Mistakes that Marginalize

Financial Advice and Low-Income Households

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One balance sheet, many rules

- Financial consumer protection and **excessive risk taking**
  - Borrowing (consumers as **debtors**), and over-indebtedness
  - Investing (consumers as ‘**investors’**; bank deposit), and exposure

<table>
<thead>
<tr>
<th>Assets:</th>
<th></th>
<th>Liabilities:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Description</td>
<td>Value</td>
<td>Description</td>
</tr>
<tr>
<td>Condo</td>
<td>$140,000</td>
<td>Mortgage</td>
</tr>
<tr>
<td>Car</td>
<td>$16,000</td>
<td>Car Loan</td>
</tr>
<tr>
<td>Computer</td>
<td>$1,200</td>
<td>Credit Card</td>
</tr>
<tr>
<td>Bike</td>
<td>$800</td>
<td>Line of Credit</td>
</tr>
<tr>
<td>SmartPhone</td>
<td>$600</td>
<td>Student Loan</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>$158,600</strong></td>
<td><strong>TOTAL</strong></td>
</tr>
</tbody>
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Financial risk, and mistakes

• What’s special with consumers on a tight budget?
  - Consequences of materialisation of financial risks may lead to social exclusion
  - In turn, reduced access to financial services:
    • Exclusion from certain market segments (not affordable)
    • Reduced ability to curb/manage financial risks
• Mistakes that marginalise:
  - Misallocation of assets and over-indebtedness harm resilience
  - Regulatory mistakes may exacerbate marginalisation
A broad array of tools: advisory services

- **Balance sheet liability side** (CCD; MCD)
  - Mandatory assessment of *creditworthiness*
  - Non-mandatory advice
  - ‘Debt advisory services’ in proposal for new CCD (include legal counselling, money and debt management, as well as social and psychological assistance)

- **Balance sheet asset side** (MiFID II; ELTIF; BRRD; STS)
  - ‘Suitability test’ for investment advice
  - Made mandatory to buy certain assets
A broad array of tools: structural measures

- Product governance
  - Ex-ante filter based on ‘target market’
- Product intervention
  - Ban based on overarching supervisory assessment
- Entry ticket
  - Excluding low-budget investors from risks (and returns…) (EuSEF; EuVECA)
  - Loan-to-value and loan-to-income ratios (national laws)
- Mandatory portfolio differentiation
  - One-size-fits-all approach to optimal risk management (ELTIF; BRRD; STS)
The importance of advice, and its limits

• ‘Adequate’ and ‘excessive’ risks are often consumer-specific
  - Case-by-case assessment reduce false positives and false negatives

• Ensuring quality is important – the case of inducements
  - No advice is better than tainted advice

• The advice gap
  - A problem inherent to any licensure system
  - Are we condemned to missing financial consumers on a tight budget? The UK experience
Fixing financial advice

1. Introducing a brand new service (‘financial advice’)?
   - Facilitates joint provision of all advisory services to enable general financial planning – particularly useful for low-income consumers
   - Should include broad array of services – ‘debt advisory services’ as a model

2. Subsidising its provision?
   - Not just a matter of welfare state: financial mistakes and stability concerns (externalities from subprime crisis)
   - Possibly avoiding cross-subsidization – a voucher system to:
     • Support independent advice
     • Nudge towards consumption of advice