Coercive Selling on (tied) deposit accounts: mortgage loans and the effect in the commissions related with the maintenance of customer accounts

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Abstract:

Banks impose undue pressure on, or coerce, clients to buy products and/or services from the bank or any of its affiliates, as a condition for obtaining another product or service from the bank, where at least one of the products or services offered in the package is not available separately ("tied package"), even when the products and/or services are functionally independent. Often, these "tied packages" contracts do not specify all the future prices, so that a long-term relationship is decided by short-term contracts. These practices, where the banks exploit tied packages and/or use aggressive commercial practices, including onerous or disproportionate non-contractual barriers to the rights to terminate a contract or to switch to another product or another trader (coercion), in order to maintain "hostage" customers within a product or service that they do not want or need, threatening them with the termination of the contractual relationship regarding another product or service, included in the package, creates *ex post* monopoly, for which firms compete *ex ante*.

This antitrust and restrictive practices as a huge impact in the real life of the financial consumers, in particular, but no exclusively, for the financial consumers who have revolving credits / open-end credits (*i.e.* credit card debt, lines of credit, *etc*.) or instalment loans / close-end credit (*i.e.* mortgage loan, car loan, appliance loan, *etc*.) , which are a large part of the European financial consumers, since in these cases there are many and big difficulties in switching payment/current accounts. The consumers are held hostages to these tied packages that combining slow-moving services/products with fast-moving services/products, because the providers (banks) create a contractual barrier that prevents the consumer to switch to another service/product or another trader or terminate a contract. Providers leverage the fact of customers being hostages of a tied package and/or using aggressive commercial practices like coercion, to unilaterally impose the price of the product or the service whose purchase

depends on the acquisition of the main product or service (*i.e.* the bank unilaterally decides raise running costs/fees of the basic transaction account that is tied to a mortgage loan).

We found evidences the average net fees are explained in 42.7% by the volume of the mortgage loans, and hast statistical significance with p value< 0.05 for a group of Banks in Eurozone, excluding the United Kingdom that is an outlier.

This was an expected result due to the practice of coercive tied selling, in which banks require the opening and maintenance of a demand deposit account to grant a mortgage loan, restricting the competition by preventing the switching, allowing the unilateral rise of such commissions and customers aren't able to escape. The banks leverage the fact of customers being hostages of a tied package (mortgage loans + deposit account) to unilaterally impose the price of the maintenance deposits accounts.

The Directive 2005/29 EC of the European Parliament and of the Council of 11 May 2005, concerning unfair business-to-consumer commercial practices in the internal market ("Unfair Commercial Practices Directive"), particularly Article 9 (d), and the Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 Text with EEA relevance, namely but not limited to the Article 12(1), has not been enough to end those kinds of unfair commercial practices.

Keywords: coercive selling, tied package, bundle package, cross selling, antitrust, unfair commercial practices, financial services, switching costs

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1. <u>Introduction</u>

1.1. <u>Conceptualization</u>

1.1.1. <u>European Directives</u>

As a general rule Directive 2014/17/EU ("MCD") determines that Member States shall allow bundling practices but shall prohibit tying practices (*cf.* Article 12(1) of the MCD).

The exception to this general rule is provided for in points (2) and (3) of Article 12 of the said MCD, which we shall detail hereunder.

The MCD is a minimum harmonization directive and therefore Member States may impose a higher level of protection which, in this case, would be not to use the exceptions to tying practices laid down in Directive and never the contrary.

For example, the MCD was transported to Portuguese legislation by Decree-Law 74-A/2017, and Portugal opted not to use the exceptions provided for in Article 12(3) of the MCD.

However, Decree-Law 74-A/2017 fails in the transposition of the said directive in omitting the purpose underlying the possibility of the lender requiring the consumer to open or keep open a current account.

As an exception to the general rule laid down Article 12 (1) and (2)(a) of the MCD allows lenders to require the consumer (or a member of their family or someone close to them) to open or maintain a payment account or a savings account, "<u>the sole purpose of which is the accumulation of capital in order to repay the principal of the loan, to pay the interest on the loan, to accumulate resources in order to obtain the loan or to constitute an additional guarantee for the lender in case of default</u>" [emphasis added].

Article 11(2)(a) of Decree-Law 74-A/2017 simply determines that the lender may require the consumer to "open or keep open a current account". That is, it determines nothing as to the purpose of such a requirement, eliminating its teleological element in the transposition.

Now the catastrophic failure in the transposition of the said MCD to Portuguese law notwithstanding, it is known that an individual may always demand compensation for damage suffered in a Member State where there is a causal link between such damage and the rights under the provisions of the Directive incorrectly transposed, as is clear from the clarification of the interpretation in the so-called “Andrea Francovich and Danila Bonifaci and others *v.* Italian Republic”[1] case.

The rules of interpretation of any norm dictate that one must seek to reconstruct its *animus* following a hermeneutic methodology, and one must consider the extent of its meaning and the normal interpretation elements of any law or regulation: grammatical, historical, systematic and *ratio legis*.

Not to be fastidious, having resolved the grammatical question, considering that the letter of the directive is unquestionable even by virtue of its teleological element when it states that the sole purpose of the requirement of opening and maintaining a payment account or a savings account is “the accumulation of capital in order to repay the principal of the loan, to pay the interest on the loan, to accumulate resources in order to obtain the loan or to constitute an additional guarantee for the lender in case of default”, we are dealing with its systematic element – above all the unity of the legal system.

The possibility for the lender to require the consumer or a family member or close relation of the consumer to open or maintain a payment or a savings account, has the only purpose which is given by the teleological element above and by the Directive 2014/92 / EU of the European Parliament and of the Council of 23 July 2014 ("PAD").

According to recital 12 of PAD:

> *“[t]he provisions of this Directive concerning the comparability of fees and payment account switching should apply to all payment service providers, as defined in Directive*

[1] Join cases C-6/90 (Andrea Francovich and Danila Bonifaci and others v. Italian Republic) and C-9/90 (Pretura di Vicenza and Pretura di Bassano del Grappa), November 19, 1991.

2007/64/EC. The provisions of this Directive concerning access to payment accounts with basic features should apply only to credit institutions. All provisions of this Directive should concern payment accounts through which consumers are able to carry out the following transactions: place funds, withdraw cash and execute and receive payment transactions to and from third parties, including the execution of credit transfers. As a consequence, accounts with more limited functions should be excluded. For example, accounts such as savings accounts, credit card accounts <u>*where funds are usually paid in for the sole purpose of repaying a credit card debt, current account mortgages*</u> *or e-money accounts should in principle be excluded from the scope of this Directive. However, should those accounts be used for day-to-day payment transactions and should they comprise all of the functions listed above, they will fall within the scope of this Directive. Accounts held by businesses, even small or micro enterprises, unless held in a personal capacity, should fall outside the scope of this Directive. Member States should be able to choose to extend the application of this Directive to other payment service providers and other payment accounts, for example those which offer more limited payment functions*."

With high nitescence, It should be noted that Recital 12 of the PAD, *inter alia*, that "savings accounts" are excluded from the scope of that directive where funds are usually paid in for the sole purpose of repaying a credit card debt, current account mortgages. This means that the payment or savings account which may be required by the lender within the scope of Article 12 (2) (a) of the MCD, must have as its sole purpose the accumulation of capital intended to repay the principal of the claim, to pay interest on the claim, to pool resources in order to obtain the claim or to construct a supplementary guarantee for the lender in case of default, since only accounts in these precise conditions are exempted from the scope of application of the aforementioned "PAD". That is, <u>accounts that allow to perform daily payment transactions it's enough to exclude the categorization of "payment or a savings account" under the terms defined in Article 12 (2)(a) of the MCD</u>, as is clear from the clarification of the interpretation in the so-called "Bundeskammer für Arbeiter und Angestellte *v*. ING-DiBa Direktbank Austria Niederlassung der ING-DiBa AG"[2] case.

The Recital 12 of the PAD, along with the provisions of Directives 2005/29/EC [Articles (8) and (9)], 2014/65/EU [Articles (24) and (25)] and the Treaty on the Functioning

[2] Case C-191/17 (Bundeskammer für Arbeiter und Angestellte *v*. ING-DiBa Direktbank Austria Niederlassung der ING-DiBa AG), October 4, 2018.

of the European Union [Article (102)], should be taken into account in the interpretation to be extracted from Article 12(2)(a) of the MCD.

The unity of the legal system is one of the most important factors of the interpretative technique and a decisive factor by virtue of the principle of the evaluative coherence or axiology of the law.

Thus, there is no doubt as to the interpretation to be drawn in respect of the lender's purpose in requiring the consumer to keep open a current account and that, *in casu*, the current accounts be used exclusively for the repayment of mortgage loans.

On the other hand, the *ratio legis* of Article (12)(2)(a) of the MCD *in fine* is of such a glow, like the rays of the sun or other star of like magnitude, that the light that shines on Article 11(1)(a) of Decree-Law 74-A/2017, unveils the incorrect transposition of the said Directive. On transposing the Directive as it did, Portuguese law transformed the teleological element included in Article 12(2)(a) of the MCD in fine into a vagabond notion in the legal discourse, that does not exist in the thinking of the European legislator.

Now the *ratio legis* clarifies the purpose of the lender's requirement that the consumer keep a current account open, one that only permits the lender to reduce its exposure to the risk of default by the borrower and, in consideration thereof, agrees to conclude (approve) such a credit agreement and possibly reduce the risk premium ("spread") demanded.

Firstly, there are cases where consumers do not use the current account (which forms the "tied-package") to accumulate capital to repay the principal of the loan, to pay the interest on the loan, to accumulate resources or to construct an additional guarantee for the lender in the event of default, for this is neither provided for in the contract nor were the lenders obliged to do so.

Secondly the fact that borrowers have a current account with the lender is not able to decrease the risk of default on the payment of the said mortgage-loan instalments (*ratio legis* of the said Directives), in that there are cases where the borrowers do not receive any income in that account (and were never required to receive it) nor have deposited any amount in the account in order to accumulate capital to repay the principal of the loan, pay the interest on the loan, accumulate resources or construct an additional guarantee for the lender in event of default. Many borrowers merely transfer every month the exact amount required to pay the instalment, the maintenance fees and the insurance related to the loan. In reality and notably, the use of a current with the lender under the conditions and with the effects described above entails a greater risk of default of payment of mortgage-loan instalments than would be the case were the payment of the instalments made, for example, by direct debit to the account held with another credit institution, where the borrowers may have domiciled their salaries and/or receive their income and/or have their savings.

The current account that borrowers are required to open and maintain with the lender so as to access the mortgage-loan product could never constitute a reason for the approval of such a loan and/or to obtain a more favourable spread due to the decrease the risk of default (for this not the case, rather the contrary).

One can therefore perceive that the sole purpose of such an obligation is that the lender may charge management and maintenance fees to the customers – who are taken hostage in this way – and may increase them unilaterally without (re)negotiating the terms of the "tied package", the customers being unable to combat such an increase by changing the service provider and the current-account products.

Taking advantage of the obligatory associated sale, which is not even provided for contractually and is therefore, besides a tied package, a coercive sale using the definition provided by Article 9(d) of Directive 2005/29/EC ("UCPD"), the lenders keep the borrowers hostages of the mortgage loan (in which is very difficult to switch suppliers), to unilaterally and abusively impose an increase of the costs of the management fee and of the current-account maintenance. Consequently, the cost inherent in the mortgage-loan contract is significantly higher than that initially contracted by virtue of the increase that was not declared in the contract (in the Annual Percentage Rate of Charge) at the moment of its conclusion.

Therefore, this practice also violates the set of contractual and pre-contractual duties of information within the scope of the negotiation, conclusion and term of the loan agreements, which has to be complete, true, updated, clear, objective and fair to the consumer, in particular the information set out in articles 14 and 17 of the MCD, with emphasis on the Annual Percentage Rate of Charge ("APRC").

This is because the costs of opening and maintaining a specific account and of using a means of payment both for transactions and also to make use of the credit of that account, as well as for other costs relating to payment transactions, both called "costs to be paid periodically" are included in the total cost of the loan to the consumer whenever the opening or maintaining of an account is obligatory in order to obtain the loan or to obtain it under the terms and conditions marketed [cf. Article 17(2) of the MCD].

It should be highlighted the Article 17(2) of the MCD which explicitly states:

> *"[t]he costs of opening and maintaining a specific account, of using a means of payment for both transactions and drawdowns on that account and of other costs relating to payment transactions* ***shall be included in the total cost of credit to the consumer*** ***<u>whenever the opening or maintaining of an account is obligatory in order to obtain the credit or to obtain it on the terms and conditions marketed</u>***" [emphasis added].

On the condition that ***"[t]he calculation of the APRC shall be based on the assumption that the credit agreement is to remain valid for the period agreed*** *and that the creditor and the consumer will fulfil their obligations* ***<u>under the terms and by the dates specified in the credit agreement</u>***"[emphasis added], the only possibility granted for a change in such costs is in the

> *"case of credit agreements containing clauses allowing variations in the borrowing rate and, where applicable, in the charges contained in the APRC but unquantifiable at the time of calculation, the APRC shall be calculated on the assumption that the borrowing rate and other charges will remain fixed in relation to the level set at the conclusion of the contract."* [*cfr.* Article 17 (3) and (3) of the MCD].

In all cases observed it was found that the APRC presented to borrowers did not take into account the current-account maintenance costs that the lenders obliged the borrowers to open and/or maintain with the lenders to obtain the mortgage loan, for these costs were increased unexpectedly by the lenders and unilaterally by the borrower in a manner such that they could not be reflected in the APRC presented at the time of conclusion of the mortgage-loan contract.

Even though the *occasio legis* of the aforesaid MCD and in particular of the PAD does not constitute a decisive element of the interpretation, one must determine the reasons that inspired the European legislator in drafting such directives.

The anti-competitive practices as described above undermine the competitiveness, growth and job creation in the European. The elimination of physical and technical barriers, with emphasis on eliminating all direct and indirect obstacles and increase of the choice of consumer at a national and supranational level, as well as the quality and transparency of the offers, it´s important to create an efficient internal market

That is why the “switching” is one of the priorities the European Commission, along with the need to ensure a

> "*a high level of consumer protection in the area of credit agreements relating to immovable property and in order to ensure that consumers looking for such agreements are able to do so confident in the knowledge that the institutions they interact with act in a professional and responsible manner (...) develop a more transparent, efficient and competitive internal market, through consistent, flexible and fair credit agreements relating to immovable property, while promoting sustainable lending and borrowing and financial inclusion, and hence providing a high level of consumer protection.* "[*cfr*. Preamble of the MCD].

Thus, the *occasio legis* that inspired the European legislator is clearly and perfectly materialized in the MCD.

It can be argued whether or not the relevant European Directives[3] need to be improved in order to avoid controversial transposition into to the internal legal systems of the Member States, as is the case in Portugal with regard to the transposition of the DCM, but one thing is absolutely clearly: the intention of the European legislator and the priorities of

[3] Directive 2014/17/EU (article 12); Directive 2005/29/EC 11 (articles 8 and 9); Directive 2014/65/EU (articles 24 and 25); Directive 2014/92/EU (item 12 of the preamble and article, articles 9 to 13); TFEU (Article 102).

the European Commission – "*a high level of consumer protection in the area of credit agreements relating to immovable property*".

The lack of firmness and clarity in European Directives brings us to the problem described, the effects of which we will now detail.

1.1.2. Problem identification

Sometimes, providers exploit tied packages and/or use aggressive commercial practices, including onerous or disproportionate non-contractual barriers to the rights to terminate a contract or to switch to another product or another trader (coercion), in order to maintain "hostage" customers within a product or service that they do not want or need, threatening them with the termination of the contractual relationship regarding another product or service, included in the package.

For example, banks often require to customers that hire home mortgages, the obligation to contract a basic transaction bank account[4]. The customer can only give up on his basic transaction account, in case of liquidation of the home mortgage, even if the bank unilaterally decides to raise running costs/fees of the basic transaction account. Sometimes the bank increases those costs more than 500%, in just a few years! However, banks do not allow customers maintaining a home loan without a basic transactional bank account, despite being functionally independent services.

This anti-competitive practice and conduct which restrict competition are likely to cause an increase in the price of each individual service/product offered in the package and the switching costs for the consumer as well.

Providers leverage the fact of customers being hostages of a tied package and/or using aggressive commercial practices like coercion, to unilaterally impose the price of the product or the service whose purchase depends on the acquisition of the main product or service.

[4] Known as "current account", "checking account" or "demand deposit account".

The kind of problems upon described are exactly those faced on the Class Action nº 7617/T8PRT 15.7, which runs in Portuguese courts against a Portuguese Bank. In these Class Action, customers of a Portuguese Bank made a home loan and were required to keep a basic transaction bank account for paying the loan installments. In face of the subsequent increase of management cost of the basic transaction bank account (more than 500%), customers required the bank to close the transaction bank account and agreed paying the installments in another bank account, in cash or by transfer, however their proposal was denied by the bank, which continued to charge and increase the management fees for that basic transaction account. The plaintiffs argue that they are facing a coercive sale.

1.1.3. Exploiting the problem

The robustness in the increase of the commissions related to the opening and maintaining of customers' bank accounts that several banks have systematically reported in their annual reports, *i.e.* BCP Group (2018, p. 52)[5], in Portugal, or Caixabank (2018, p. 26)[6], in Spain, among others, is related to:

a) increase in the number of active customers and/or;

b) limited market capacity in the presence of increased demand (capacity constraints) and/or;

c) anti-competitive practices and conducts which restrict competition.

The law of demand states that, *ceteris paribus*, the quantity demanded of goods or services varies inversely with its price. In other words, the higher the price of commissions the lower the demand for these services should be. If we observe an increase in aggregate commissions charged by the bank and reported in its annual report and an increase in the

[5] According the Annual Report 2017 (BCP, 2018. Annual Report 2017 [online]. [accessed 14-11-2018]. Available from World Wilde Web: https://ind.millenniumbcp.pt/relcontas/2017/files/RCBCP2017_1.en.pdf

[6] According the Consolidate Financial Statments 2017 (CaixaBank Group, 2018. Financial statements and management report of the CaixaBank Group that the Board of Directos, at meeting held on 22 February 2018, agreed to submit to the Annual General Meeting [online]. [accessed 14-11-2018]. Available from World Wilde Web: https://www.caixabank.com/deployedfiles/caixabank/Estaticos/PDFs/Informacion_accionistas_inversores/MEMGRUPCAIXABANK31122017-CNMV-ING.pdf)

number of active customers, the amount of the commissions charged to each customer should decrease or, at least, not increase – this is because every competitive equilibrium is Pareto-optimal according with Pareto (1906)[7], Hicks (1939)[8], among others. Otherwise, we can say that is not a perfectly competitive economy.

Assuming that the transaction bank accounts tend to be homogeneous services (without differentiation) and that consumers make rational choices, we can say that for these products / services the consumers are price takers. In an economy in which all the firms (banks) can't influence the price at which they sell their products and services because they are too small and we are in a perfect competition (without any restrictive practice of competition), we have "price-takers [consumers] and not price-makers [providers]" (Scitovsky's, 1952)[9].

Thus, for a market (country) where there is more than one bank with a similar offer of transaction bank account, we can say that the consumers of these services are "price takers" resulting in a loss of the market share before a price increase above the competition.

Customers have access to more information, the service is easily understood and comparative information is easy to obtain at low cost, allowing them to compare prices more rationally Crosby & Stephens (1987)[10]. The customers that perceive less the real differences between products or services, are less loyal to brands and have a greater sensitivity to price (Kotler, 2000)[11].

It is known that Bertrand paradox has no direct practical application, since the services / products are not totally homogeneous, especially when they are services that presuppose a lasting relationship with customers (not a single transaction), vehicles for the acquisition of other services and the quality depends on the quality and safety of the supplier, as with banks and deposit accounts.

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[7] Pareto, Vilfredo (1972). Manual of Political Economy. New York: A. M. Kelley.
[8] Hicks, John Richard (1939). Value and Capital. London: Oxford University Press. 2nd ed., paper, 2001. ISBN 978-0198282693.
[9] Scitovsky, Tibor. 1952. Welfare and Competition. London: George Allen & Unwin
[10] Crosby, Lawrence A., & Stephens, Nancy. (1987). Effects of relationship marketing on satisfaction, retention, and prices.
[11] Kotler, Philip (2000). Marketing Management. 14nd ed., 2011). ISBN 978-0132102926.

Nevertheless, even if we are not in the presence of perfectly homogeneous services, we need to assume that the banks business is a price-taker commodity, and in that assumption the price increases can be related to capacity constraints (Edgeworth, 1889)[12].

In other hand, anti-competitive practices and conducts which restrict competition, which hinder or prevent the “switching”, especially in long-term customer relationships services, allow suppliers to charge more than their competitors for the same type of service without losing market share. This is because the consumers, to avoid these costs, don’t “switch” and continue to buy in the same company. The anti-completive practices and conducts obstructs efficiently buy-selling matching (Farrel & Klemperer, 2007)[13], obstruction that the Banks are causing.

A large switching costs and/or onerous or disproportionate non-contractual barriers to the right to terminate a contract or to switch to another provider, lock in the consumer once the initial purchase is concluded. These practices, where sometimes the provider “offer complete (“life-cycle”) contracts that specify all prices. But often contracts do not specify all the future prices, so that a long-term relationship is governed by short-term contracts. This pattern creates *ex post* monopoly, for which firms compete *ex ante*” (Farrel & Klemperer, 2007).

The answer to the problem raised is intuitively withdrawn: anti-competitive practices and conducts which restrict competition.

However, we shall seek to answer it through observation and analyses of the lender’s financial data (*i.e.* commercial banks).

1.1.4. **Problem formulation**

If competition were really efficient all the time, without capacity constraints, without barriers or constraints to “switching” (in an economic environment where the customers can

[12] Edgeworth, Francis (1889). The pure theory of monopoly. Reprinted in Collected Papers relating to Political Economy. 1. Macmillan. 1925.
[13] Farrell, Joseph and Klemperer, Paul (2006). Coordination and Lock-In: Competition with Switching Costs and Network Effects. Available at SSRN: https://ssrn.com/abstract=917785 or http://dx.doi.org/10.2139/ssrn.917785.

choose each service individually in any bank), the services and products are fairly homogeneous (even if not perfect) and assuming that banks are a price-taker commodity, it is difficult to believe that banks would have been able to raise running costs/fees of the basic transaction account more than 500%, in just a few time, just like the some banks did in the last years.

Everything suggest that the robustness in the increase of the commissions related to the opening and maintaining of customers' bank accounts that several banks have systematically reported in their annual reports, is related to anti-competitive practices and conducts which restrict competition.

The present study intends to answer the main question:

Are the anchor services and/or slow-moving services, such as mortgage loans, likely to enable banks to systematically increase their commissions unilaterally in the tied services, such as deposit accounts?

1.2. Unfair practices

1.2.1. Cross selling

Considering the description of "cross selling" proposed in ESMA's Guidelines: "*offering of an investment service together with another service or product as part of a package or as a condition for the same agreement or package*" (ESMA, 2016) [14].

Cross selling is a kind of bundling, so the description of bundle goes well for cross selling too.

1.2.2. Bundle Package

Considering the description of "cross selling" proposed in ESMA's Guidelines: "*offering of an investment service together with another service or product as part of a package or as a condition for the same agreement or package*" (ESMA, 2016)[15].

[14] According to definition used in the ESMA's Guidelines on cross-selling practices (ESMA, 2016. *Guidelines on cross-selling practices* [online]. [accessed 14-11-2018]. Available from World Wilde Web: https://www.esma.europa.eu/sites/default/files/library/2016-574_en_guidelines_on_cross-selling_practices.pdf)

Cross selling is a kind of bundling, so the description of bundle goes well for cross selling too.

Considering the description of "bundled package" proposed in ESMA's Guidelines : *"[a] package of products and/or services where each of the products or services offered is available separately and where the client retains the choice to purchase each component of the package separately from the firm*" (ESMA, 2016)[16].

And in Article 4(27) of the Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014:

> "*[b]undling practices' means the offering or the selling of a credit agreement in a package with other distinct financial products or services where the credit agreement is also made available to the consumer separately but not necessarily on the same terms or conditions as when offered bundled with the ancillary services*."

Bundling is a widely used practice, especially in telecoms and computer businesses. In general, we agree that a bundled package offers potential benefits for consumers, such as lower prices and lower risks (*i.e.* insurance linked to a loan) while, at the same time, reduces risks for the provider, enabling him to offer a better deal for the customer, among other potential benefits.

In the case of bundled packages, and without pretending to be paternalistic or making recommendations on the assumption that consumers or financial institutions can't make simple decisions, we think that it's enough to empower the consumers with clear and simple information on price of the bundled package and on each its components products or services, namely with a clear breakdown of all relevant known costs, all the future prices (for all services/products) such as monitoring and administration fees; transactions costs and pre-payment penalties charges, so the consumer can decide enter or not in a long-term relationship based in all the costs and conditions along the "life-cycle" of the contracts and

[15] According to definition used in the ESMA's Guidelines on cross-selling practices (ESMA, 2016. *Guidelines on cross-selling practices* [online]. [accessed 14-11-2018]. Available from World Wilde Web: https://www.esma.europa.eu/sites/default/files/library/2016-574_en_guidelines_on_cross-selling_practices.pdf)
[16] *Ibid*, page 5.

not only considering the short-term conditions, allowing the consumer to make an informed decision.

1.2.3. <u>Tied Package</u>

Considering the description of "tied package" proposed in ESMA's Guidelines : "*[a] package of products and/or services where at least one of the products or services offered in the package is not available separately to the customer from the firm*" (ESMA, 2016)[17].

And in Article 4(26) of the Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014: "*[t]ying practice means the offering or the selling of a credit agreement in a package with other distinct financial products or services where the credit agreement is not made available to the consumer separately.*"

We agree that a tied package can deliver potential benefits for the consumers, for the same sort of reasons as a bundled package.

But, unlike bundled packages, the tied package is a subtle form of combining slow-moving services/products with fast-moving services/products, bundling them, and create a contractual barrier that prevents the consumer to switch to another service/product or another trader or terminate a contract, because the consumer can't obtain a clear and simple information on price each product or service in the package, once at least one of the products is not available separately.

1.2.4. <u>Coercive Selling</u>

Considering the description of "coercive selling" proposed in the The Directive 2005/29 EC:

> "*any onerous or disproportionate non-contractual barriers imposed by the trader where a consumer wishes to exercise rights under the contract, including rights to terminate a contract or to switch to another product or another trader*" (Directive 2005/29 EC)[18].

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[17] *Ibid*, page 5

2. Methodology

2.1. Chooses the banks to analyze

The banks in Eurozone were chosen to carry out this study. In order to obtain a more representative sample, we chose the largest banks operating in each country studied (from a group of nine countries, including Portugal, Spain, United Kingdom, France, Germany, Belgium, and Greece), considering the number of active customers and/or annual revenues.

2.2. Choose the data

In addition to the choice of use the largest banks in each country, we tried to obtain the data from the annual reports of the individual accounts and, only when it was not possible, we used the consolidated accounts. This is because certain banks have a pan-European dimension and also exposure to US markets, which could be a *bias* to a study that is restricted to Europe.

2.3. Bias

2.3.1. Overfitting

There could be an overfitting problem when analyzing the lenders' financial statements with data that are known and selected with a view to obtaining a given result. This problem is very common in machine learning, especially when it comes to data mining, (which was not used here).

This *bias* could happen using the same time-series data to select borrowers with certain characteristics and to perform the regressions.

In such cases, overfitting occurred because we were submitting data in respect of

[18] Directive 2005/29 EC of the European Parliament and of the Council of 11 May 2005, concerning unfair business-to-consumer commercial practices in the internal market ("Unfair Commercial Practices Directive"), particularly Article 9 (d).

which it was already known that, for the period under review, they would respond to certain characteristics of the lenders, and the expected results would therefore be subject to bias by reason of those pre-selected characteristics.

Seen in this light, it would be the same as saying that we are faced with oversearching, not in the classical sense, but in the alternative explanation that using rules on the selection of the lenders on the precise information of the time series that will be the same as the ones used in the regressions, there is a possibility of evaluating the revenue of the lenders with account management and maintenance fees as to whether they are influenced by anti-competitive practices (*i.e.,* tied and coercive selling), allowing advance filtering of those lenders who may possibly use these practices or not.

The way to deal with this *bias* was relatively simple in the matter of the selection of the banks: Eurozone banks were chosen in accordance with their annual revenue and/or number of active customers, further limited by access to the said information, and neither the volume of net fees nor the volume of mortgage loans were used as selection criteria.

2.3.2. Data-snooping

No adjustments were made to the parameters of the choice of banks and data in the light of the results obtained by any combination of the variables involved in the analysis.

The parameterizations made in the regressions are those commonly used in these processes.

Given the foregoing there is no risk of data snooping, which usually occurs when using in-sample data to parameterize the tests and the same data to achieve them.

2.3.3. Postdictive error

The postdictive error occurs when information is used in the tests that will be available only after the fact occurs (Tharp, 1998)[19].

This type of error is set aside in this study, because the data used are those set out in the audited financial statements of the lenders and only the relationship between these variables is tested, no type of information being produced on the basis thereof that would only be available after the test.

2.3.4. Bias on the net fees (income)

The absence of standard information on the part of the lenders in respect of the net fees may constitute a bias factor.

This risk of *bias* is great considering that besides the various lenders analyzed not reporting the net fees in the same way, in some cases there is no distinction between the amounts charged by way of current-account management fee and another type of management and maintenance fees (*i.e.* securities deposit accounts, credit cards, *etc.*).

This risk of bias is real and must be considered significant in the observation of the results presented.

To reduce or mitigate this risk of bias one must obtain the current account management and maintenance fees in accordance with their type and with the differentiation of the accounts that are associated with the mortgage loan and those that are not – which could not be obtained for this study.

2.3.5. Correlation between active clients and value of mortgage loans

We found a high correlation (88%) between the "active customers" variable and the "mortgage" variable, and for this reason we do not use these two predictor variables to perform a multiple linear regression.

[19] Tharp, Van K. (1998). Trade Your Way to Financial Freedom. McGraw-Hill, 1999.

However, in some cases the number of customers may represent a bias regarding the results obtained, in that no sectional study was performed (for lack of data) by type of customer (i.e., private banking, access to minimum banking services account, *etc*.). As and where possible, an effort was made to expunge the sample of customers that are companies or equivalent entities.

2.3.6. Bias in consolidated financial statements

We tried to obtain the data from the separate annual reports and accounts, but it was not always possible to extract the variables needed for the study of those financial statements, which obliged us, in some cases, to use consolidated financial statements.

Use of consolidated financial statements constitutes a risk of bias, as many lenders have a pan-European dimension and also exposure to US markets, which does not guarantee uniformity of the data taking into account that there may be significant differences in management policies and, in particular, in the collection of account maintenance and management fees, in accordance with the geographical position of each lender (which seems to happen with lenders of the United Kingdom).

3. Coercive Selling *v.* Maintenance of Customer Account

3.1. Description of the variables under analysis

3.1.1. Number of active clients

The number of active clients is a key variable in this study.

Firstly, this variable was used to select the larger banks in the light of the number of consumers.

Secondly, the number of active customers is required to determine the average amount of the current account management and maintenance fees (whether they have a mortgage loan or not). That is, it is the entire universe of the lenders' customers, regardless of the products contracted.

3.1.2. Mortgage loans volume

The volume of mortgage loan contracts (by value) obtained from the lenders' reports and accounts is used as a variable in predicting the average amount of the current account management and maintenance fees charged to each customer ("average net fees"), on the assumption that mortgage loan contracts allow, through tied selling and coercive selling with the current accounts, (unilateral) imposition of a higher price for the current account management and maintenance fees than the banks would be able to impose if the borrowers were not hostage to a tied package of this nature (long-term contracts where it is difficult to switch suppliers).

3.1.3. Net fees (income)

The net fees obtained from the lenders' report and accounts are used to formulate the response variable. The choice of this variable is based on the assumption that lenders can more easily impose (unilaterally) a higher price for current account management and maintenance fees when the lender imposes the amount required to open and maintain the account in order to grant the mortgage loan to the borrower greater than the one that banks would be able to impose were the borrowers not hostages of the said tied package.

However, in order to reduce any bias derived from the lack of sectioning by type of customer, the average net fees obtained by dividing the net fees by active customers are taken into account. This is because, in overall terms, a larger number of customers supposedly represents greater revenue in current account management and maintenance fees, there being no guarantee that the penetration ratio of the mortgage loan product in active customers is the same for all lenders. That is, there might be the case of a bank that has large account maintenance and management fees revenues due to having a large number of customers, few mortgage loans granted and also lower average management fees per customer than another bank with lesser amount of revenue and a larger mortgage loan portfolio.

Were it possible to obtain the percentage of penetration of the mortgage loan product in active customers we could use this amount to weight the average net fees of all active customers and thus obtain a more robust response variable, or even use such a figure (penetration ratio) as a predictor variable. But it did not prove possible to obtain this figure for all the borrowers that constitute this sample.

3.2. Description of the linear regression model

In order to verify if the costly banks (the highest average net fees charged by the bank) are associated with a bigger volume of mortgage loans (anchor services), we used the *supra* described variables as potential predictors of the net fees charged by the banks, in a model of linear regression.

Considering the high correlation (88%) between the two predictors, we didn't used the "active customers" with the "mortgage" to perform a multiple linear regression. But we used the "active customers" combined with the "net fees" like a response (outcome) variable:

$$average\ net\ fees = \frac{net\ fees}{active\ customers}$$

The analysis of the linear regression is made for the average net fees of the group of eight countries and for the same group but excluding the UK because the weight of active customers of United Kingdom (36,70%), and because we notice that UK is a outlier in our data.

3.3. Results

Table 1 linear regression average net fees explained by mortgage loans

Regression		All (n=16)	Excluding UK (n=13)
Average Net fees	€m	2244.0 ± 3039.	3418.2 ± 2480.
Coercive Selling			
Alfa (intercept)		4.880	4.224
		0.000	*0.001*
Mortgage loans		-0.521	2.865
		0.611	*0.015*
R^2		0.019	0.427

Test statistic and *p* value (in italics) are presented.

The value of mortgage loans on balance sheet has a significant influence on the average net fees charged by the bank for the group that excludes the UK (n = 13).

The group that excludes the United Kingdom, average net fees are explained in 42.7% by the volume of the mortgage loans, and hast statistical significance with p value< 0.05.

The group that includes the United Kingdom (n = 16), the average net fees cannot be explained by the mortgage loans. UK seems be an outlier, because the average net fees are very distant from the other average net fees observed.

Table 2 Correlations between financial iliteracy and average net fees

	FINANCIAL ILITERACY	*MORTGAGE*	*AVG NET FEES*
FINANCIAL ILITERACY	100.00%		
MORTGAGE	-72.32%	100.00%	
AVG NET FEES	4.97%	-13.78%	100.00%

We tested the hypothesis of the UK presenting a lower average net fees than the banks of the other countries observed due to a greater financial literacy (score 67 vs 41 on average – excluding UK), but no correlation was found between the financial literacy and average net fees.

We believe the UK banks are outliers because is general banking practice is that banks do not charge account management and maintenance fees, and these fees are applied only in very specific and rare cases. Other services, such as providing debit cards, are also free. One of the major sources of revenue of UK banks in the matter of fees arises from account overdrafts, whether authorized or not.

4. Conclusions

The group that excludes the United Kingdom, average net fees are explained in 42.7% by the volume of the mortgage loans, and hast statistical significance with *p* value< 0.05.

This was an expected result due to the practice of coercive tied selling, in which banks require the opening and maintenance of a demand deposit account to grant a mortgage loan, restricting the competition by preventing the switching, allowing the unilateral rise of such commissions and customers aren't able to escape.

The banks leverage the fact of customers being hostages of a tied package (mortgage loans + deposit account) to unilaterally impose the price of the maintenance deposits accounts.

The group that includes the United Kingdom (n = 16), the average net fees cannot be explained by the mortgage loans. UK seems be an outlier, because the average net fees are very distant from the other average net fees observed.

The lower average net fees in UK banks when compared with the other countries observed is not explained for the greater financial literacy (score 67 *v.* 41 on average – excluding UK).

We believe the UK banks are outliers because is general banking practice is that banks do not charge account management and maintenance fees, and these fees are applied only in very specific and rare cases. Other services, such as providing debit cards, are also free. One of the major sources of revenue of UK banks in the matter of fees arises from account overdrafts, whether authorized or not.

Notwithstanding these commercial practices such as bundled or tied offers fall within the scope of the Article 9 (d) of the Directive 2005/29 EC (like was the interpretation of the European Court of Justice in the "Total Belgium" case[20]), and the prohibition on the practice of the tied selling in article 12(2)(a) da Directive 2014/17/EU, unfortunately, these sorts of problems continue occurring, and the courts of the Members States are far from finding quickly solutions.

The kind of problems upon described are exactly those faced by the plaintiffs on the Class Action nº 7617/T8PRT 15.7, which runs in Portuguese courts against a Portuguese Bank. In that Class Action, customers of a Portuguese Bank made a home loan and were required to keep a basic transaction bank account for paying the loan installments. In face of

[20] Joined cases C-261/07 (VTB-VAB NV e Total Belgium NV) and C-299/07 (Galatea BVBA v Sanoma Magazines Belgium NV), April 26, 2009.

the subsequent increase of management cost of the basic transaction bank account (more than 500%), customers required the bank to close the transaction bank account and agreed paying the installments in another bank account, in cash or by transfer, however their proposal was denied by the bank, which continued to charge and increase the management fees for that basic transaction account. The court of first instance (in Portugal) decided in favor of the bank, accepting that the practice of tied selling is legal and the bank prevented the lenders from switching the provider of the deposit account at the same time as it unilaterally increases the costs for the maintenance and management of that deposit account is not an abuse of right and does not violate the Europeans Directive.

4.1. Possible solutions

In general, member States shall all prohibit tying practices, when the product or service and their components are functionally independent. The provider must be available to sell them separately, and specify all prices, included the future prices.

For example, banks sell actively home loans and life insurance policy linked to home loans. Some of life insurances are created specifically to cover risks related to a particular home loan product, thus, in some cases cannot be available to be sold separately. In that specific case, we are dealing with a tied package. In those circumstances, banks must be available to sell a home loan without obligating the costumer to buy them life insurance. On the other hand, it can be accepted that the bank can refuse to sell life insurance policy as this is not marketed and advertised actively, and is functionally dependent from the home loan.

Exceptions to the general rule (prohibition of tying practices) may be admitted when tied packaging results in an effective and clear benefit for consumers, considering the offer and the prices available in the market for the same type of products and only in cases where the more favourable conditions obtained in the relevant product are necessarily related to the need to acquire the other products that make up the package.

That is, tied packaging can only be allowed when one or more products that constitute it enable the consumer to reduce the risk of breach of contract of the relevant product or service established with the provider and, as a result of this decrease of the risk, there is an unquestionable reduction of the price of all the products that make up the package compared to the offer and prices available on the market for the same type of products.

For example, the lender may require that a house-purchase savings account be opened for the sole purpose of accumulating capital that can be used exclusively to pay off a part or all of the mortgage loan, provided this results in lower cost (spread) of the mortgage loan for the borrower or if it is determinant for its approval. It is unacceptable that the lender may require the purchase of a product and/or service that does not reduce the borrower's risk towards the lender in contracting a certain product and hence reduce the cost (spread) of the loan for the borrower or permit its approval.

Under no circumstances, be it a bundled package or a tied package, a provider should be allowed to unilaterally change contracts of products or services sold, causing damages to the costumer, and needs to specify all future prices of the package and for each single product or service that are functional independent.

The costumer should be informed *ex ante*, with a clear breakdown of all relevant known present **and future costs**, such as monitoring and administration fees, transactions costs, and pre-payment penalties of the products or services contracted, and those conditions should not change over time.

In the case of the future prices of the package are unquantifiable at the time of the celebration of the contract, the tied packaging must be prohibit.

The solution for the identified problems involves the following measures:

a) Improve Article 12(2) of Directive 2014/17/EU, providing it with a wording that clarifies and limits the exceptions to the general rule prohibiting tying practices, particularly that such a ban may be withdrawn only in the cases set out in (a), (b) and (c) when the requirement to contract such products results in an effective and clear benefit for consumers, considering the offer and prices available on the market for the same type of products and only in those cases where the more favourable conditions obtained for the relevant product are necessarily related to the need to acquire the other products that make up the package, in particular enabling the consumer to reduce the risk of defaulting on the loan and, as a result of that reduction of the risk, there is an unquestionable reduction of the price ("spread") of the loan, as well as a reduction in the computation of the price of all the products that make up the package compared to the offer and prices available on the market for the same type of products.

b) Improve Article 12(3) of Directive 2014/17/EU, providing it with a wording that clarifies and limits the exceptions to the general rule prohibiting tying practices, particularly that such a ban may be withdrawn only when the requirement to contract such products results in an effective and clear benefit for consumers, considering the offer and prices available on the market for the same type of products and only in cases where the more favourable conditions obtained for the relevant product are necessarily related to acquisition of the other products that make up the package that in particular, but not exclusively, enable the consumer to reduce the risk of defaulting on the loan and, as a result of that reduction of the risk, there is an unquestionable reduction of the price ("spread") of the loan, as well as a reduction in the computation of the price of all the products that make up the package compared to the offer and prices available on the market for the same type of products.

c) Improve the Article 17 of the Directive 2014/17/EU in order to ensure that costumer should be informed *ex ante*, with a clear breakdown of all relevant known present and future costs, such as monitoring and administration fees, transactions costs, and pre-payment penalties of the products or services contracted, and those conditions should not change over time, and in the case of the future prices of the package are unquantifiable at the time of the celebration of the contract, the tied packaging must be prohibit.

d) Improve the Article 9 (d) of the Directive 2005/29 EC and articles 8 and 10 (1) of the Directive 2014/92/EU with the expressed spirit or purpose of the Article 24 Directive 2016/97/EU in order, *mutatis mutandis*, to prohibit the banks and investments firms from practicing coercive tied selling, more specifically, prohibit banks to coerce a client to have a bank account subject to monitoring and administration costs as a condition for buying another product (e.g. insurance, mortgage, funds, *etc*.), even when the bank account is linked to another product or service, or in alternative, exempt from cost the merely instrumental bank accounts used for sole purpose of repaying a revolving credits / open-end credit (*i.e.* credit card debt, lines of credit, *etc*.) or instalment loans / close-end credit (*i.e.* mortgage loan, car loan, appliance loan, *etc*.)

e) Materialization of the original intention of the Joint Committee of the EBA, the EIOPA, ESMA, to produce guidelines on cross-selling practices that would apply to banking, insurance and investment management, in order to prohibit banks from practicing coercive tied selling, more specifically prohibit banks to coerce a client to have a bank account as a condition for obtaining another product or service form the bank (included loans, mortgage, insurances, and investment products).

f) Improve the Guidelines on Cross-Selling Practices under MiFID II in order to prohibit the banks and investments firms from practicing coercive tied selling, more specifically prohibit the banks/investments firms to coerce a client to have a bank account as a condition for obtaining another investment product or service form the bank/investment firm.

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