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The EACB answer to ESAs Discussion Paper on automation in financial advice

04 March 2016

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 30 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4,200 locally operating banks and 67,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 205 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 81 million members and 805,000 employees and have a total average market share of about 20%.

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Q1. Do you agree with the assessment of the characteristics of automated financial advice tools presented in this Discussion Paper? If not, please explain why.

The EACB has several reservations with regard to the characteristics as proposed in the paper as follows:

- We are against the idea to identify something as advice when "reasonably perceived by the consumer as financial advice" and do not agree with the statements on page 10 point 12 and page 13, point 23. In analysing automated financial advice we should depart from the legal framework that already exists around advice (e.g. MIFID, IDD, MCD)
- It should be borne in mind that not every automated tool that names financial products on the basis of certain criteria supplied by the consumer constitutes advice. A general distinction has to be made between automated recommendations and just the results of – likewise automated – searches. To co-operative banks pivotal is the distinction between advice as an automated recommendation on the one hand and a search tool on the other hand. If an automated tool with respect to MiFID and MiFID II fulfils the regulatory requirements of a financial advice it should be governed by the same supervisory requirements as advice provided by a human adviser. Bearing this in mind advice means that the recommendation that is given to the client is based on an individual suitability assessment which especially takes the personal and financial situation, his other financial objectives, his knowledge and his willingness to take risks into consicderation.
- Human advice should not be discriminated against compared with automated advice. The same activities should instead be subject to the same regulatory standards. It should thus also be ensured that, in online business as well, the term "advice" may only cover recommendations which – in regard to securities, at any rate – are based on a consumer questionnaire in line with the supervisory requirements applying under securities law and on a suitability assessment. Conversely, it should be made clear to consumers if merely "selection aids" are involved that are designed simply to help them make an investment decision on their own responsibility.

From the perspective of the EACB, especially the following cases cannot be seen to constitute advice:

- Search engines that select products from a universe of products solely on the basis of criteria input by the consumer. Such automated selection tools are currently in use at national level. They allow consumers to preselect products suitable for them from a provider's universe of products, using simple selection criteria. This is also made sufficiently clear to consumers by the tools' design and operating process. These selection tools do not constitute advice and they are thus, for good reason, also not subject to the more stringent requirements governing the provision of advice. With regard to section 24, there are tools on the market in the securities sector that mostly categorise consumers on the basis of their risk appetite/risk expectations and then recommend model portfolios. This process is not treated as advice in standard market practice.

- Tools which – based on information input by consumers – recommend spreading an investment across different asset classes in a certain way. Since consumers are merely recommended a portfolio structure at asset class level based on their input, without any specific financial instruments being named, the conditions for investment advice are not fulfilled in this case.

Q2. Are there any other relevant characteristics of automated financial advice tools?

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Q3. Are you aware of examples of automated financial advice tools being used in the banking, insurance, and/or securities sectors? Please provide examples, giving details of their operating process.

Keeping the above mentioned delineation of what we understand to be automated financial advice in mind, we see very few real "advice" tools. Q1.

Q4. Do you offer/are you considering offering automated financial advice tools as part of your business model? If so, please briefly describe: i) what type of entity you are, e.g., long established, start-up, a product provider, an intermediary; ii) the service you provide (e.g. to what extent do you integrate human interaction in the tool you provide?); iii) the nature of your clients; iv) your business model; v) who developed the automated tool (i.e. an external company or developed internally?); and vi) the size of your activity and/or forecast activity?

Co-operative banks, which tend to be heavily focused on the consumer and SME segment of the market having as a key characteristic that clients can become members, are typically small in size on an individual basis and create economies of scale by grouping themselves and working with central institutions that take over key functions. They sometimes do offer digital tools that help the customers to select kinds of products out of a wide product range by using a limited number of categories or automated tools that the client in providing information to the bank to prepare as much as possible a loan application discussion. They tend to be used as a complement to human interaction and not as a replacement. In addition, they offer simulators and calculators. The EACB observes a tendency, especially in the area of investment services, to introduce digital tools (not necessarily for advice) for certain client groups to reduce cost where the regulator intervened in the business model for the provision of advice.

Q5. Do you consider there are barriers preventing you from offering/developing automated financial advice tools in the banking, insurance and securities sectors? If so, which barriers?

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Q6. Do you consider the potential benefits to be accurately described? If not, please explain why.

Co-operative banks believe that the ability to deliver advice at the same time to a number of clients without waiting for individual meetings is an important element, although not the only one. It is true that it could increase the ability to offer potentially more services to clients. However, the benefits listed in the Discussion Paper are not specific to automated financial advice tools as defined in the chapter 'Main characteristics of automated financial advice tools'. For instance, there are adviser-facing tools providing such benefits: financial advisors may rely on such tools, which provide them with up-to-date data, consistent information, logical algorithm, prices of transaction benchmark, etc.

Thus, the ESAs should remain watchful to avoid opposing advice issued by an adviser to that provided by an automated tool. Indeed, low-cost advice shouldn't be promoted, with the intention of favouring speedy access and advice delivery, to the detriment of the reliability of personalised advice, which is based on a more detailed knowledge of the customer.

In particular, with regard to:

- Benefit 1 `Consumer pays less´ , co-operative banks would like to stress that this may be true for fee-based advice, where consumers have to pay a fee for a recommendation irrespective of whether or not they then choose a product, thus making it particularly expensive especially for less wealthy consumers. By contrast, in the case of commission-based advice consumers are not charged directly for the advice. They are instead billed indirectly and only once they have actually chosen a product, i.e. once they have made a decision based on a recommendation. Consumers are billed indirectly, no matter through which distribution channel they contact their bank. They therefore determine where, how and when they wish to obtain advice or aid in making a decision. Consumers must be free to do so in the future as well. The broad group of less wealthy consumers should never be forced into switching to automated advice. Precisely these consumers rely particularly heavily on personal support when it comes to financial provision for the future/financial advice, as experience shows that the less money they have, the less financial knowledge and experience they possess and the less willing or motivated they are to take care of financial provision arrangements themselves.

- Benefit 2 'A wider range of consumers has access to advice through automated tools' (page 16 of the Discussion Paper), co-operative banks would like to highlight that automated advice cannot be adapted to all customer segments.

- Benefit 3 'Consumers have access to a wider range of service providers using automated advice tools' (pages 16-17 of the Discussion Paper), considering that the aim is to manage a portfolio, it seems difficult for a customer to take advantage of different tools as they would be very different in scope, risk models, etc.

- Benefit 4 `Consumers obtain financial advice in a faster, easier and not time-consumeing way. Co-operative banks would like to stress that this argument is based on the idea that answering a few questions and specifying a few criteria can produce a result on a par with advice obtained personally in a branch. The supervisory requirements under MiFID I, but certainly also under MiFID II, obliges advisers to do much more than just collect a few details about clients. Instead, they are required to make a comprehensive analysis of clients' personal and financial circumstances and to identify clients' investment preferences together with clients, taking due account of these circumstances. Clients sometimes pursue conflicting financial objectives, and these have to be discussed jointly by client and adviser and reconciled. Sometimes clients overlook important needs particularly when it comes to financial protection against risks; where insurance is concerned, this is only revealed after an adviser takes full stock of all existing or, as the case may be, missing insurance policies. Only if a tool offered online does the same should it be "classifiable" as advice. Whether the data input required is actually less time-consuming for consumers is doubtful. If such a questionnaire is to be compiled, for example, by means of extensive profiling through evaluation of contract data, usage data and internet footprint data, it should be pointed out that substantial data protection obstacles first have to be overcome in this respect

- Benefit 5 'Consumers receive more consistent advice when they use automated tools' (page 17 of the Discussion Paper). Co-operative banks are of the opinion that this may be perceived as an advantage in individual cases. Nevertheless, it should not be underestimated that precisely the adviser's personal experience can also be extremely beneficial to a recommendation. After all, it is again ignored in this context that current automated product selection tools do not conduct any check similar to a suitability assessment, so that automated advice and face-to-face advice cannot in fact be compared. In particular, automated advice does not normally allow any processing of individual descriptions of complex personal situations. Automated tools may avoid behavioural biases, but at the same time we think that advice is consistent as long as relevant personal information is correctly and exhaustively collected. No matter how good the logical allocation engine of the automated tool and its data sources, if an automated advice tool relies on a basic customer classification only, the resulting advice is less good than human advice.

- With regard to the benefit to consumer in terms of quality of service (page 17 of the Discussion Paper), co-operative banks would like to stress that, despite benefits deriving from automated .support, it should also be kept in mind that at least by now only a human advisor is able to provide truly personalized advice, perfectly understand the consumer's risk appetite (investment products), evaluate a consumer's priorities against the complexity of families histories, guide a consumer through unexpected life events, explore the full range of products and choices with a consumer, consider all accounts, products, investments, etc. a consumer holds, and have a dialogue with a consumer.

- Finally, a further purported advantage is that automated tools allow consumers to more easily document the advisory process, e.g. in the form of a printout (see section 39 of the Discussion Paper). Such a generalisation is incorrect. When obtaining advice in a branch, clients also receive not only the written record of advice prescribed by law but also, particularly where integrated advice is concerned, printouts containing both full details of the information on which advice was based and of the recommendations made

In addition, the quality and correctness of the advice resulted from an automated financial tool should not be overestimated. Such a tool can only work properly if the customer fills it with the correct data. Tools can help him with additional information and a clear and recognisable tool structure but at least it is up to the client to use ist.

Q7. Are you aware of any additional benefits to consumers? If so, please describe them.

First of all, co-operative banks would like to stress that the the best benefit to consumers is that they should have the option to opt for an automated financial tool or for human advice or a mix of both to receive advice from financial institutions. It should be up to the customer on which channel he likes to communicate with his bank.

This being said, co-operative banks are of the opinion that, on the one hand in addition to the benefits to consumers listed in the Discussion Paper, another benefit is that automated financial tools could in some cases remove a potential barrier to obtaining services to the extent that some consumers/customers could find it difficult to interact face-to-face with an advisor. On the other hand, co-operative banks believe in general that automated financial advice tools could be instruments that complement face-to-face advice, helping customers to compare both types of service, with their different approaches and processes, bearing in mind that human open interaction cannot be fully substituted - by nature - by algorithms and artificial intelligence.

Q8. Do you see any differences in the potential benefits arising for consumers in each of the banking, insurance and securities sectors?

It is difficult to formulate a comment that would be valid across different countries and markets other than a general one in that the less complex the products are, the more use can be made of digital (but not necessarily advice)tools.

Q9. Have you observed any of these potential benefits? If so, please provide examples and describe the kind of benefit that has accrued.

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Q10. Do you consider the potential benefits to financial institutions to be accurately described? If not, please explain why.

Keeping in mind again the delineation of "automated financial advice" outlined under question 1, Co-operative banks believe that the expected benefit is to be a lever of growth, both by reaching new consumers and providing additional service to actual ones

However, when estimating the cost reduction, it has to be taken into account that the initial cost of developing tools that actually select products for the customer in the same way as in a face to face a suitability assessment for example in the context of investment services is likely to be very high. It is questionable whether any tool currently available on the market performs such complex selection for the user. In investment services in particular, It is more tools enabling consumers to successfully copy third-party investment strategies that appear to be successful in the marketplace at present. This process, too, is geared less to making recommendations to consumers and more to helping them make decisions on their own.

With regard to the benefit relating to the size of the potential client base (Benefit 9, page 19 of the Discussion Paper), co-operative banks generally agree with the benefit indicated, as it is true that the online presence of a company/financial institution, which provides an attractive online offering, may improve its market position, but at the same time it is worth noting that the online channel is not the only one that could increase the market position of a company/financial institution.

A further benefit referred to in section 42 (Benefit 10) of the Discussion Paper is that institutions can use automated financial advice tools to deliver a more standardised "*consumer experience*" free of human interpretation. To allow proper comparison, however, comparable standards would have to be defined for both face-to-face and online advice. For example, a tool that matches available products solely against the clients' risk appetite can hardly be called "advice".

Finally, concerning the benefit relating to the quality of service and in particular to the statement that the provision of advice by financial institutions is more easily auditable because automated tools are more easily interrogated, co-operative banks believe that this might be true but in the future it could be more difficult because the algorithm could be more complex. Consequently automated processes that are documented ex ante, can be difficult to review and monitor for financial institutions (e.g. by Compliance, Risk or Audit functions). It may also be difficult on an ex post basis to interrogate decisions made by complex automated tools with complex algorithms.

Q11. Are you aware of any additional benefits to financial institutions? If so, please describe them.

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Q12. Do you see any differences in the potential benefits arising for financial institutions in each of the banking, insurance and securities sectors?

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Q13. Have you observed any of these potential benefits? If so, please provide examples and describe the kind of benefit that has accrued.

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Q14. Do you agree with the description of the potential risks identified? If not, explain why.

Co-operative banks don't see any risks on the market. It is in the primary interest of the financial institution to design the automated tool in the best way possible for the customer. Despite this, it may happen that a customer cannot cope with a particular automated tool. In this case, the customer could seek advice by using phone, email, chat or by going to a branch. In addition, the tools co-operative banks develop are self-explanatory as a bank wants the best outcome for his/her customers. It is in the bank's interest to make customers understand how the tool works.

With regard to Risk 4 'Consumers have limited and/or unclear information about the extent to which the tool produces recommendations tailored to them' (page 23 of the Discussion Paper), we would like to highlight that it is important to make the customer using an automated tool aware of whether the advice received from the automated tool is to provide him/her merely with some assistance in his/her finalisation of a purchase of a financial product or with a recommendation.

With regard to Risk 6 'Consumers are unaware that the personal data they input in the tool is used in ways they did not envisage when they provided it' (page 25 of the Discussion Paper), we are of the opinion that the newly adopted Data Protection Regulation, which aims to increase the use of new media, already provides adequate protection. Consequently, a special data protection law for automated advice is not necessary.

With regard to Risk 7 'Consumers make unsuitable decisions because of limitations or assumptions within the tool' (pages 25-26 of the Discussion Paper), co-operative banks believe that usually the tools are designed to be self explaining. In more complex cases help buttons are used to give the client additional information. If in individual cases it really is not obvious enough from the tool itself that no financial advice is provided, additional hints can be given to the customers

Q15. Do you consider there to be any risks missing? If so, please explain.

Q16. Do you see any differences in the potential risks arising for consumers in each of the banking, insurance and securities sectors?

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Q17. Have you observed any of these risks causing detriment to consumers? If so, in what way?

Q18. Do you agree with the description of the potential risks identified? If not, explain why.

With respect to the risks identified EACB would like to point out that the following:

1) Sections 79-81 refer to the danger of financial institutions being held liable for providing flawed automated advice. This liability risk applies not only to automated advice, but also to flawed face-to-face advice. It is thus all the more important to define, particularly in legal terms, from which point onwards an automated proposal in relation to a given product is deemed to be a recommendation and thus also advice in the legal sense. This is important particularly also in the context of the regulatory requirements so that financial institutions have legal certainty.
2) We are not convinced about Risk number 15 (page 28 of the Discussion Paper) as it states that 'If providers of automated advice tools also offer consumers the possibility to engage with a human advisor as an alternative means to obtain advice, consumers may overuse that alternative means so as to supplement the automated advice on the product/service'. Crucially, although co-operative banks recognise the added benefits of automated financial advice tools, the provision of automated advice should never prevent financial institutions from providing alternative means of obtaining advice. Consumers should have the option to opt for one means or the other or both to receive advice from financial institutions.
3) With regard to risks related to liability allocation (page 28 of the Disucssion Paper), these risks should not materialise because the service provider should render easily, directly and permanentaly accessibile to the customer all the information as requested by Art. 5 of Directive 2000/31/EC (E-commerce Directive).

Q19. Do you consider there to be any risks missing? If so, please explain.

Co-operative banks believe that there are no other immediate risks missing.

Q20. Do you see any differences in the potential risks arising for financial institutions in each of the banking, insurance and securities sectors?

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Q21. Have you observed any of these risks causing detriment to financial institutions? If so, in what way?

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Q22. Would you agree with the assessment of the potential evolution of automated advice? Please provide your reasoning.

Co-operative banks are of the opinion that - for the potential evolution of automated advice - It would be crucial to see how the various kinds of advice the customer uses will interact. Indeed, it is possible that a customer will start with the use of an automated tool, subsequently switch to video or phone banking advice and finally also go to a branch for a face-to-face meeting. Once again, we think it is important to stress that the customer should be free to choose among the alternative channels available and not be pushed in choosing one or the other.

Q23. How do you think that the market for automation in financial advice will evolve in the near future in the banking, insurance and investment sectors? Please also provide details of any relevant data or information to support your views, where available.

With regard to the banking sector, co-operative banks believe that automated financial tools in general (but not necessarily financial advice tools) will likely gain importance in the near future considering the increasing in the digitalisation trend, the appetite from some banks to approach new customer groups and the need for cost reductions. At the same time, co-operative banks believe that automated financial advice/digital tools never fully replace human advice, in particular for important decisions such as buying a house or investing for the future. In addition, even when automated tools are used, a consumer will always have the possibility to ask questions to his/her account manager or to another member of staff.

Q24. Are there any other comments you would like to convey on the topic of automation in financial advice?

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