one physical office with a small team of employees present in each Member State (i.e. through establishment but not with a branch network). For many of these companies, they will operate a small office in the Member States where they are active yet provide their financial service products through an online platform only, usually with a significant amount of back-office support located in another Member State.

So the Directive has had no substantial impact on cross-border distance provision to retail customers. Those very few companies that were identified as operating with a direct cross-border strategy all stated that their business decision to provide financial service products cross-border via distance marketing was not significantly affected by the DMD. A supplier in the banking industry identified the E-Commerce Directive as more significant; the insurance company identified the third non-life insurance Directive as most significant for their cross-border operations. However, these companies generally welcomed the DMD because any initiatives targeting harmonisation were considered as being beneficial for their operations.

In addition to the very little cross-border distance marketing that is taking place, there may be some unsolicited cross-border distance purchase. Some products e.g. basic savings accounts or general insurance products could be acquired cross-border from distance providers operating inside a particular MS, by customers from other MS (i.e. case D2D identified in Table 9 of Section 4). This would be the case, for example, if a consumer from one country, say Ireland, were to make a deposit or purchase an insurance contract from a provider in the UK either by telephone or via a website, without the provider being involved in active marketing to Irish customers. There are substantial business barriers to such purchases, for example the UK sales system may not accept an Irish address and postcode; but there is no legal or regulatory barrier to such purchase taking place. The DMD, by creating greater consumer confidence in the disclosure and withdrawal rights for such contracts, could in theory create conditions that encourage this type of transaction. There is little or no quantitative data on the extent of such sales and lack of information in our surveys and case studies suggest that such purchases take place only on an extremely small scale. This may also be partly caused by the fact that in many cases distance marketing providers of consumer financial services targeted at the domestic market do not seem to accept customers resident in other Member States.

A further issue is whether the Directive might have *discouraged* distance marketing of banking and insurance products by introducing specific withdrawal rights for consumer financial services marketed at a distance. This was the assessment of a minority of the industry associations. However, our interviews with suppliers suggest that this has not been a serious practical problem. For example, there have not been widespread withdrawals from consumer loan contracts marketed and completed using distance channels, as a way of obtaining short-term interest-free credit.

To conclude, the economic impact of the Distance Marketing Directive on the cross-border provision of retail financial service has certainly been very minor. This does not mean that the Directive has had little or no overall economic impact, but any substantive economic impact has been on the existing distance marketing within the various domestic national markets for retail financial services within the various EU Member States. According to industry stakeholders, there has been some[86] increase in compliance costs for firms engaged in distance marketing, because they have had to provide more information than previously required and because the Directive introduced a difference in the disclosure requirements and withdrawal rights for domestic products, depending upon whether they are marketed at a distance or not.

At the same time there will have been impacts on the demand for financial services sold through distance marketing, potentially beneficial but difficult to quantify, for example encouraging a greater volume of distance selling if the higher disclosure requirements and greater withdrawal rights give consumers more confidence in financial services marketed and concluded at a distance. These demand effects are likely to have been largest for those products such as non-life insurance and

[86] According to the view of EBIC (the European Banking Industry Committee) provided to Civic Consulting this increase of costs has even been substantial. However, as it was not part of the mandate of the contractor to analyse the economic impact of the DMD on distance marketing of consumer financial services within the various domestic national markets, no final conclusion on this issue can be provided here.

investment funds where direct marketing is already an important delivery channel. But these impacts, both on costs of marketing and supplying at a distance and on demand, have been almost entirely limited to domestic distance marketing of financial services, and have had little or no impact on cross-border distance marketing of most retail financial products and services.

ANNEX I: SUMMARY OF LEGAL ANALYSIS

Goal

The report examines the potential impact of divergent national consumer rights to information provision and early withdrawal on the willingness and ability of suppliers and consumers to sell or buy financial products by means of the Internet or other similar means of distance selling. The project evaluates how Directive 2002/65/E has to date been incorporated into national law, how the different options have been applied by national legislators and which other comparable information rights and duties, arising under existing autonomous national law, have created overlapping or additional barriers to cross-border transactions beyond the scope of the applicable EU regulations.

Contributions

The project is based on contributions reporting on national provisions in the Member States provided by 27 national legal experts, in the main professors of law, from government reports provided by the European Commission, from a survey of financial service providers, a survey of national associations of financial service providers conducted in the parallel research project and from the views of consumer organizations in all 27 Member States, including consumer ombudsmen. The experts responded to the questions of the research team in three stages. This project focused on the law, while a sister project simultaneously investigated the problems encountered in practice in the cross-border distance marketing of financial services in the EU.

Legal Problems

All experts, consumer organisations and ombudsmen reported that there was no significant cross-border commerce in the distance marketing of financial services to consumers in the EU. This finding was in line with the comments received from the supplier side. The legal experts were only able to report on a few examples or discussions in their respective countries in which problems concerning the cross-border distance selling of financial services are specifically addressed. Consumer organizations do not show much experience of complaint-handling in this area. Only the French ombudsman reported complaints by foreigners in France relating to investment products. Most interviewed were of the opinion that legal differences are not a major impediment to cross-border sales of this kind. They assume that other non-legal factors, such as language, culture and the nature of the financial services concerned, are more relevant to the limited trade in cross-border financial services to date. Legal problems in relation to information rights involve distance selling in general, rather than cross-border transactions in particular.

Scope of Regulations

The project focused on legal differences in the law applicable in different countries which might constitute an obstacle to cross-border commerce. The scope of this research was defined by the different sources of diversity in national law in relation to information duties. These duties may stem from (1) regulations using the leeway offered under Article 4(2) of the Directive 2002/65/EC, either to maintain or to introduce additional national information rights, (2) general obligations under contract law to inform consumers or to provide adequate advice, (3) obligations derived from national product-specific regulations, which go beyond those required by existing EU law either (a) because of minimum harmonisation or (b) because of differences in the application of the relevant EU law.

Article 4(2) Distant Marketing

As far as the scope of Article 4(2) is concerned, about one-fifth of Member States claim that they have introduced additional duties relating to the provision of information, while about two-fifths claim that they have made use of the leeway to maintain additional national information rights. However some Member States, as well as experts, understand "use" to mean having maintained the "option", while others understand it more literally. With regard to all information rights applicable to financial services in general, as well as the general information duties provided by special consumer laws or the civil codes, all countries provide for additional information duties, which apply to foreign providers of financial services in the context of distance marketing. The report cites these general duties, in addition to specific duties to provide information.

Product Specific Information Duties

Product-specific duties to provide information duties account for most of the existing information-provision duties in EU Member States. Knowledge of duties of that nature in existence under EU law is useful for identifying any additional law existing at national level. For this reason the report first assembles information relating to 49 products or situations in respect of which the EU Directives in credit, insurance, payment systems and investment relevant to this report provide information duties. EU legislation providing for information duties covers the following matters: complaints, contractual changes, cost elements, execution, intermediaries, language, liabilities, litigation, marketing, payments, price parameters, product description, registration, representatives, right of withdrawal, risks, applicable rules, supervision, supplier identification, termination, time periods. The national reports reveal an even greater range of information rights at national level. The question of whether such rules are "additional" to EU law requires discussion of each of these rules with respect to the relevant EU Directives.

Article 6(3) Right of Withdrawal

With regard to the right of withdrawal, one-third of Member States, representing about half of the consumer market, has made use of the leeway in relation to all types of housing finance as defined by Article 6(3), always including both definitions. On the other hand, only three Member States, amounting to more than 20 % of all consumers in the EU, have made use of the option to exclude the right of withdrawal where officials (such as notaries) have been involved. The differences are fairly standardised and do not seem to have the potential to create legal problems.

Article 6(8) Cancellation

Most countries report that other rights of early termination exist, either in the form of a cancellation right or indirectly, through nullity or other sanctions. Although there is an overlap, no problems are reported apart from the problem of obligatory motor insurance, which cannot be terminated retroactively. Consumers are generally entitled to choose to exercise the right that is the most favourable to them. This may give way to legal problems.

Article 11 Sanctions

Highly specific systems of sanctions are preserved by the open definition of sanctions contained in the Directive for breach of duties to provide information. These range from civil, to administrative to criminal penalties. In addition, different procedures apply, from class action to complaint boards, as well as different court procedures. Differences in sanctions, particularly those derived from non-fulfillment of information rights, may be one of the main sources of legal barriers to cross-border financial services and products. In most cases, this situation entails legal advice costs for suppliers. It may also give rise to uncertainty for consumers, with the result that consumers may prefer to enter into a contract with a supplier from their own country. Differing sanctions and procedures are capable of creating trade barriers.

ANNEX II: FOCUS GROUP RESULTS

Analysis of demand side barriers

General findings

Consumers in focus groups conducted in 2006 in Great Britain, Germany and the Czech Republic[87] indicated relatively high reluctance to taking out credit in another Member State. The participants in all three focus groups, although experienced internet shoppers, stated a certain level of discomfort when shopping for credit via internet in another Member State, more so than cross-border internet purchases of other goods or services (e.g. flight tickets, clothing). The main concerns regarding taking out consumer credit in another country were: language issues, currency and exchange rate conversion issues, practical issues, cultural differences, perception, confidence and trust issues, and security concerns. A number of the focus group participants also cited being rather uninformed about EU-wide consumer protection rights and uninformed in general about the terms and conditions involved when taking out a consumer credit agreement in another country.

Focus group analysis

The main concerns voiced by consumers in the focus groups regarding cross-border purchases of financial services fall generally under two barriers identified in the report and frequently mentioned by providers of financial services as demand-side barriers; namely:

1. Differences in language

2. Consumer preference for own national providers

These will be discussed below along with a discussion of motivations identified by the focus group participants that might encourage them to search cross-border for financial services, despite their concerns.

Demand side barrier 1: Consumer preference for own national providers

The barrier "consumer preference for own national providers" is understood to mean providers located within national borders. This barrier dominated the conversations in all focus groups as a main concern. Consumer preference for nearby providers was

[87] The focus groups were conducted for Civic Consulting by Opinion Leader Research, a market research company in the context of a study conducted for the European Parliament considering the "Broad economic analysis of the impact of the proposed directive on consumer credit" (2007). The focus groups consisted of 8-9 consumers of mixed age and gender, who are experienced on-line shoppers, but have not yet done this cross-border. This is an especially relevant target group, as cross-border consumer credit agreements are likely to be concluded online and any growth in this area is likely to be linked to an increase in cross-border shopping. During the 2-hour focus group, participants were asked a set of predetermined questions related to their experience, followed by wider questions and discussion. The protocol for the focus groups was developed by Civic Consulting. The focus groups were conducted London, Berlin and Prague between December 14-18th, 2006.

either based on: (a) a need for traditional face-to-face contact (as opposed to distance contracts); or (b) a certainty about the service or redress available to them in their Member State (as opposed to cross-border contracts).

Some respondents objected to not having personal contact with a financial adviser when taking out credit in another country. They also pointed out that purchasing financial services or signing a loan agreement was a sufficiently complicated issue to deal with in person, in one's own country, and is only more difficult when attempting this within another Member State. Others, even when favourable to the idea of taking out consumer credit in another country, pointed out that they felt there were minimal advantages to this compared to the extra effort, risks and obligations involved with taking out consumer credit in another Member State.

Focus group participants voiced concerns over trust and privacy issues as another significant barrier preventing them from purchasing consumer credit cross-border. For example, participants expressed uncertainty as to what would happen to their personal data, and which laws and regulations were available to safeguard their personal data and finances when they purchased cross-border. A number of focus group participants indicated that they would be willing to take out a loan or another type of financial service, or at least look into it, provided they were guaranteed the same consumer protection rights in another Member State as are available to them within their national borders. No participants were aware of any pan-European consumer protection laws available to them.

The following comments are representative of the results of the focus groups:

Czech participant: "*I'd mind the contact. You have your own personal banker here. Whenever I have a problem, I can contact him and he helps me. Simply, they can help me with the paperwork in case I do not understand it. In this case you'd have to go to Germany to fix the problem. And it would become expensive by calling to Germany.*"

Czech participant: *"[if it is for a] comparable price then one chooses Czech pages because of language and accessibility."*

German participant: *"If something goes wrong, the impact will be much higher than if you just buy a DVD player. When you're dealing with such amounts, I need to have all the information, or at least feel that I have all the information that I need. I don't want to get the feeling that I might have missed out on some information that was provided somewhere on the website."*

German participant: *"The further away it is the less you know about the legal situation."*

British participant: *"You really are stepping into the unknown doing it from another country. I think that's the main thing."*

British participant: *"It's just having that piece of mind that there is some kind of contact in this country rather than somewhere abroad."*

Demand side barrier 2: Difference in language and culture

Several participants in the focus groups emphasised that language was a significant barrier for them when shopping online cross-border for a financial service product. In fact, while they felt comfortable shopping for a product across borders in another language than their mother tongue, they were more reticent when in came to financial services, and indicated the need to have translations of the terms and conditions and contracts. All three focus groups were in line with the Eurobarometer findings citing language as a major concern for consumers.

Concerns related to language seemed to be tied to a sense that they would not understand all the critical financial details of the terms and conditions that might expose them later to risk. The following comments are representative of the results of the focus groups:

Czech participant: *"In case of loan, even being it in English I wouldn't order it. I wouldn't feel sure, I would have to have it translated in detail."*

German participant: *"Even a mental effort, because you think, goodness, maybe I will get bank statements in French language."*

British participant: *"The small print is not always in English."*

British participant: "*I'd be inclined to maybe do it with a British bank with a foreign branch so like Barclays and get their advice as I'm talking to someone in English and understanding the whole thing."*

Motivations for going cross-border

Despite the barriers hindering or discouraging consumers from making direct cross-border purchases of financial service products; a number of the participants were not opposed to making such purchases. Participants seemed most likely to purchase financial service products if the product was relatively simplistic and straightforward, thereby implying that these products are easier to understand and involve a lower risk despite potential language differences or discrepancies in the consumer protection. Participants indicated that they would be primarily motivated to purchase consumer financial services cross-border if there were products available cross-border that could not be obtained in their own Member States or if the price was "significantly" better.

Product availability was mentioned as a motivational factor. A few consumers mentioned that products simply are not available in their own countries. For example, British participants in the focus group discussed the convenience of having a credit card from within the Eurozone to use when they are travelling so as to avoid conversion charges on their cards from British banks. Czech participants mentioned that sometimes cross-border companies require a Maestro card to make a purchases of goods or services which many Czech consumers do not have; therefore, they would be motivated to obtain an account cross-border in order to have such a card.

Participants expressed that better prices available cross-border need to be significant enough to compensate for the opportunity cost of the extra research and time likely to be necessary when making direct cross-border purchases of consumer financial service products. Many participants suggested that with simplistic products with less risk, the cost savings would not be significant enough. Therefore, it would be more sensible to search cross-border for products that could lead to high cost savings; however, a few participants indicated that these products are often very complex and involve a considerable amount of money, thereby exposing them to too much risk when they don't have a complete understanding of the terms and conditions, the consumer protection rights available to them, appropriate redress mechanisms, and the service and support they can expect from their cross-border bank.

ANNEX III: PARTICIPATING STAKEHOLDERS

Participating associations of financial service providers

National associations responses to questionnaire	Location
Austrian Savings Banks Association	Austria
Austrian Insurance Association (VVO)	Austria
Verband österreichischer Banken & Bankiers*	Austria
Belgian Finance Federation / la Fédération belge du secteur financier (Febelfin)	Belgium
Belgian Insurance Association (Assuralia)*	Belgium
Association of Banks in Bulgaria (ABB)	Bulgaria
Insurance Association of Cyprus	Cyprus
Czech Banking Association	Czech Republic
Czech Insurance Association (CAP)	Czech Republic
Danish Bankers' Association	Denmark
Danish Mortgage Banks*	Denmark
Danish Insurance Association	Denmark
Eesti Kindlustusseltside Liit	Estonia
Federation of Finnish Financial Services (two responses – one for the insurance sector and one for the banking sector)	Finland
Fédération Française des Sociétés d'Assurances (FFSA)	France
Groupe Caisse d'Epargne (GCE)	France
Gesamtverband der Deutschen Versicherungswirtschaft e.V., (GDV)	Germany
German Savings Bank Association / Deutscher Sparkassen- und Giroverband e. V. (DSGV)	Germany
Hellenic Association of Insurance Companies	Greece
Hellenic Bank Association (HBA)	Greece
Association of Hungarian Insurance Companies (MABISZ)	Hungary
Irish Banking Federation (IBF)*	Ireland
Italian Insurance Asssociation (ANIA)	Italy
Italian Banking Association / Associazione Bancaria Italiana (ABI)	Italy
Association of Lithuanian Banks (LBA)*	Lithuania
Association des Banques et Banquiers Luxembourg (ABBL)*	Luxembourg
Malta Insurance Association*	Malta
Polish Chamber of Insurance / Polska Izba Ubezpieczeń (PIU)	Poland
Associação Portuguesa de Seguradores (APS)	Portugal

Portuguese Banking Association / Associação Portuguesa de Bancos (APB)	Portugal
Slovakian Banking Association (SBA)*	Slovakia
Slovakian Insurance Federation*	Slovakia
Slovenain Insurance Association / Slovensko Zavarovalno Združenje	Slovenia
The Bank Association of Slovenia	Slovenia
Spanish Banking Association / Asociación Española de Banca (AEB)	Spain
Swedish Bankers´Association	Sweden
Swedish Insurance Federation / Sveriges Försäkringsförbund	Sweden
The Association of British Insurers (ABI)	United Kingdom
British Bankers' Association (BBA)*	United Kingdom

* These respondents provided an official response not in the form of the questionnaire

Participating financial service providers

Financial service providers' responses to questionnaire	Location
Admiral Group plc	United Kingdom
Advanzia	Luxembourg
AEGON Hungary Composite Insurance Company	Hungary
AIB	Ireland
AIG Europe S.A. Branch Office in Hungary	Hungary
Allianz	Germany
Allianz Hungaria Insurance Company	Hungary
Alpha Insurance Ltd.	Cyprus
Atlantic Insurance Company Public Ltd	Cyprus
AXA Versicherung AG	Germany
Banco Banif e Comercial dos Açores SA	Portugal
Banco BPI S.A.	Portugal
Banco Internacional do Funchal	Portugal
Banco Santander	Spain
Banco Santander Totta	Portugal
Bank Austria - Creditanstalt	Austria
Bank of Ireland Group	Ireland
Bank of Valletta plc	Malta
Bankinter S.A.	Spain
Banque et Caisse d'Epargne de l'Etat	Luxembourg
Banque Raiffeisen S.C., cooperative society	Luxembourg
BBVA	Spain

Bipop Carire	Italy
BNP Paribas	France
BPN - Banco Portugues de Negocios	Portugal
Caixa Banco de Investimento	Portugal
Caixa Economica Montepio Geral	Portugal
Citibank International plc, Greek Branch	Greece
Citigroup	USA
Commercial General Insurance Ltd.	Cyprus
Consum.it	Italy
Corona Verzekeringen N.V.	Belgium
CSOB Poisova	Slovakia
Danske Bank A/S	Denmark
Delta Lloyd Life	Belgium
Dexia Luxembourg	Luxembourg
Dimenzio Insuarance Associatation	Hungary
Direct Line	Germany
Erste Bank der oesterreichischen Sparkassen AG	Austria
Erste Sparkassen Biztosító Zrt.	Hungary
Ethniki Insurance (Cyprus) Ltd	Cyprus
EuroLife Ltd.	Cyprus
FINAREF	France
FINAREF Risques divers	France
FinecoBank SPA	Italy
Finibanco S.A.	Portugal
Gan Direct Insurance Ltd	Cyprus
GasanMamo Insurance Ltd.	Malta
General Insurance of Cyprus Ltd.	Cyprus
Generali zavarovalnica	Slovenia
Genertel Biztosito Zrt.	Hungary
Genialloyd	Italy
Geniki Bank	Greece
Hellenic Bank Public Co Ltd	Cyprus
HSBC Trinkaus & Burkhardt AG	Germany
If skadeförsäkring	Sweden
IF Skadeforsikring AB	Sweden
Ineas	The Netherlands

ING Direct	The Netherlands
ING Luxembourg	Luxembourg
Interlife Insurance Co. Ltd.	Cyprus
Intesa Sanpaolo	Italy
Laiki Cyprialife	Cyprus
Laiki Insurance Company Ltd	Cyprus
Mediocredito Centrale (MCC) S.p.A.	Italy
Municipal Bank	Bulgaria
Olympic Insurance Company Ltd	Cyprus
OTP Garancia Insurance	Hungary
Piette & Partners Verzekeringsmaatschappij NV	Belgium
Probank	Greece
Progressive Insco Ltd	Cyprus
Quinn Insurance	Ireland
Royal Bank of Scotland Group	United Kingdom
Royal Crown Insurance Co Ltd	Cyprus
Santander Consumer (UK) plc	United Kingdom
Santander Consumer Finance	Spain
Sparkasse Bremerhaven	Germany
TVM België N.V.	Belgium
Ulster Bank	Ireland
UniCredit Banca d'Impresa	Italy
UniCredit Banca S.p.A.	Italy
UniCredit Banka Slovenija d.d.	Slovenia
UniCredit Private Banking S.p.A.	Italy
UNIQA Versicherungen AG	Austria
Uniqua	Austria
Universal Life Insurance Public Company Limited	Cyprus
Ydrogios Insurance Company Ltd.	Cyprus

Note: Some stakeholders wished to remain anonymous and are therefore, not listed in this table.

ANNEX IV: SURVEY QUESTIONNAIRES

CIVIC CONSULTING

VAN DIJK MANAGEMENT CONSULTANTS

EVALUATION OF THE DISTANCE MARKETING DIRECTIVE

*

SURVEY OF ASSOCIATIONS

OF FINANCIAL SERVICE PROVIDERS ACTIVE IN DISTANCE MARKETING

Please return filled questionnaire by email to survey@civic-consulting.de no later than

4 February 2008

(please return in Word format and do not convert to a pdf document)

The Health and Consumer Protection Directorate General of the European Commission has launched an analysis of the economic impact of Directive 2002/65/EC[1] concerning the distance marketing of consumer financial services on the conclusion of cross-border contracts. The information you will provide through this questionnaire will be crucial in evaluating the current status of the internal market for financial services and in defining further steps to be taken at EU level.

This questionnaire is targeted to associations of financial service providers. There is a separate questionnaire for your member companies which we kindly ask you to circulate. We very much appreciate your contribution to this study.

Please note the following definitions for the purpose of this questionnaire:

Consumer financial services: Any service of a banking, credit, insurance, personal pension, investment or payment nature.

Distance marketing: Sales conducted - including conclusion of the contract - without face-to-face contact (i.e. by Internet, telephone, fax or mail).

Cross-border distance marketing: Distance marketing of financial services directly from one EU Member State to consumers in another EU Member State (i.e. the services are not sold through local presence by branches or majority holdings in the country where the consumer is resident).

If you have any further questions, do not hesitate to contact:

Kristen Schubert (survey@civic-consulting.de) Phone: +49 30 2196 2295 Fax: +49 30 8196 2298

1. Please identify yourself:

a. Please identify the name of your association:

Please specify

b. Please identify the country in which your association is headquartered:

Please specify

c. Please identify the main business sector of your member companies:

Please select from the dropdown menu

[1] For more information: http://ec.europa.eu/consumers/cons_int/fina_serv/dist_mark/background_en.htm

d. How many member companies do you represent:

Please specify

e. Questionnaire completed by:

Name, position, contact details

2. Do your member companies conduct distance marketing of consumer financial services (cross-border and/or national)?

☐ Yes *(if Yes, please proceed with next question)* ☐ No *(if No, please proceed to question 5)*

3. What were your member companies' <u>total sales</u> (for insurance: total premium income) of consumer financial services in 2006 by means of <u>distance marketing</u> (i.e. the total of your national and cross-border sales)? [2]

Please estimate sales/premium income (total of distance marketing) (in national currency)

Which percentage of the total business income of your member companies does this figure represent?

Please estimate % of total business income

4. Of your member companies' total sales (for insurance: premium income) of consumer financial services in 2006 by means of distance marketing (provided in question 3), what percentage is sold by <u>cross-border distance marketing</u> to consumers in other EU Member States?

a. Please provide an estimate of <u>cross-border distance marketing</u> across all consumer financial services offered by your member companies (as a percentage of total sales/premium income):[3]

Please select from the dropdown menu

b. Please provide an estimate of cross-border distance marketing by <u>financial service category</u> (as a percentage of total sales/premium income):

Savings account	*Please select from the dropdown menu*
Current account	*Please select from the dropdown menu*
Credit card	*Please select from the dropdown menu*
Life insurance	*Please select from the dropdown menu*

[2] If your member companies sell both insurance and other financial services, please provide the estimated sum of premium income and sales for all products sold by means of distance marketing

[3] If your member companies sell both insurance and other financial services, please estimate the percentage of the sum of premium income and sales for all products sold by means of distance marketing

Motor insurance	*Please select from the dropdown menu*
Other insurance (health, home, travel, care, etc.)	*Please select from the dropdown menu*
Stocks or shares, bonds, derivatives, etc.	*Please select from the dropdown menu*
Collective investments	*Please select from the dropdown menu*
Private pension plan	*Please select from the dropdown menu*
Mortgage / home loan	*Please select from the dropdown menu*
Other loans (including consumer credit)	*Please select from the dropdown menu*
Other financial services	*Please select from the dropdown menu*

Comments

5. What are the major problems/barriers, if any, faced by your members wishing to offer financial services from a distance to consumers in other EU Member States?

a. Most important barrier is:

Please select from the dropdown menu

b. Second most important barrier is:

Please select from the dropdown menu

c. Third most important barrier is:

Please select from the dropdown menu

If "other" was selected in (a) (b) or (c), please specify

6. Please assess the relevance of possible internal market problems/barriers caused by differences between Member States laws regarding the following areas:

a. Differences between the minimum information requirements of Directive 2002/65 and more stringent information requirements contained in new or existing laws in MS allowed by article 4 (2) are …

Please select from the dropdown menu

b. Differences between MS laws on right of withdrawal based on different choices MS have made on whether or not to provide that the right of withdrawal shall not apply in the cases mentioned in Article 6 (3) of Directive 2002/65 are …

Please select from the dropdown menu

c. Differences between the right of withdrawal granted by Directive 2002/65 and those granted by existing MS legislation in relation to cancellation, termination or non-enforceability of a distance contract that is exempt from full harmonisation under Article 6 (8) are …

Please select from the dropdown menu

d. Differences in the implementation of other relevant Directives (e.g. Directive 2000/31/EC on electronic commerce) into MS legislation are …

Please select from the dropdown menu

e. Differences in Member States contract law provisions are …

Please select from the dropdown menu

f. Other legal differences are …

Please select from the dropdown menu

Please specify the relevant area

7. What is the impact of the problems/barriers indicated above (in questions 5 and 6) regarding cross-border distance marketing of financial services for consumers in other Member States?

a. Impact on operating and/or administrative costs (e.g. costs relating to legal advice) of your members that conduct or consider conducting cross-border distance marketing of financial services?

Please specify

b. Impact on the range, prices and conditions of financial services offered at a distance to European consumers?

Please specify

c. Impact on the competitive position of your member companies within the European internal market?

Please specify

8. How would you describe the general impact of Directive 2002/65/EC concerning the cross-border distance marketing of consumer financial services?

a. Impact on the number of consumer financial services contracts concluded through cross-border distance marketing to consumers in other EU Member States: The number of such contracts has …

Please select from the dropdown menu

b. Impact on consumer confidence regarding cross-border financial services: Consumer confidence has…

Please select from the dropdown menu

c. Impact on consumer demand for cross-border financial services: Consumer demand for financial services offered cross-border by means of distance marketing has …

Please select from the dropdown menu

d. Impact on the availability of consumer financial services offered cross-border by means of distance marketing: The availability of such services has …

Please select from the dropdown menu

e. Impact on the range / variety of consumer financial services offered cross-border by means of distance marketing: The range / variety of such services has …

Please select from the dropdown menu

f. Impact on competition EU-wide regarding those consumer financial services provided by your members: Competition has …

Please select from the dropdown menu

Comments on general impacts

9. Do you think that the EU efforts to promote an internal market in consumer financial services by means of distance marketing are working? What new measures, if any, would help to change consumer attitudes, or remove possible barriers?

Comments

10. How do you expect the sales of financial services contracts concluded by your member companies through <u>cross-border distance marketing</u> to consumers in another EU Member State to change in the next 5 years if no major legislative change at EU level were to happen (estimated percentage change over the whole period)?

Please select from the dropdown menu

Comments

CIVIC CONSULTING

VAN DIJK MANAGEMENT CONSULTANTS

EVALUATION OF THE DISTANCE MARKETING DIRECTIVE

*

SURVEY OF COMPANIES

PROVIDING FINANCIAL SERVICES BY MEANS OF DISTANCE MARKETING

Please fill in online questionnaire[1] no later than

4 February 2008

(or return this questionnaire by email to sgo@bvdmc.com)

The Health and Consumer Protection Directorate General of the European Commission has launched an analysis of the economic impact of Directive 2002/65/EC[2] concerning the distance marketing of consumer financial services on the conclusion of cross-border contracts. The information you will provide through this questionnaire will be crucial in evaluating the current status of the internal market for financial services and in defining further steps to be taken at EU level.

All views you express in this questionnaire will only be quoted anonymously and the data will not be transmitted to third parties. We very much appreciate your contribution to this study.

Please note the following definitions for the purpose of this questionnaire:

Consumer financial services: Any service of a banking, credit, insurance, personal pension, investment or payment nature.

Distance marketing: Sales conducted - including conclusion of the contract - without face-to-face contact (i.e. by Internet, telephone, fax or mail).

Cross-border distance marketing: Distance marketing of financial services directly from one EU Member State to consumers in another EU Member State (i.e. the services are not sold through local presence by branches or majority holdings in the country where the consumer is resident).

Please provide your comments in English, German, or French.

If you have any further questions, do not hesitate to contact:

Sonia Gonzalo (sgo@bvdmc.com) Phone: +32.2.641.00.87 Fax: +32.2.641.00.30

1. Please identify yourself:

a. Please identify the name of your company:

Please specify

b. Please identify the country in which your company is headquartered:

Please specify

[1] Please visit: http://www.surveyz.com/TakeSurvey?id=76652&responseCheck=false

[2] For more information: http://ec.europa.eu/consumers/cons_int/fina_serv/dist_mark/background_en.htm

c. Please identify your main type of business:

Please select from the dropdown menu

d. Please identify your company size:

Please select from the dropdown menu

e. Questionnaire completed by:

Name, position, contact details

2. Do you conduct distance marketing of consumer financial services (cross-border and/or national)?

☐ Yes *(if Yes, please proceed with next question)* ☐ No *(if No, please proceed to question 8)*

If yes, what is your most important distribution channel (i.e. telephone, internet, mail, fax)?

Please select from the dropdown menu

If "combination of channels" was selected, please specify

3. What were your total sales (for insurance: total premium income) of consumer financial services in 2006 by means of distance marketing (i.e. the total of your national and cross-border sales)? [3]

Please estimate sales/premium income (total of distance marketing) (in national currency)

Which percentage of your total business income does this figure represent?

Please estimate % of total business income

4. What kind of consumer financial services are offered by distance marketing?

a. Which of your financial services offered by distance marketing is the most relevant to you (in terms of sales / premium income)?

Please select from the dropdown menu

If "other financial service" was selected, please specify

[3] If you sell both insurance and other financial services, please provide the estimated sum of premium income and sales for all products sold by means of distance marketing

b. Which of your financial services offered by distance marketing is the second most relevant to you (in terms of sales / premium income)?

Please select from the dropdown menu

If "other financial service" was selected, please specify

5. Are any of these financial services offered by distance marketing available cross-border to consumers in other EU Member States?

☐ Yes *(if Yes, please specify below and proceed)* ☐ No *(if No, please proceed to question 8)*

If "yes", please specify the type of service

a. Is your cross-border distance marketing of financial services available EU-wide or only in selected EU Member States?

☐ EU-wide ☐ Selected EU Member States

b. Are the prices for these financial services offered by distance marketing the same for all Member States in which you are active or do they vary by Member State?

☐ Prices are the same ☐ Prices are different in different Member States

c. Concerning other product characteristics: do you offer the same consumer financial services for all Member States in which you are active or do the characteristics of the services offered to consumers vary by Member State?

☐ Same characteristics of services
☐ Different characteristics of services in different Member States

d. Please list any reasons why the prices or other characteristics of your financial services offered by distance marketing might differ by Member State?

Please comment

6. Of your total sales (for insurance: total premium income) of consumer financial services in 2006 by means of distance marketing (provided in question 3), what percentage is sold by cross-border distance marketing to consumers in other EU Member States?[4]

Please select from the dropdown menu

[4] If you sell both insurance and other financial services, please estimate the percentage of the sum of premium income and sales for all products sold by means of distance marketing

7. When did you first begin to offer financial services from a distance to consumers cross-border in other EU Member States?

Please list year

8. Do you plan to expand (or develop, if you do not already) your offerings of financial services from a distance to consumers in other EU Member States?

☐ Yes ☐ No

Please specify

9. Overall, when considering to provide financial services to consumers in other Member States, which of the following approaches would you prefer?

☐ Distance marketing ☐ Local presence (e.g. branches or majority holdings in local banks)

Please specify

10. What are the major problems/barriers, if any, faced by suppliers wishing to offer financial services from a distance to consumers in other EU Member States?

a. Most important barrier is:

Please select from the dropdown menu

b. Second most important barrier is:

Please select from the dropdown menu

c. Third most important barrier is:

Please select from the dropdown menu

If "other" was selected in (a) (b) or (c), please specify

11. What has been the impact of the problems/barriers indicated above on your operating and/or administrative costs when providing financial services to consumers in other Member States?

Please select from the dropdown menu

Please specify

12. What has been the impact of the problems/barriers indicated above on your competitive position within the European internal market?

Please select from the dropdown menu

Please specify

13. How would you describe the impact of Directive 2002/65/EC on your distance marketing of financial services to consumers in other EU Member States?

Please select from the dropdown menu

Comments

14. Do you think that the EU efforts to promote an internal market in consumer financial services by means of distance marketing are working? What new measures, if any, would help to change consumer attitudes, or remove possible barriers?

Comments

15. How do you expect your sales of consumer financial services through cross-border distance marketing to consumers in another EU Member State to change in the next 5 years if no major legislative change at EU level were to happen (estimated percentage change over the whole period)?

Please select from the dropdown menu

Comments

ANNEX V: RESULTS OF SURVEY OF BUSINESS ASSOCIATIONS

1. Please identify yourself:

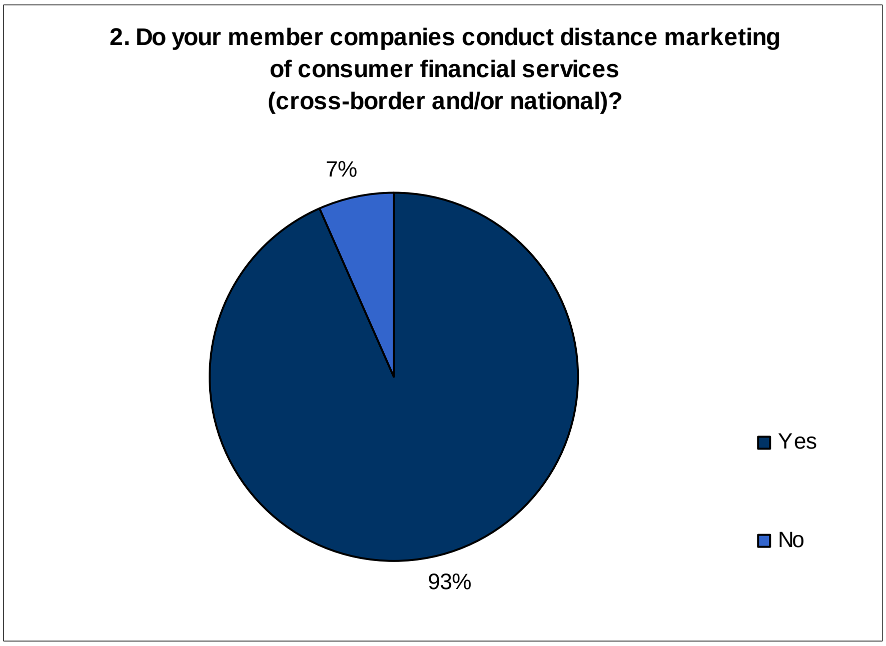
c. Please identify the main business sector of your member companies:

Sector	Responses
Banking	14
Insurance	16
TOTAL	30

d. How many member companies do you represent?

Sector	Responses
Banking	2,947
Insurance	2,118
TOTAL	5,065

2. Do your member companies conduct distance marketing of consumer financial services (cross-border and/or national)?



3. What were your member companies' total sales (for insurance: total premium income) of consumer financial services in 2006 by means of distance marketing (i.e. the total of your national and cross-border sales)?

Sector	Euro	Number of responses
Banking	4,200,000,000	1
Insurance	57,553,604,085	10
TOTAL	61,753,604,085	11

Which percentage of the total business income of your member companies does this figure represent?

Sector	Median (%)	Number of responses
Banking	5.0	5
Insurance	1.8	11

4. Of your member companies' total sales (for insurance: premium income) of consumer financial services in 2006 by means of distance marketing (provided in question 3), what percentage is sold by cross-border distance marketing to consumers in other EU Member States?

a. Please provide an estimate of cross-border distance marketing across all consumer financial services offered by your member companies (as a percentage of total sales/premium income):

	No answer	0%	<0.1%	<1%	<5%	<10%	<20%	<50%	>50%	Don't know
TOTAL	3	9	5	4	0	0	0	0	0	9

b. Please provide an estimate of cross-border distance marketing by financial service category (as a percentage of total sales/premium income):

	No answer	0%	<0.1%	<1%	<5%	<10%	<20%	<50%	>50%	Don't know
Savings account	13	6	2	0	0	0	0	0	0	9
Current account	13	7	2	0	0	0	0	0	0	8
Credit card	13	6	1	1	0	0	0	0	0	9
Life insurance	6	9	3	1	0	0	0	0	0	11
Motor insurance	6	9	3	1	0	0	0	0	0	11
Other insurance (health, home, travel, care, etc.)	6	8	4	1	0	1	0	0	0	10
Stocks or shares,	13	6	1	1	0	1	0	0	0	8

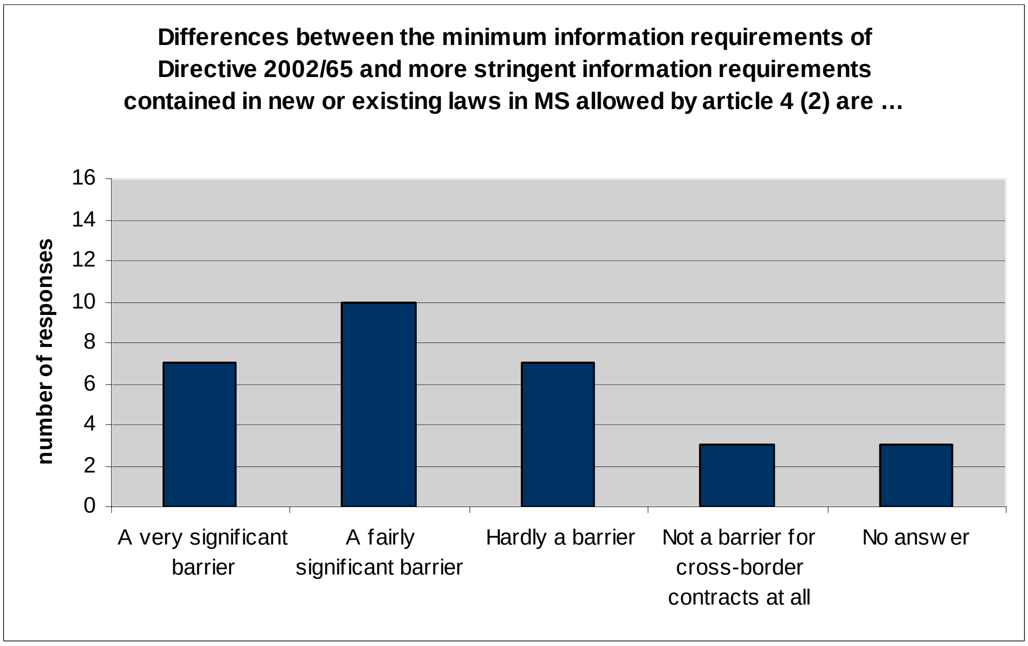
bonds, derivatives, etc.										
Collective investments	12	6	1	2	0	0	0	0	1	8
Private pension plan	12	6	2	1	0	0	0	0	0	9
Mortgage / home loan	13	6	2	0	0	1	0	0	0	8
Other loans (including consumer credit)	13	6	1	2	0	0	0	0	0	8
Other financial services	13	5	2	0	0	0	0	0	0	10

5. What are the major problems/barriers, if any, faced by your members wishing to offer financial services from a distance to consumers in other EU Member States?

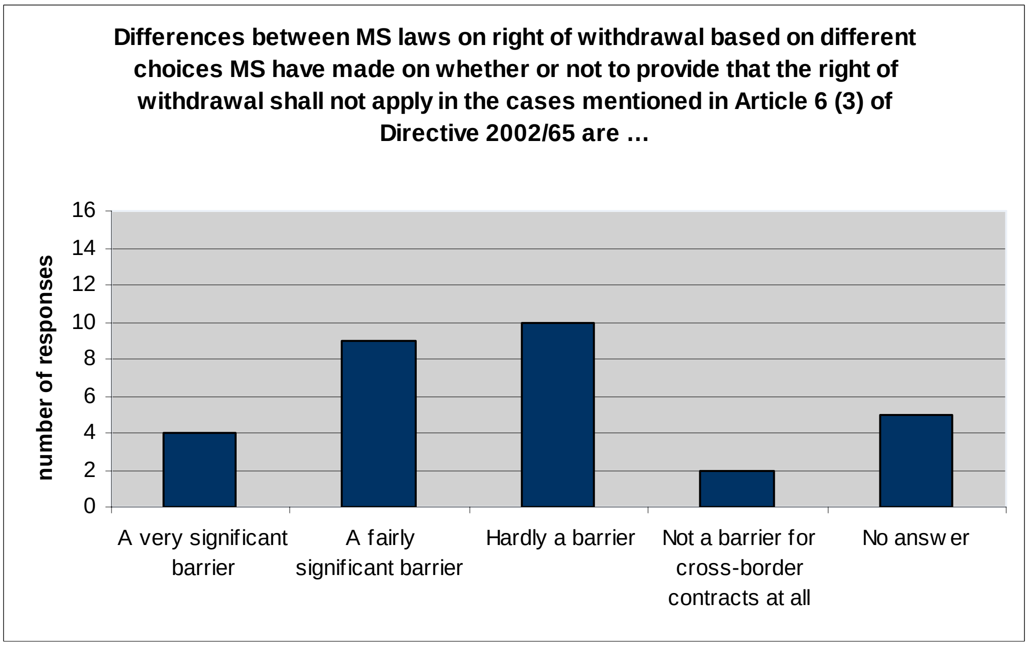
	Most important barrier	2nd most important barrier	3rd most important barrier
Absence of pan-European credit referencing system	0	1	0
Difficulties in debt recovery	1	2	2
National anti-money laundering requirements	3	0	1
Legal uncertainty regarding the applicable law	4	1	0
Lack of harmonised payment systems, etc.	0	0	0
Difficulty to conclude contracts electronically	1	1	3
Problems related to tax	0	4	2
Lack of adequate marketing opportunities	1	0	1
Differences in language and culture	1	9	7
Consumer preference for national providers	8	1	6
Different consumer demand in different EU states	1	2	4
Lack of harmonisation of relevant MS legislation	7	4	0
Lack of appropriate EU legislation	0	2	0
Other	2	2	3
No answer	1	1	1

6. Please assess the relevance of possible internal market problems/barriers caused by differences between Member States laws regarding the following areas:

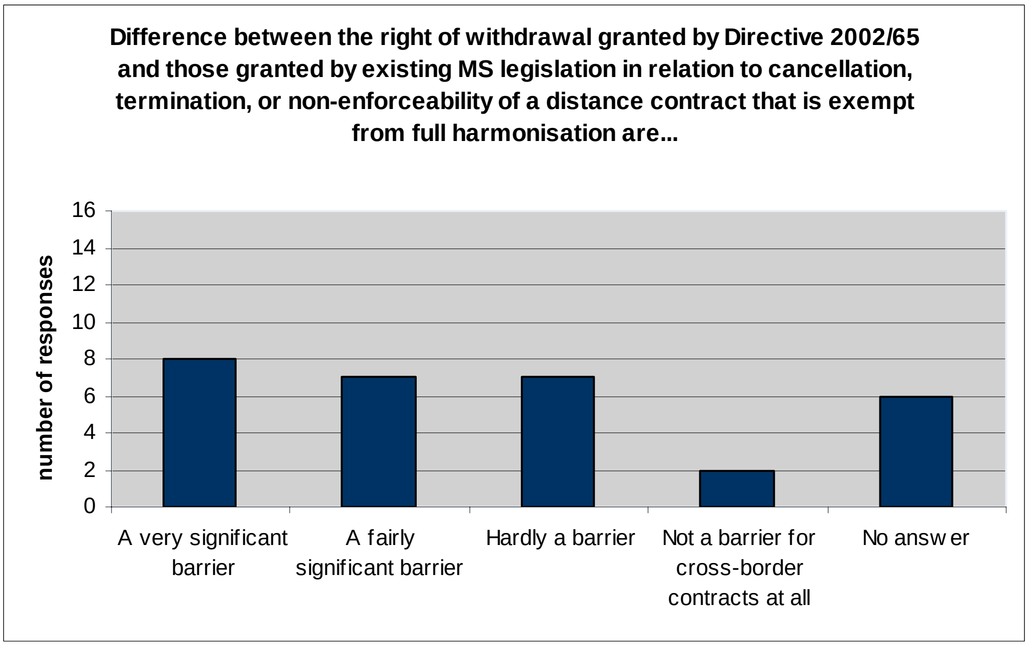
a. Differences between the minimum information requirements of Directive 2002/65 and more stringent information requirements contained in new or existing laws in MS allowed by article 4 (2) are …



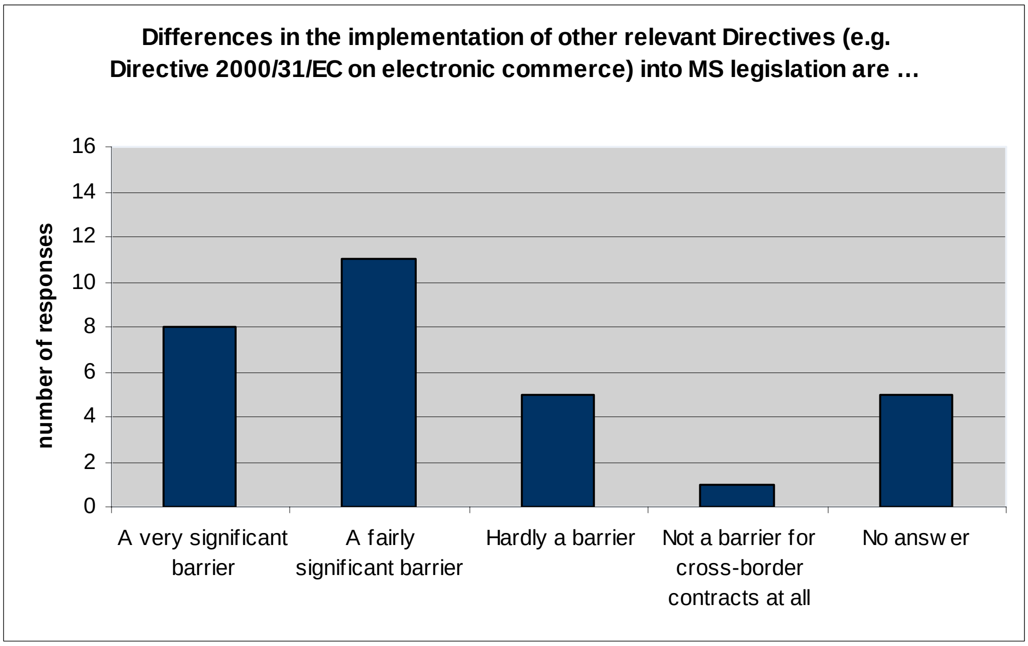
b. Differences between MS laws on right of withdrawal based on different choices MS have made on whether or not to provide that the right of withdrawal shall not apply in the cases mentioned in Article 6 (3) of Directive 2002/65 are …



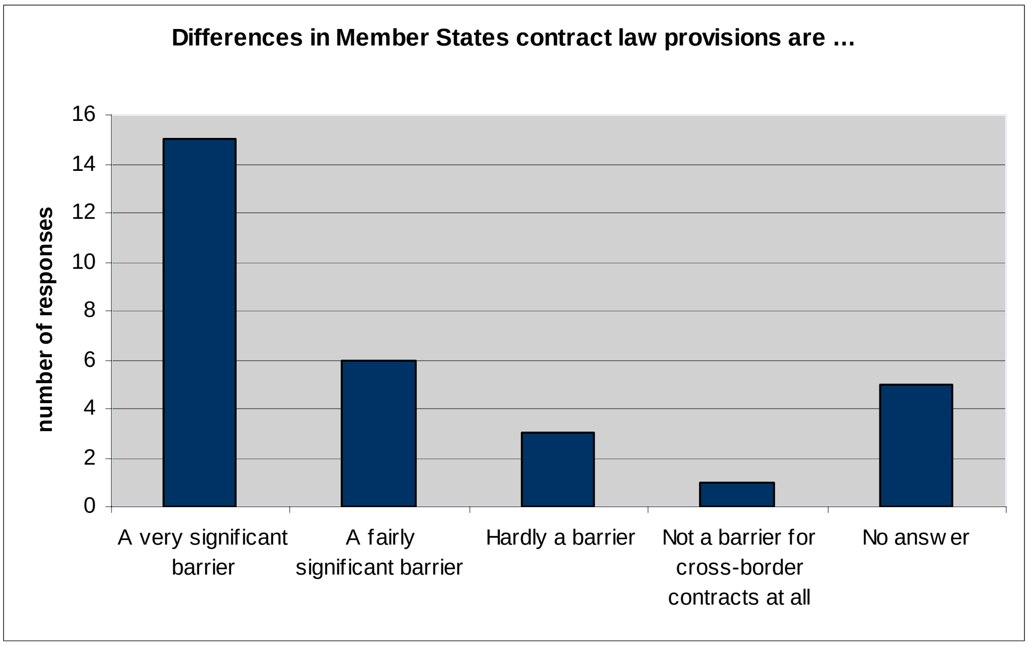
c. Differences between the right of withdrawal granted by Directive 2002/65 and those granted by existing MS legislation in relation to cancellation, termination or non-enforceability of a distance contract that is exempt from full harmonisation under Article 6 (8) are …



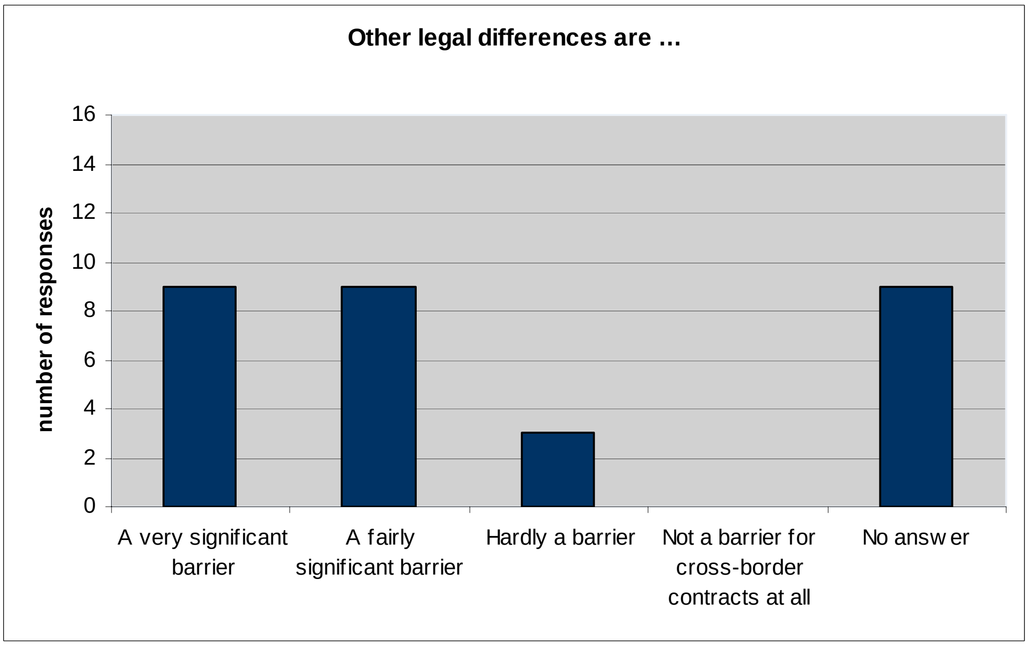
d. Differences in the implementation of other relevant Directives (e.g. Directive 2000/31/EC on electronic commerce) into MS legislation are …



e. Differences in Member States contract law provisions are …



f. Other legal differences are …



7. What is the impact of the problems/barriers indicated above (in questions 5 and 6) regarding cross-border distance marketing of financial services for consumers in other Member States?

a. Impact on operating and/or administrative costs (e.g. costs relating to legal advice) of your members that conduct or consider conducting cross-border distance marketing of financial services?

Qualitative responses

b. Impact on the range, prices and conditions of financial services offered at a distance to European consumers?

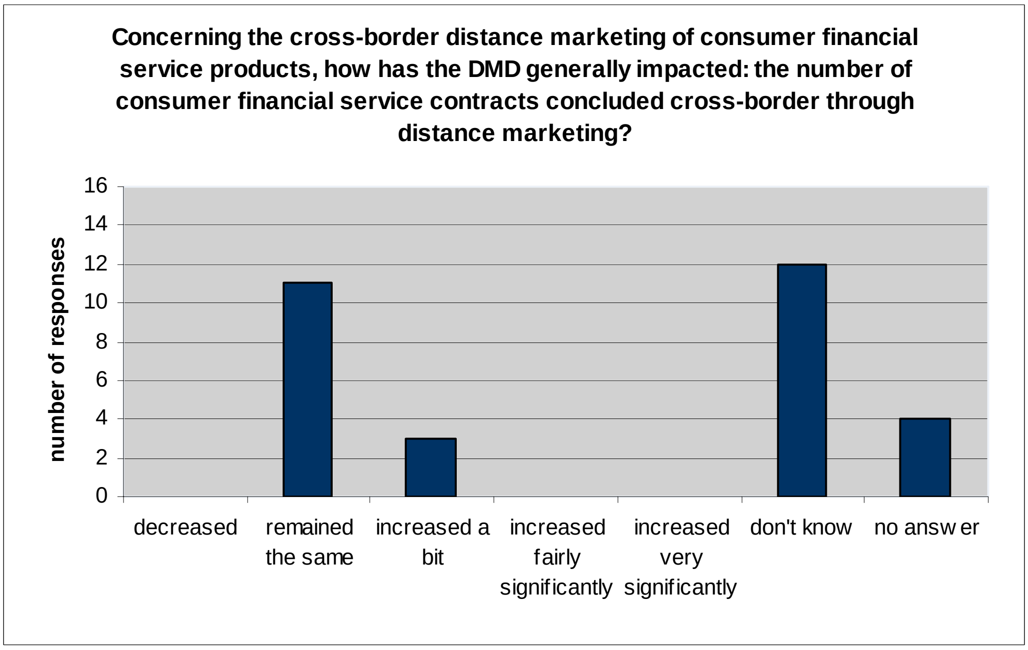
Qualitative responses

c. Impact on the competitive position of your member companies within the European internal market?

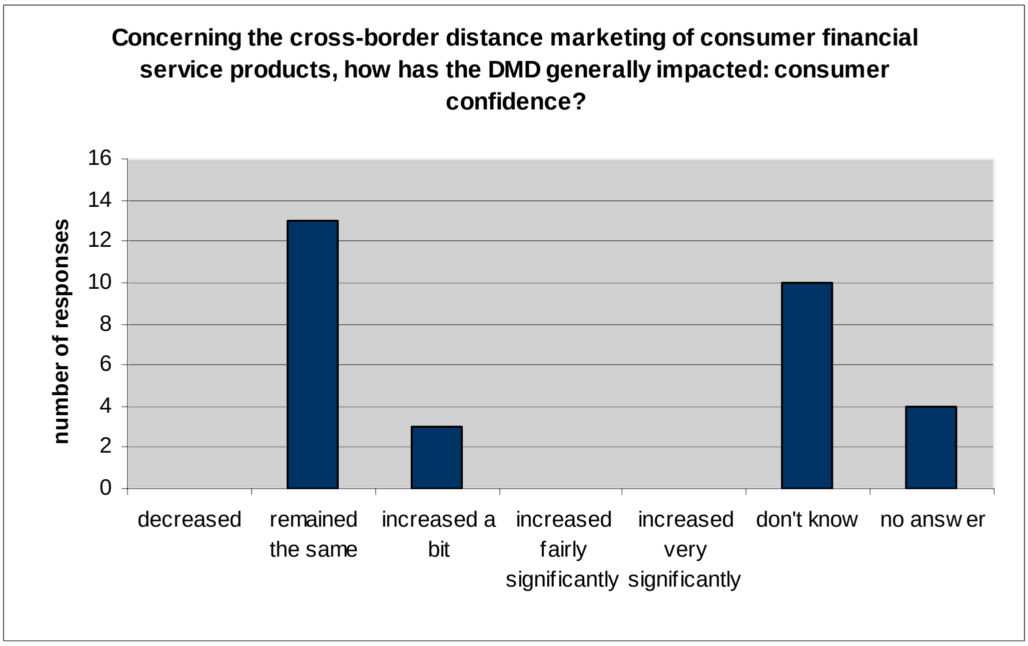
Qualitative responses

8. How would you describe the general impact of Directive 2002/65/EC concerning the cross-border distance marketing of consumer financial services?

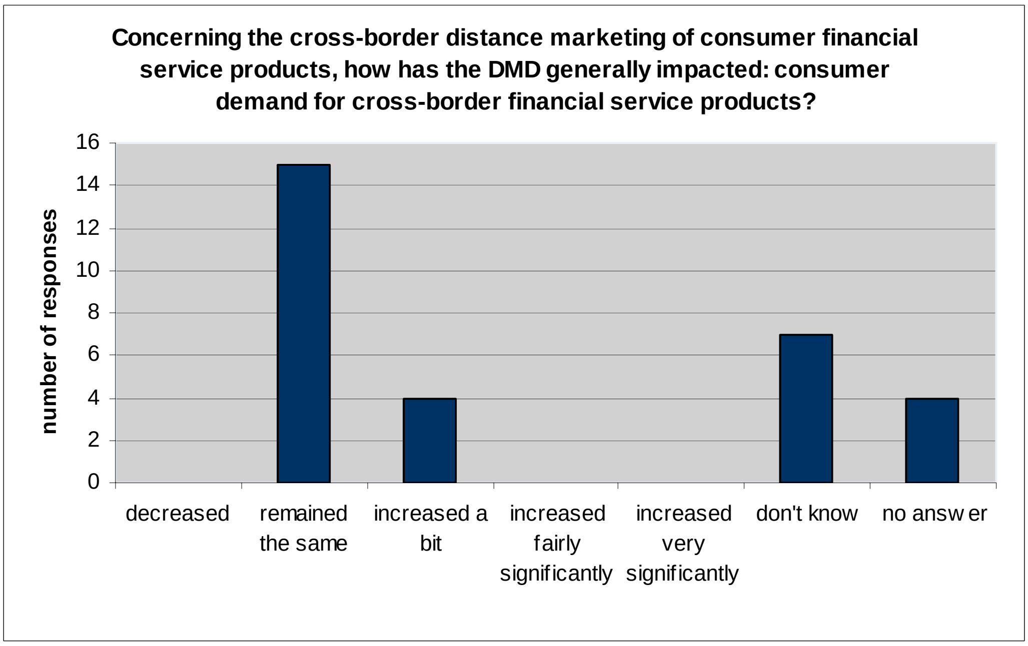
a. Impact on the number of consumer financial services contracts concluded through cross-border distance marketing to consumers in other EU Member States: The number of such contracts has …



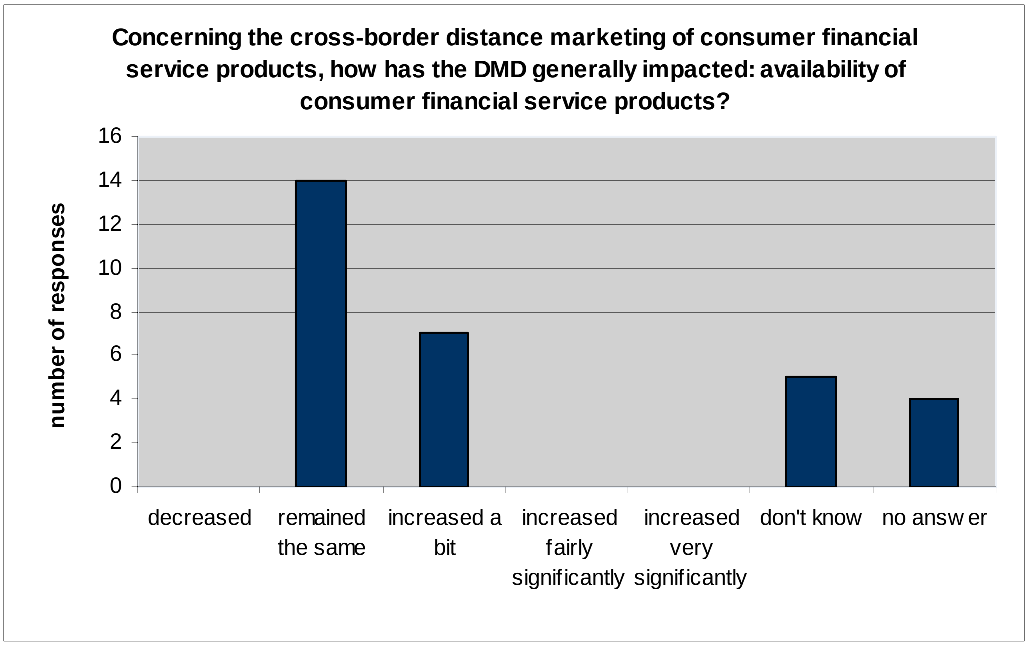
b. Impact on consumer confidence regarding cross-border financial services: Consumer confidence has…



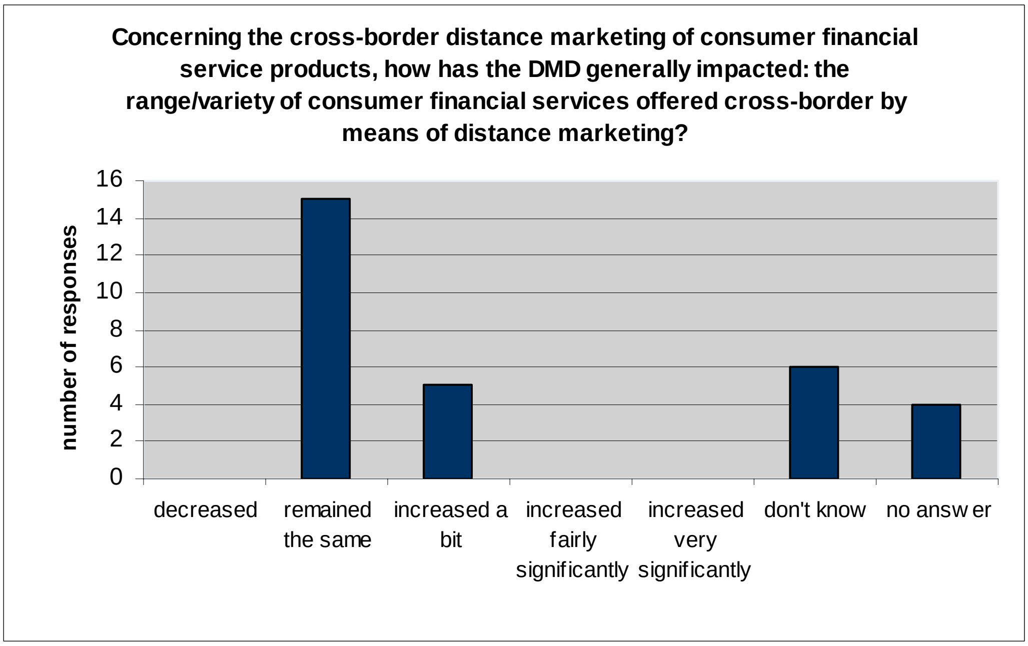
c. Impact on consumer demand for cross-border financial services: Consumer demand for financial services offered cross-border by means of distance marketing has …



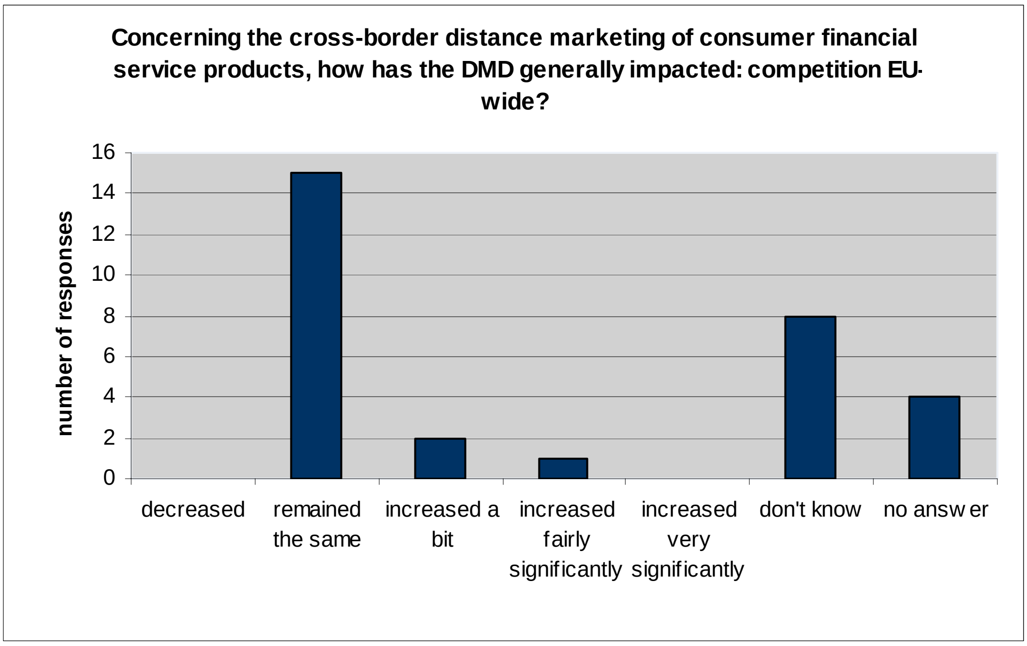
d. Impact on the availability of consumer financial services offered cross-border by means of distance marketing: The availability of such services has …



e. Impact on the range / variety of consumer financial services offered cross-border by means of distance marketing: The range / variety of such services has …



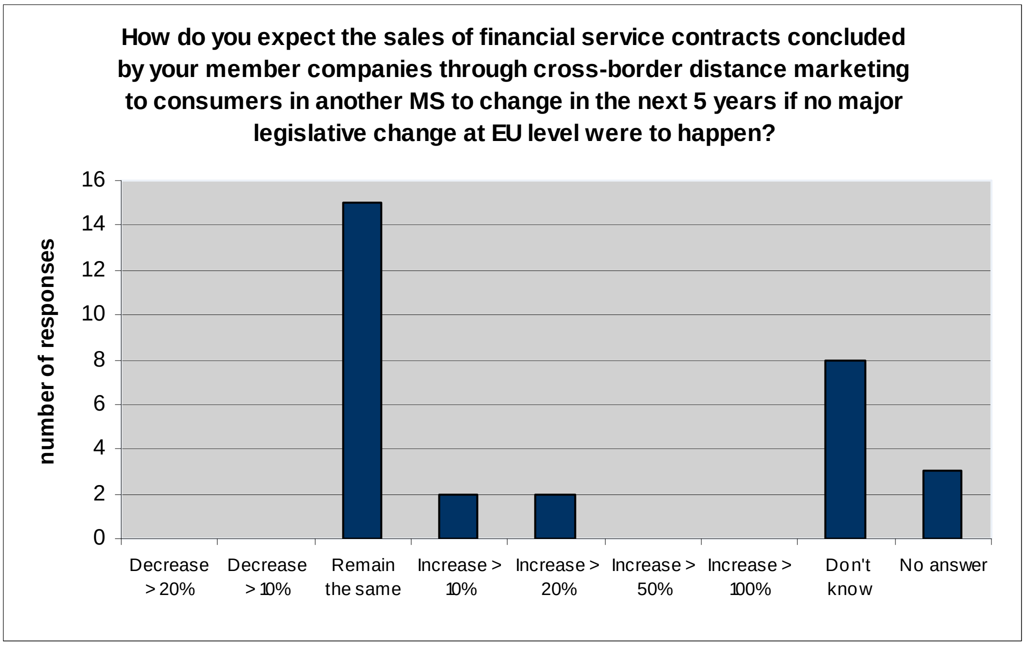
f. Impact on competition EU-wide regarding those consumer financial services provided by your members: Competition has …



9. Do you think that the EU efforts to promote an internal market in consumer financial services by means of distance marketing are working? What new measures, if any, would help to change consumer attitudes, or remove possible barriers?

Qualitative responses

10. How do you expect the sales of financial services contracts concluded by your member companies through cross-border distance marketing to consumers in another EU Member State to change in the next 5 years if no major legislative change at EU level were to happen (estimated percentage change over the whole period)?



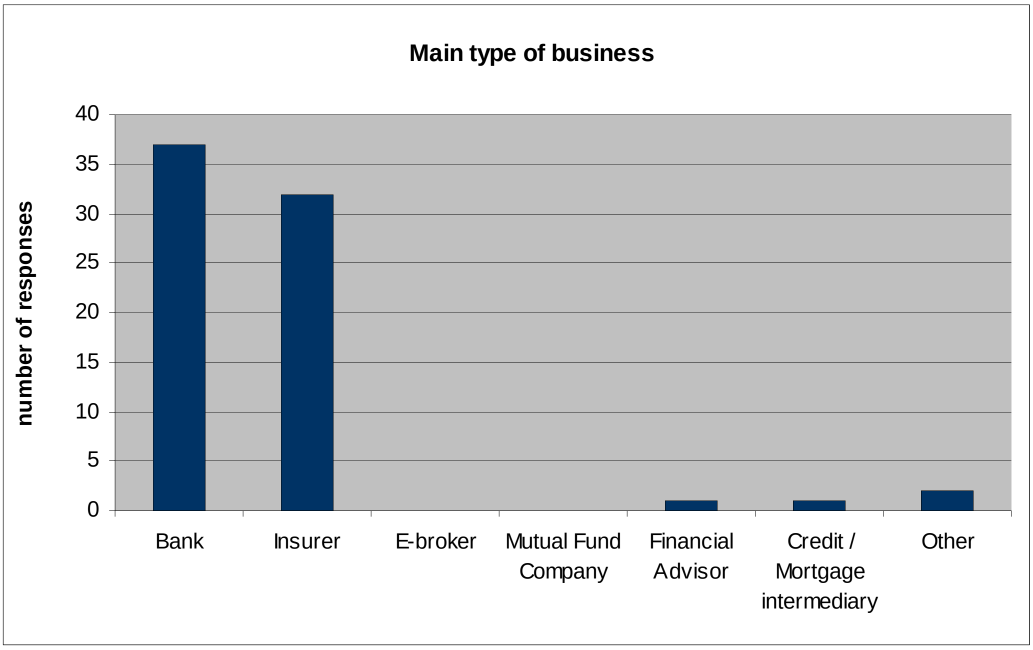
ANNEX VI: RESULTS OF SURVEY OF COMPANIES

1. Please identify yourself:

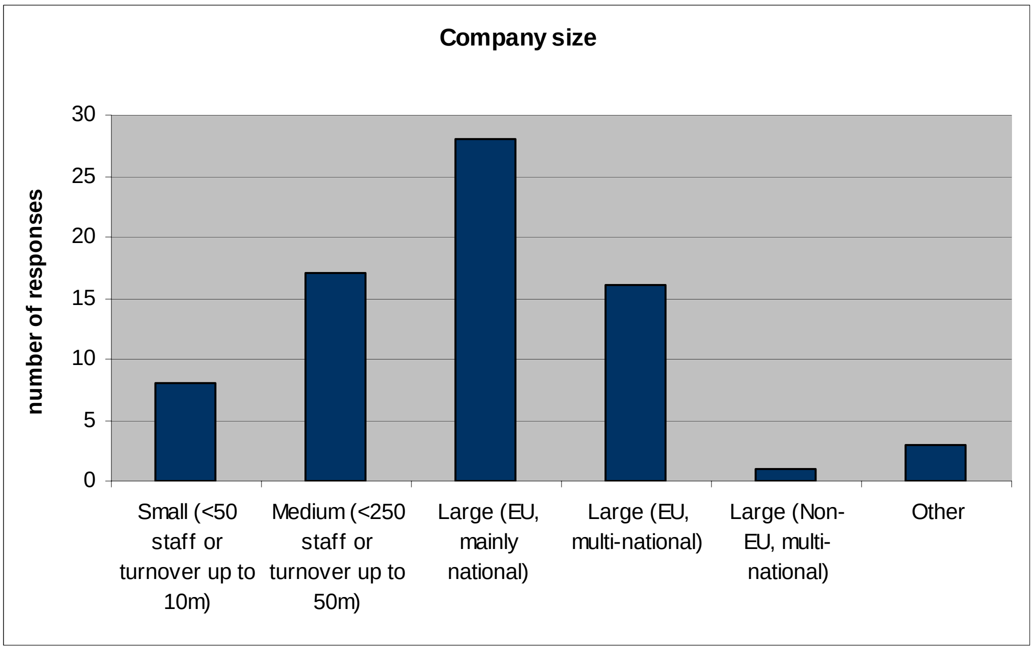
a. Please identify the name of your company:

Location	Number of responses
Austria	3
Belgium	4
Bulgaria	1
Czech Republic	0
Cyprus	16
Estonia	0
Denmark	1
France	2
Finland	0
Germany	3
Greece	3
Hungary	6
Ireland	1
Italy	8
Latvia	0
Lithuania	0
Luxemburg	4
Malta	2
Netherlands	1
Poland	0
Portugal	8
Romania	0
Slovakia	1
Slovenia	2
Spain	4
Sweden	1
United Kingdom	2

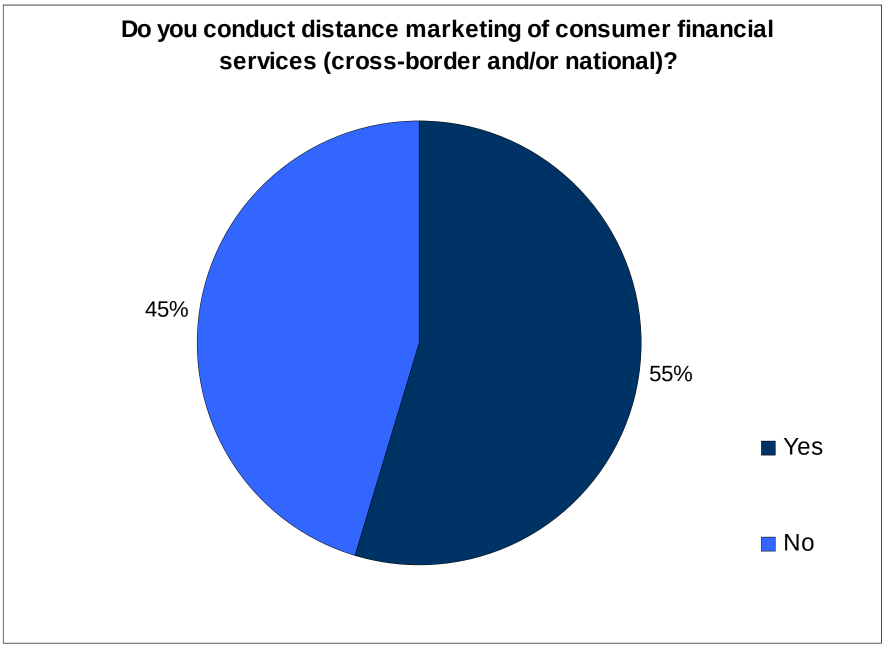
c. Please identify your main type of business:



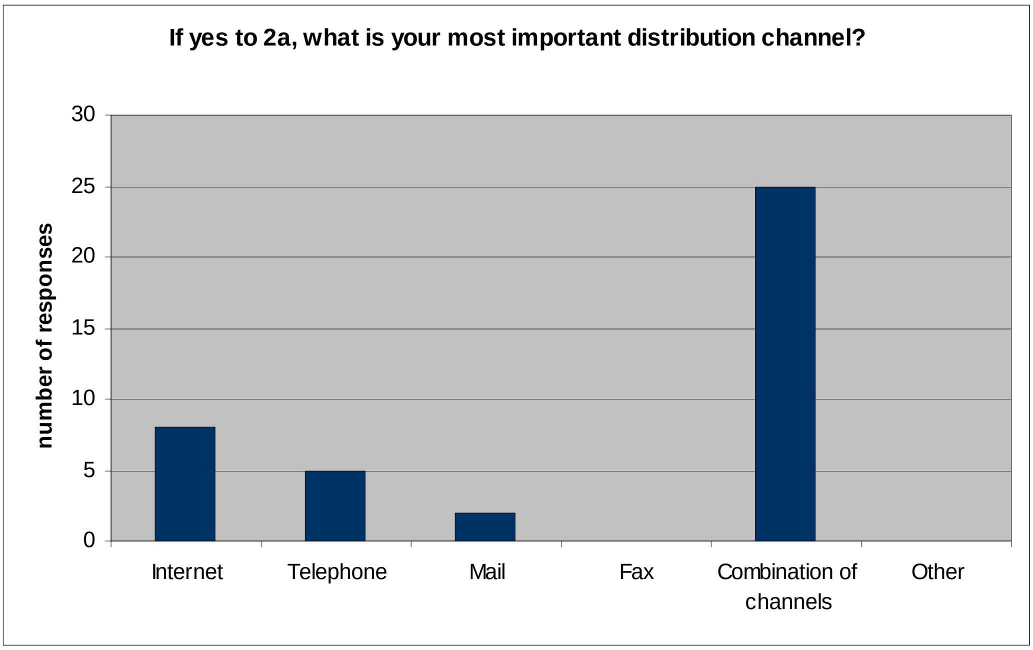
d. Please identify your company size:



2. Do you conduct distance marketing of consumer financial services (cross-border and/or national)?



If yes, what is your most important distribution channel (i.e. telephone, internet, mail, fax)?



3. What were your total sales (for insurance: total premium income) of consumer financial services in 2006 by means of distance marketing (i.e. the total of your national and cross-border sales)?

Please estimate sales/premium income (total of distance marketing) (in national currency)

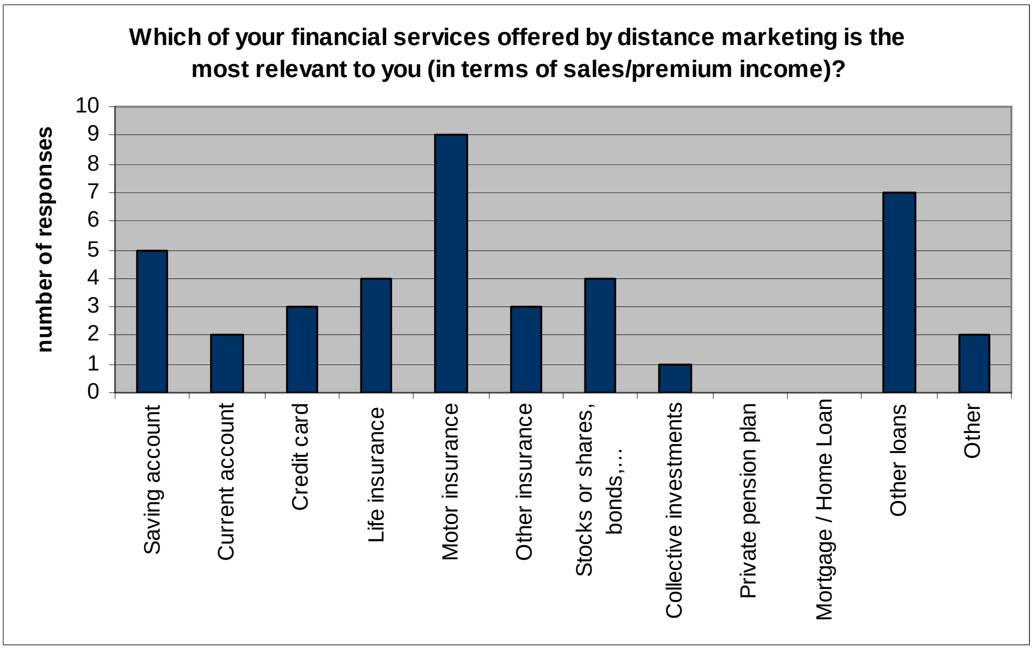
Sector	Euro	Number of responses
Banking	184,345,600,072	9
Insurance	122,782,888	12
TOTAL	184,468,382,960	21

Which percentage of your total business income does this figure represent?

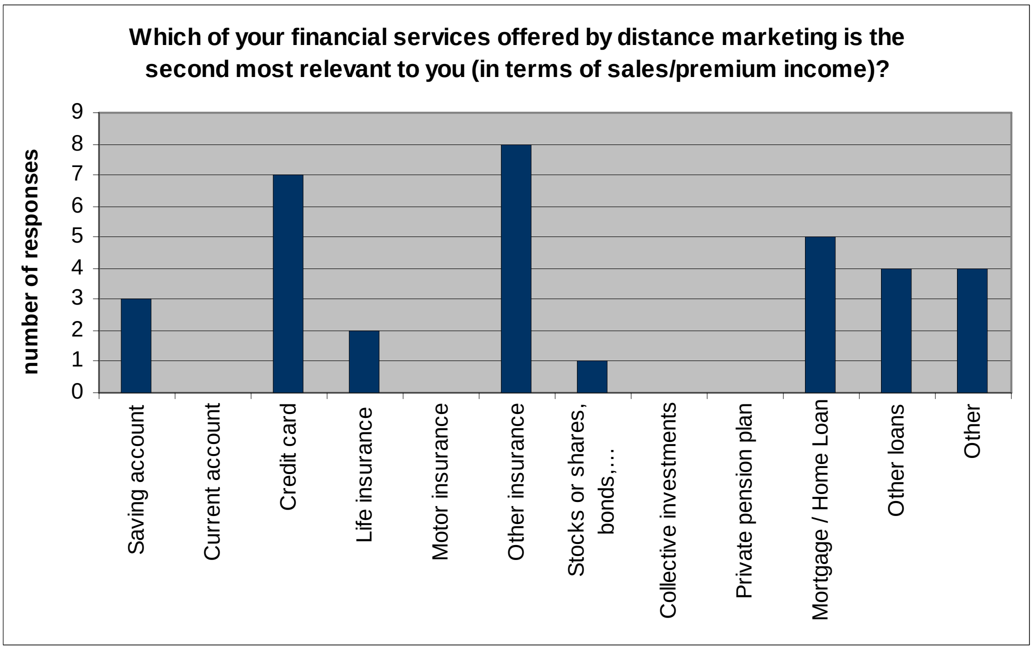
Sector	Median (%)	Number of responses
Banking	3	13
Insurance	1.50	12

4. What kind of consumer financial services are offered by distance marketing?

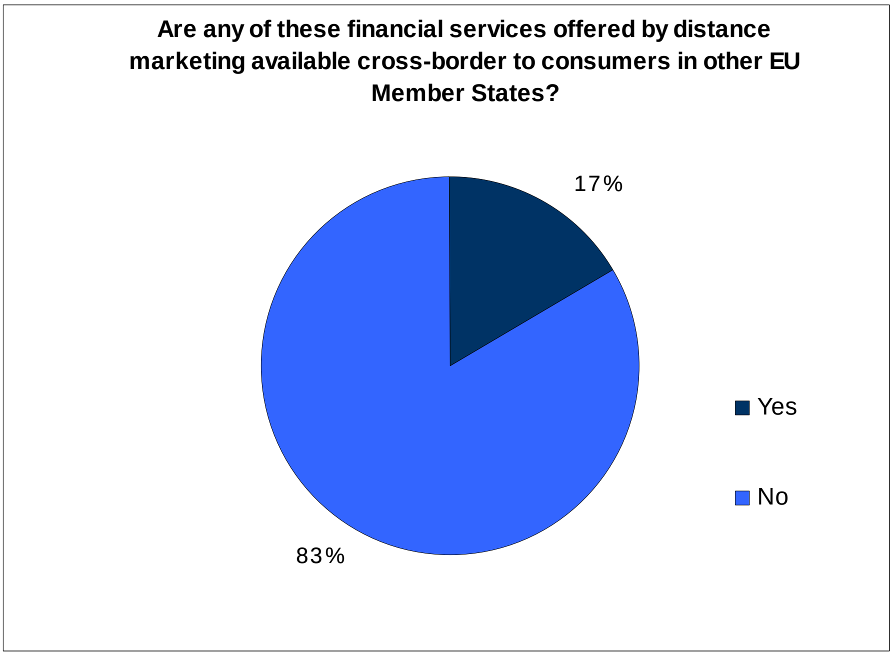
a. Which of your financial services offered by distance marketing is the most relevant to you (in terms of sales / premium income)?



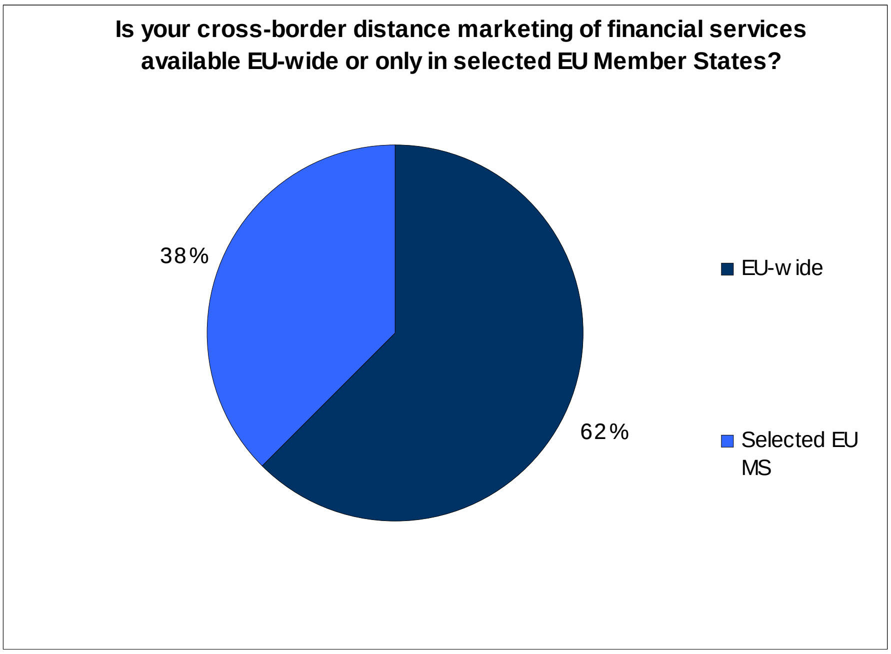
b. Which of your financial services offered by distance marketing is the second most relevant to you (in terms of sales / premium income)?



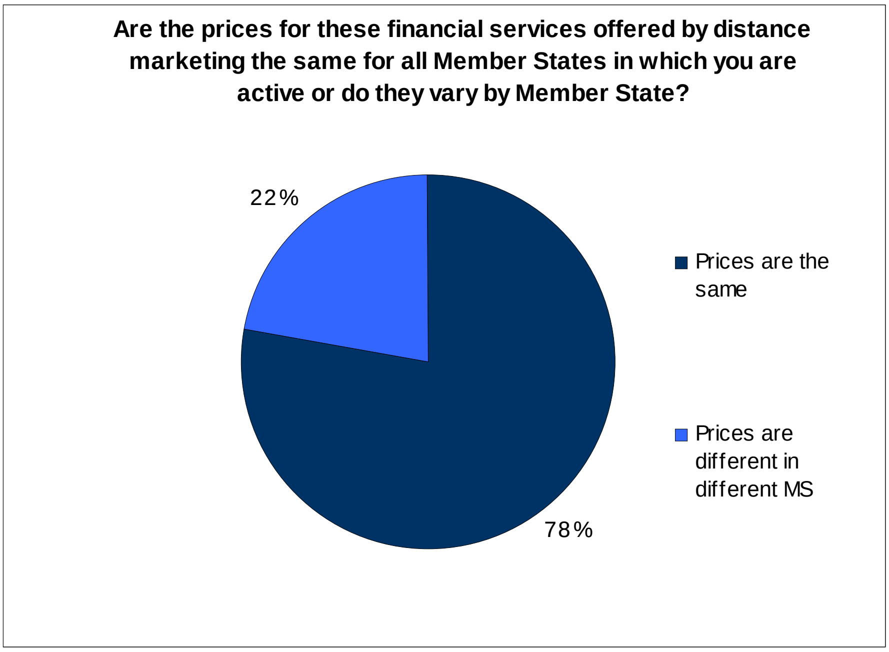
5. Are any of these financial services offered by distance marketing available cross-border to consumers in other EU Member States?



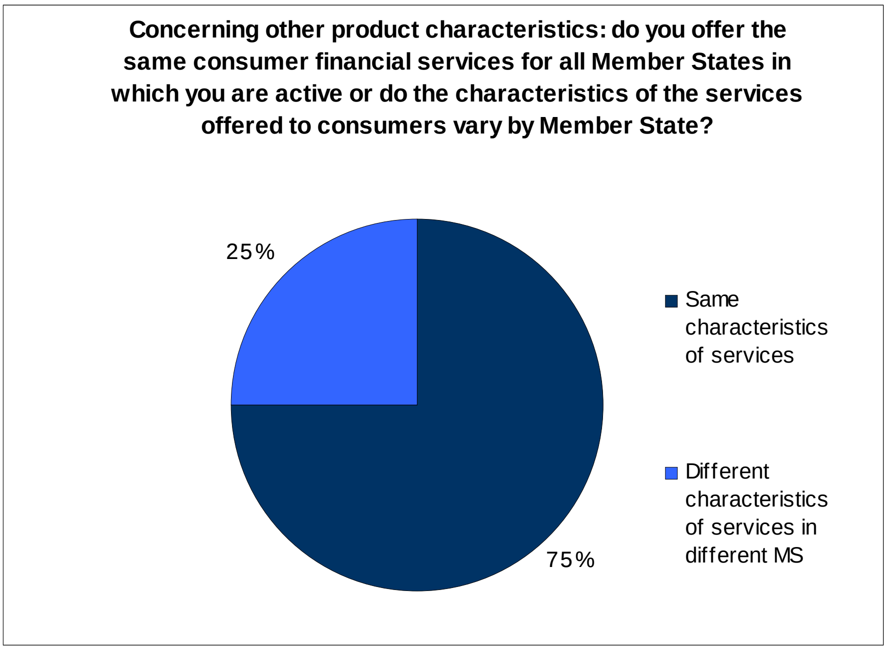
a. Is your cross-border distance marketing of financial services available EU-wide or only in selected EU Member States?



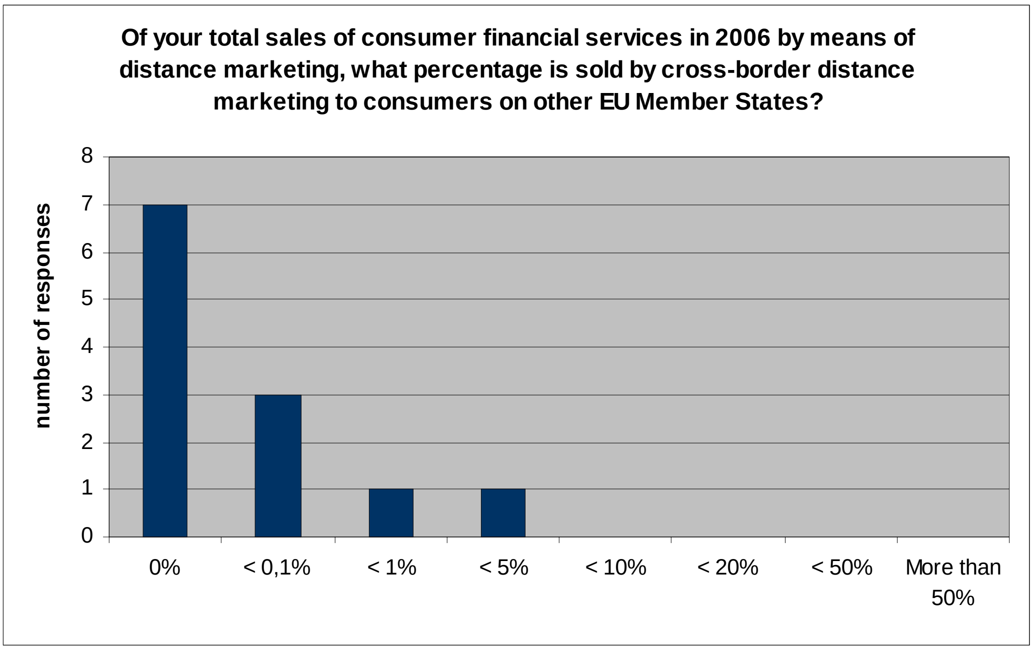
b. Are the prices for these financial services offered by distance marketing the same for all Member States in which you are active or do they vary by Member State?



c. Concerning other product characteristics: do you offer the same consumer financial services for all Member States in which you are active or do the characteristics of the services offered to consumers vary by Member State?



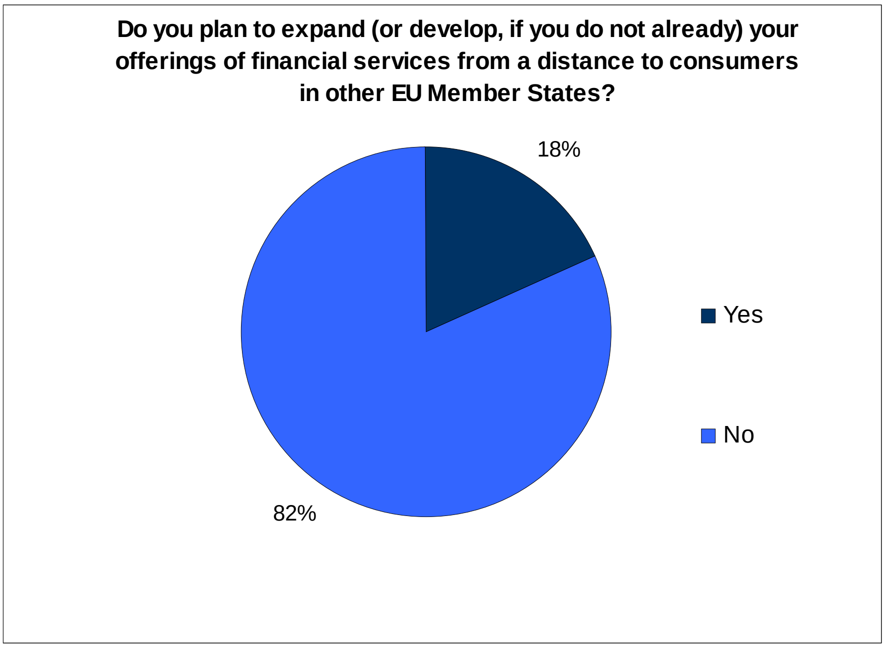
6. Of your total sales (for insurance: total premium income) of consumer financial services in 2006 by means of distance marketing (provided in question 3), what percentage is sold by cross-border distance marketing to consumers in other EU Member States?



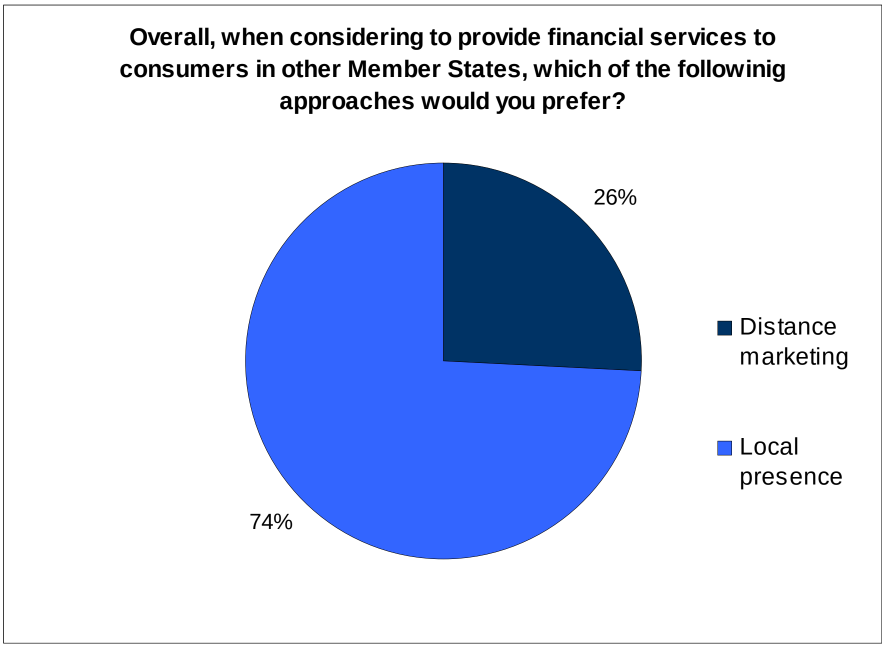
7. When did you first begin to offer financial services from a distance to consumers cross-border in other EU Member States?

Responses
1991
1997
1999
1999
2000
2001
2004
2004

8. Do you plan to expand (or develop, if you do not already) your offerings of financial services from a distance to consumers in other EU Member States?



9. Overall, when considering to provide financial services to consumers in other Member States, which of the following approaches would you prefer?

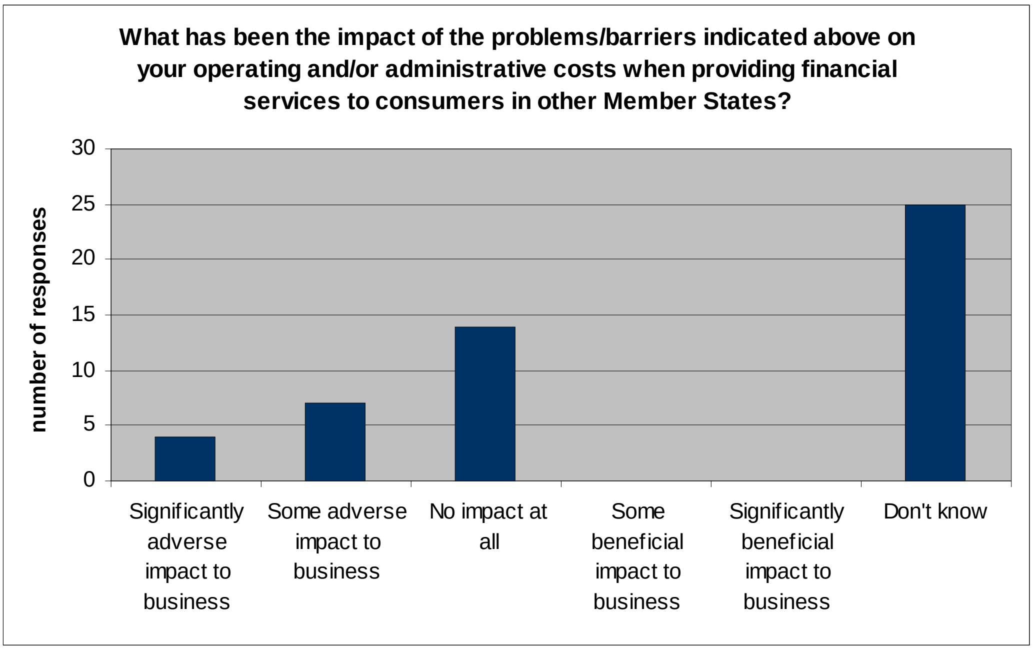


10. What are the major problems/barriers, if any, faced by suppliers wishing to offer financial services from a distance to consumers in other EU Member States?

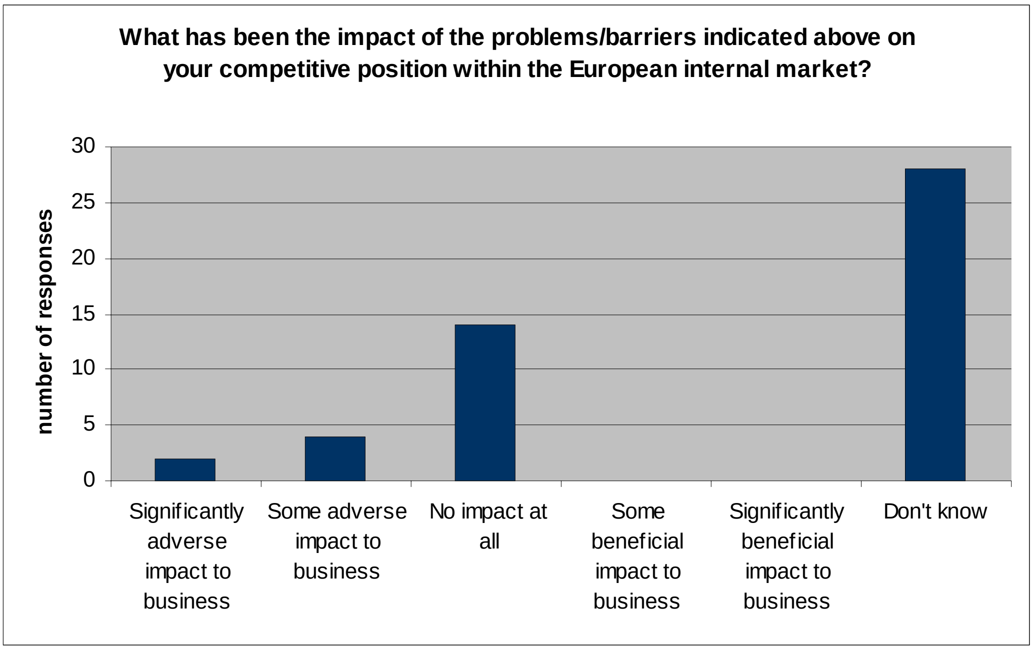
	Most important barrier	2nd most important barrier	3rd most important barrier
Absence of pan-European credit referencing system	3	4	3
Difficulties in debt recovery	2	1	5
National anti-money laundering requirements	6	1	2
Legal uncertainty regarding the applicable law	7	6	2
Lack of harmonised payment systems, etc.	1	4	2
Difficulty to conclude contracts electronically	4	6	10
Problems related to tax	0	3	4
Lack of adequate marketing opportunities	6	1	3
Differences in language and culture	7	7	10
Consumer preference for national providers	6	7	4

Different consumer demand in different EU states	7	6	3
Lack of harmonisation of relevant MS legislation	6	3	1
Lack of appropriate EU legislation	1	5	1
Other	4	2	0

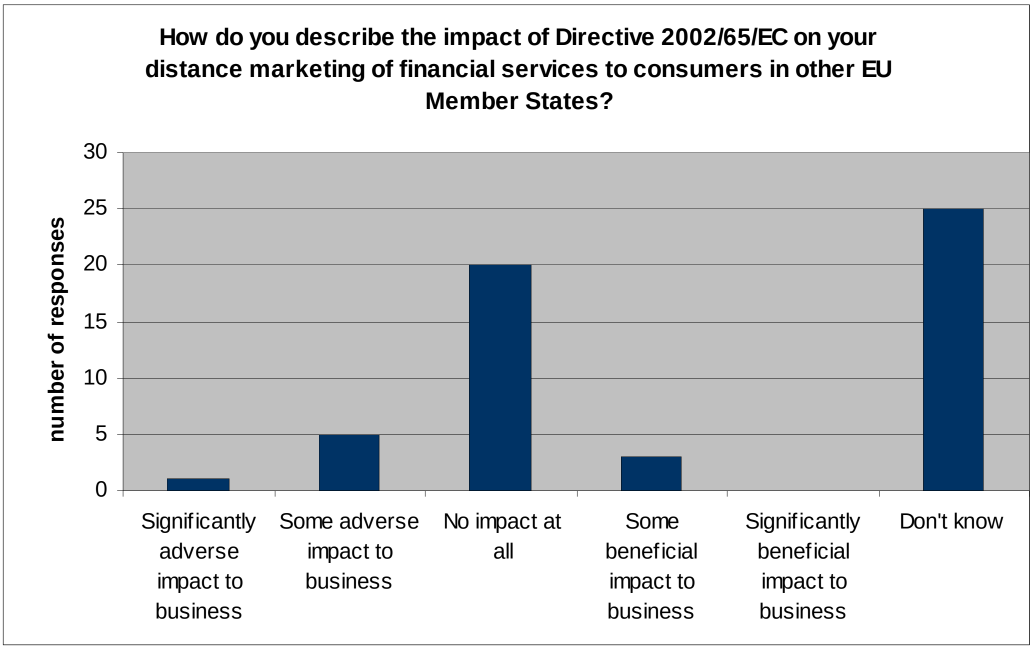
11. What has been the impact of the problems/barriers indicated above on your operating and/or administrative costs when providing financial services to consumers in other Member States?



12. What has been the impact of the problems/barriers indicated above on your competitive position within the European internal market?



13. How would you describe the impact of Directive 2002/65/EC on your distance marketing of financial services to consumers in other EU Member States?



14. Do you think that the EU efforts to promote an internal market in consumer financial services by means of distance marketing are working? What new measures, if any, would help to change consumer attitudes, or remove possible barriers?

Qualitative responses

15. How do you expect your sales of consumer financial services through cross-border distance marketing to consumers in another EU Member State to change in the next 5 years if no major legislative change at EU level were to happen (estimated percentage change over the whole period)?