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Regulatory Affairs in Europe

New deal on mobile phone payments

In November 2007, the EU officially adopted the Payment Services Directive. This piece of legislation is designed to bring about more competition both in the national payment services market as well as on a cross-border level, which has so far been effectively hampered by the lack of a clear legal framework. Once transposed into national law by all EU member states by 1 November 2009, consumers are expected to benefit from a designated time limit for the execution of payments, the ability to make cross-border direct debits and the use of debit cards across the EU.

But consumers might not have to wait until the end of 2009 to be able to enjoy easier and more convenient ways of making payments. According to the GSM Association (GSMA), a global trade body representing the world's major mobile operators, the deployment of a new payment system using mobile phones is expected to be rolled out by the end of this year or the beginning of 2009. Once deployed, consumers will profit from purchasing goods or services in shops, restaurants or train stations by using their mobile phone device, whose chip will communicate with contactless readers to carry out the payments.

As announced on 30 June, a cooperation agreement between GSMA and the European Payment Council (EPC), which represents 8,000 banks in the EU, the European Economic Area (EEA) and Switzerland, will accelerate the development of the new technique. A series of trials around the world is currently being carried out before banks will be able to “deliver better mobile payment services to their customers, supported by mobile operators’ infrastructure”, according to a GSMA press release. As the current legal state of affairs does not allow telecom companies to act as payment services providers in different EU countries, a so-called ‘trusted services manager’ will be established, interfacing with banks and mobile operators. The GSMA-EPC cooperation will thus have to focus on “defining a contractual framework document detailing the minimum set of requirements” of this integrated third party.

In a joint statement, Commissioners Viviane Reding and Charlie McCreevy welcomed the announcement of the cooperation between GSMA and the EPC. “Bringing more competition to the payment services market has been my aim and agreements such as this show the possibilities that new technologies and innovative approaches offer in this regard. This is exactly what the Payment Services Directive, which comes into force at end of 2009, is designed to promote”, McCreevy said.

Reding added that “voluntary industry agreements by the mobile industry are always welcome where they bring about concrete benefits to consumers and enhance the level-playing field for European companies in due respect of competition rules”.

Documentation: Download the full text of the Directive at <http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:319:0001:0036:EN:PDF>.

EP adopts declaration on micro-credit

On 5 May 2008, the European Parliament adopted a written declaration on micro-credit. In the declaration, the EP emphasises the role of micro-credit in the EU’s Neighbourhood and development assistance policies and in the context of the Barcelona Process, a regional framework created in 1995 by the EU and most Mediterranean states with the aim of promoting political and security partnerships and creating an area of shared economic prosperity. By underlining the importance to help women in that connection, the EP highlights the significance of micro-credit not only as a measure to foster economic growth, but also to promote social inclusion. Past experience has shown that lending small amounts to disadvantaged persons results in the development of highly successful self-help employment projects, ameliorating the economic conditions of the borrowers. The declaration was signed by a majority of 424 (out of 785) MEPs, leading to the formal adoption of the document. As envisaged in the procedure, the next step is to transmit the declaration, together with the names of the signatories, to the Council and the Commission.

Documentation: Download the text of the EP’s declaration at <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+WDECL+P6-DCL-2008-0002+0+DOC+PDF+V0//EN&language=EN>

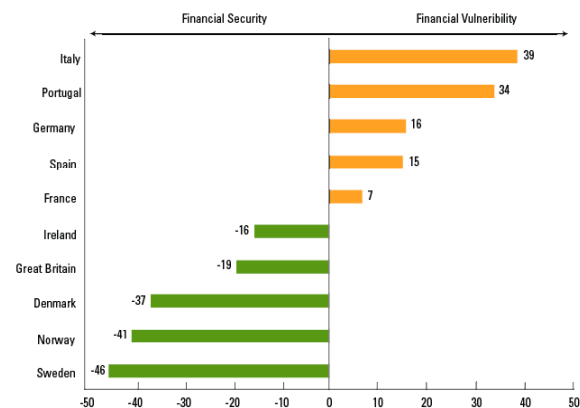
Developments in Europe and the US

Financial vulnerability index developed

Genworth Financial, Inc., an international company that provides insurance products, has published a new index for measuring consumer financial vulnerability. This index, which sheds new light on how consumers perceive their financial stability, comes at a time of financial market turmoil, rising food prices and increasing default rates for different types of credit. The index was developed jointly by ECRI and the Personal Finance Research Centre (PFRC) at the University of Bristol, under a research partnership funded by Genworth. It presents the share of respondents in a 10-country survey who reported feeling financially vulnerable relative to the share of respondents who reported feeling financially

secure. The initial survey was conducted in the summer of 2007. “With the financial environment changing at such a rapid pace, this first reading of the Index provides an important baseline from which to track any shift in consumer financial vulnerability or security”, said David Lane, regional manager for Western Europe at Genworth Financial, Inc. The index is primarily based on consumers’ past experiences and future expectations, the latter of which are influenced by such factors as employment prospects and general economic conditions. The second survey for the index will be conducted in autumn 2008.

Overview of financial vulnerability in 10-countries surveyed



Source: European Trends in Consumer Financial Vulnerability – ECRI/PFRC – June 2008.

The index shows that this ratio is the highest for Italy and Portugal, followed by Germany and Spain. Financial vulnerability is less of an issue – at least at the national level – for consumers in countries such as Denmark, Norway and Sweden, whereas disaggregated analysis reveals important differences between age brackets or on the basis of gender. For instance, data collected for Great Britain reveal:

- 6% of households are financially vulnerable and feel that their situation is unlikely to improve.
- 14% feel financially secure and expect their situation to improve.
- 48% of households have experienced financial difficulty to some degree.
- 9% of households are regularly unable to pay bills on the final reminder.
- 7% of households are constantly struggling or falling behind.

The joint CEPS-PFRC project has produced reports: an Applied Report that presents the results, and a Technical Report that describes the methodology.

Documentation: Download the text of the 2-part report at www.ecri.eu or http://www.genworth.co.uk/genworth_index.html

World Bank develops consumer protection diagnostics

The World Bank has started a large-scale international pilot project on diagnostic evaluation of consumer protection and financial education in retail financial services. Since 2007, this project was developed under leadership of Sue Rutledge, Regional Corporate Governance Coordinator at the World Bank. The results of the project, entitled “Diagnostic Review of Consumer Protection and Financial Literacy”, will be officially released in Washington this September (for the US) and presented in Europe in October at an ECRI workshop. So far, the evaluations have concentrated on European and Central Asia countries including Azerbaijan, Croatia, the Czech Republic, Romania, Russia and Slovakia.

The baseline conclusion of the diagnostic is that consumers should have: i) access to sufficient information for financial choices, ii) recourse to cost-effective dispute resolution processes and iii) access to programmes for consumer financial literacy. A cornerstone of the World Bank’s work in this field is the development of a template of good practices in financial services. The main issues reviewed in the diagnostic are consumer protection laws and institutions, sales practices and disclosure, customer account handling, privacy protection, guarantees and compensation schemes, mechanisms of recourse and financial literacy measures. Results of the *Diagnostic Review* will be published by the World Bank in the upcoming months.

Further information: See the World Bank’s website: www.worldbank.org/eca/consumerprotection

Fed presents proposals for consumer protection

In May of this year, the US Federal Reserve Board published new proposals to protect consumers from unfair practices regarding credit cards and overdraft services. The rules under the Federal Trade Commission Act (FTC Act) propose changes to existing regulations governing Unfair or Deceptive Acts or Practices (UDAP), Truth in Lending and Truth in Savings. As stated by Federal Reserve Chairman Ben Bernanke, “credit card plans have become more complex”, which has “reduced transparency in credit card pricing and increased the risk that consumers will not understand key terms that affect the cost of using the account”.

The key provisions for credit card users in the FTC Act oblige banks to: not increase the interest rate on a pre-existing credit card balance; provide a “reasonable” amount of time for payment, reasonable being specified as a notice of 21 days prior to the payment due date; apply a consumer’s debt payments in excess of the minimum in a manner that minimises interest charges; and apply the single-cycle billing as opposed to the two-cycle billing. Further, the provisions require banks to

limit the fees of sub-prime credit cards that reduce the available credit, and demand disclosure of whether a consumer qualifies for the lowest rate and the highest credit limit in the event that a firm has advertised multiple rates. On 14 July 2008, the Fed approved another set of rules that amend the Truth in Lending Act, this time addressing home mortgage loans in particular. The objective of the latter move is to protect consumers from unfair practices and restore confidence in the mortgage market.

The Federal Reserve is also stepping up efforts to regulate mortgage lending. Since August 2007, the crisis has led to several bank failures on both sides of the Atlantic. Among the failed lenders are the US Countrywide Financial (now owned by the Bank of America), the British Northern Rock plc, and since March 2008, the US investment bank and securities trading firm Bear Stearns as well as recently the Californian IndyMac Bancorp.

While some argue that these failures are a result of over-exposure to the failing US subprime mortgage market, critical voices blame the banks’ own careless lending practices. In the final analysis, the failing US subprime market and irresponsible lending are two sides of the same coin.

Following the latest developments, the Federal Reserve approved in mid-July a tightening of rules for home mortgages which are expected to “better protect consumers and facilitate responsible lending”, according to a FED press release, while at the same time guaranteeing that credit is available to qualified customers. A key aspect of the new rules is the lender’s obligation to verify the potential borrower’s ability to repay the loan by checking both his/her income and other assets aside from the home’s value as well as creating an escrow account for property taxes and homeowner’s insurance. In addition, the FED intends to ban pre-payment penalties – fees that lenders charge borrowers who repay their mortgages early – on loans whose payment can change in the initial four years. Similarly, charges on other higher-priced loans (i.e. virtually all loans in the subprime market) cannot last for more than the first two years. Furthermore, the rules set certain advertising standards, requiring the lender to provide the borrower with additional information about rates and other loan features, while banning “deceptive or misleading advertising practices”.

In any case, new regulations will not help the thousands of (former) homeowners who have already fallen behind on their mortgages or experienced foreclosure. However, the rules – coming into effect on 1 October 2009 (with the exception of the escrow account requirement) – are intended to play a role in avoiding another similar crisis in the future.

Further information: www.federalreserve.gov

Risky electronic payments - Fight against payment fraud

A recent European Commission report published in April 2008 shows that the fight against payment fraud is an essential element in consumer confidence. The document reports on the actions and results following the implementation of the EU Action Plan 2004-2007 to prevent fraud on non-cash means of payment. The study shows that it is vital not only to ensure the security of means of payment, but also to improve consumer confidence and trust. It stated that payment cards pose severe security problems. On the one hand, there is the harm resulting from the misuse of lost and stolen cards, a problem that has persisted since the introduction of payment cards. On the other hand, a challenge more difficult to tackle is the increasing incidence of payment card information being copied and misused thereafter, for example by hacking identities online or through 'skimming' methods at ATMs, whereby the payment card information is read by small illegally installed electronic devices. With the evolution of technology, the protection of information becomes more difficult as well.

On the industry side, the Single Euro Payments Area aims at achieving high standards of security and fraud prevention. On the regulatory side, the basis has been laid by the Money Laundering Directive (2005), which includes the implementation of Know-Your-Customer policy, and the Payment Services Directive (2007). The Commission has initiated further actions in the fight against payment fraud, such as pan-European training sessions, awareness-raising events for the authorities, creation of an EU single contact point for citizens and seminars for the private sector and public authorities. According to the Commission, the most important challenge that remains is to understand the nature and the full extent of the problem. Additionally, new threats continue to emerge, e.g. data and identity theft. The Commission announced that it will closely monitor developments in this area.

Documentation: Download the full report at:
http://ec.europa.eu/internal_market/payments/docs/fraud/implementation_report_en.pdf

IIF publishes report on best practices

On 17 July 2008, the Institute of International Finance (IIF) – an association with more than 380 members from the global financial services sector – presented a 200-page report on market best practices with the aim of strengthening market confidence and restoring the industry's credibility. The document represents a response by IIF members to the turmoil in global financial markets. Josef Ackermann, Chairman of the IIF and CEO of Deutsche Bank AG, acknowledged that there are "serious weaknesses in business practices across a range of financial institutions that developed in the run-

up to the turmoil" and that it is essential that the "financial services industry persevere in its reform efforts."

The report includes key principles of conduct for best practices and recommendations to the industry for a wide range of policy issues, such as risk management, compensation policies, valuation of assets, liquidity management, underwriting and the rating of structured products as well as transparency and disclosure. Further, the IIF plans to create a market monitoring group to detect vulnerabilities and risks in the financial markets. Some of the suggestions might seem self-evident, for instance, in the area of risk management, companies are advised to "develop a robust risk culture", or regarding compensation issues, they are recommended to base pay on performance. The report will certainly be no substitute for increased regulation, and as Mr. Ackermann himself remarked, it is not a "blueprint for 'self-regulation'".

Further information: www.iif.com

Consumer credit growth slows in EU-15

In 2007, the stock of outstanding consumer credit to the household sector in the EU-27 continued to show an upward trend (5.33%) and even grew at a faster pace than in 2006 (5.03%). This, however, is largely due to the growing relative market weight of the accession countries where – despite a sharp decrease in growth rates in 2007 in a majority of the states – double-digit figures are still recorded. A look at the rates for the EMU-12 and the EU-15 reveals that growth actually slowed, from 4.85% to 3.58% and 3.99% to 3.52%, respectively. In the light of the subprime mortgage crisis and the subsequent credit crunch, these declines appear rather slim in comparison to the 2006 rates, which went down almost two percentage points from 2005 levels. See table below.

It is important to note that these aggregate growth rates mask substantial differences across the Member States. Spain and Greece, for example, experienced sharp drops respectively of 7 and 15 percentage points, while growth in Ireland and Denmark picked up. Similar to the trends in data on the overall private sector, the 12 new Member States still manage to substantially outpace consumer credit growth in the EU-15, with Bulgaria leading the field with a 48.71% increase in 2007. It should be noted that growth rates of the stock of consumer credit to the household sector are not for adjusted for inflation, so some caution is needed when interpreting the data.

Further information:
The new ECRI Statistical Package will be published soon. Log on to www.ecri.eu for more information.

Nominal consumer credit growth rates in the EU

	2005	2006	2007
AT	12.33%	-9.66%	0.26%
BE	6.30%	18.08%	10.13%
DE	-1.25%	-2.38%	-2.08%
ES	23.86%	19.39%	12.26%
EL	22.26%	22.78%	7.60%
FR	5.87%	4.77%	5.06%
FI	16.73%	10.86%	7.82%
IT	16.31%	12.50%	5.59%
IE	13.04%	2.20%	8.18%
LU	1.66%	-0.52%	2.19%
NL	4.80%	3.06%	-6.47%
PT	3.83%	20.98%	21.19%
EMU-12	6.59%	4.85%	3.58%
DK	5.95%	13.86%	19.49%
SE	11.96%	14.64%	10.88%
UK	3.42%	-0.02%	1.25%
EU-15	5.87%	3.99%	3.52%
BG	49.69%	12.31%	48.71%
CY	na	na	na
CZ	31.12%	22.94%	26.00%
EE	63.52%	89.35%	48.02%
HU	65.78%	43.96%	38.48%
LV	72.28%	63.50%	21.48%
LT	103.16%	68.08%	42.99%
MT	12.88%	17.74%	14.79%
PL	19.00%	21.52%	32.09%
RO	na	na	na
SI	6.99%	16.06%	20.13%
SK	24.85%	44.85%	15.88%
EU-27	6.90%	5.03%	5.33%

Source: ECRI Statistical Package 2008, autumn 2008 (forthcoming).

Notable Events

ECB-CFS conference on retail financial services



On 21-22 October 2008, the ECB-CFS Research Network will host a two-day conference on The Market for Retail Financial Services: Development, Integration, and Economic Effects (venue: Czech National Bank, Prague). The European Central Bank (ECB), the Center for Financial Studies (CFS) and the Czech National Bank are co-organising this event. The purpose is to present state-of-the-art international research on major issues regarding market development for retail financial services in Europe, including integration of retail financial markets and the role of retail financial services in Europe.

Among the topics on the agenda are trends in retail payment and retail banking, insurance, mutual funds, venture capital and start-up financing in Europe. Other subjects concern the role of laws, regulations and their coordination in retail finance in the European context. Keynote speakers include Gertrude Tumpel-Gugerell (Executive Board Member of the European Central Bank) and Professor Roman Inderst (University of Frankfurt).

Further information: www.ecb.eu

Commission conference on financial inclusion

On 28 May 2008, the European Commission organised a conference on “Financial Services Provision and Prevention of Financial Exclusion”, based on a report under the same title that was published that same day. The study was carried out by the Réseau Financement Alternatif, the Personal Finance Research Centre, the University of Milan and the Warsaw School of Economics. As the report reveals, two out of every ten adults in the EU-15 do not have a checking account with a bank, whereas this number amounts to more than half of the adult population in the 10 new member states that joined the Union in May 2004. A staggering 47% of adults in the EU-10 do not have any bank account at all, compared to 10% in the EU-15 countries. As the study shows, financial exclusion primarily affects people living on a low income and constrains access to essential services, such as jobs, housing, education and health care. The Commission’s report provides data on the levels, causes and consequences of financial exclusion, as well as policy recommendations.

Documentation: The programme of the conference, a presentation of the study as well as the various presentations given at the conference can be found at: http://ec.europa.eu/internal_market/finservices-retail/inclusion_en.htm

ECRI seminar on measures and policy responses towards over-indebtedness in Europe

It is expected that the provision of sophisticated and complex financial products as well as the expansion of access to credit will prove beneficial to European consumers. However, the lack of financial education and literacy paired with insufficient information and advice can lead to financial difficulties and over-indebtedness. The European Commission is committed to identifying the most appropriate and effective policy responses to the problem. Substantive analysis, however, is still hampered by the lack of a common operational definition of the phenomenon at the European level. For that reason, the Commission commissioned a study “Towards a Common European Operational Definition of Over-Indebtedness”, which was carried out by the Centre for European Policy Studies (CEPS) together with the Personal Finance Research Centre and the European Savings Institute as administrative leader. The Commission has now published the study, and the forum is open for debate.

At a half-day ECRI seminar on **15 September 2008**, the insights from the survey will be presented and discussed with policy-makers, industry officials and academics. Among the guest speakers are Jennifer Robertson from DG Market & Services and Antonia Carparelli from DG Employment & Social Policies who will present the European Commission's policy action.

Further information:

The study can be downloaded from:
http://ec.europa.eu/employment_social/spsi/studies_en.htm
The programme and the registration form are available at www.ecri.eu.

ECRI workshop on good practices of consumer protection in financial services



The World Bank is becoming a major driver of good practices in consumer protection in financial services. It has prepared an initial set of good practices in this area as a diagnostic tool for identifying priorities for future reform in financial consumer protection (see related article, p 3 in this newsletter). At a seminar hosted by the European Credit Research Institute in Brussels on **16 October 2008**, the World Bank will present its good practices to the European audience and solicit feedback from stakeholders.

The programme is intended to be expanded globally in 2009. It is expected to be helpful to the international community and those in emerging markets who are looking to establish common ground for minimum good practices in financial consumer protection.

Further information:

Visit www.ecri.eu

Dates to note in your diary

15 September 2008

ECRI seminar: Debate over proposed measures on and policy responses to over-indebtedness in Europe (see p. 5 for details)

16 October 2008

ECRI seminar: European launch of the World Bank's good practices in consumer protection in financial services (see above for details)

21-22 October 2008

ECB-CFS conference: The Market for Retail Financial Services: Development, Integration and Economic Effects (see p. 5 for details)

News about ECRI



Maria Gerhardt joins ECRI research team

ECRI has recruited a new researcher, Maria Gerhardt, who joined the institute in July 2008. She holds a Masters in Economics, with specialisation in Infonomics from the University of Maastricht, and a Research Master in International Relations and History from the University of La Rochelle, France. As part of her studies, she spent 14 months in Buenos Aires, studying at the University of Buenos Aires and gaining work experience in micro-finance. Before joining ECRI, she worked at BNP Paribas Securities Services, Paris, in the department of global custody, international settlement. Her research interests include credit markets, micro-finance, trust in institutions, retail banking and clearing and settlement.

New ECRI Publication

Policy Brief on retail financial market integration

In the latest ECRI Policy Brief, entitled *EU Retail Financial Market Integration: Mirage or Reality?*, CEPS CEO Karel Lannoo provides a bird's eye view of the current state of the EU retail financial markets and their degree of integration. Several measures covering areas such as payments, retail credit and investment funds, and stretching across different policy areas are under discussion or are in the course of being implemented, with the European Commission now starting to look more closely at the sector from a competition policy standpoint. However, the question remains whether the EU will ever manage to create a truly integrated retail financial market. Despite having been on the agenda since 1992, certain indicators reveal that progress has so far been extremely limited on the retail side. The paper reviews the related EU measures and how rule-making has evolved over the last 15 years.

Documentation: Download the text of ECRI Policy Brief No. 3 at www.ecri.eu.