Ad Hoc Expert Meeting on Consumer Protection: The interface between competition and consumer policies

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Session 4: Emerging issues in consumer protection: financial services

Presentation

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Emerging Issues in Consumer Protection: Financial Services

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Overview of Presentation

- Introduction
- Preventing systemic failure
- Financial services inclusion
- Information, education, literacy and capability
- Fair deal for individual consumers
- Conclusion – revising the UN Guidelines

Introduction

Libor scandal: Was Barclays the worst offender?

“What Barclays did was extremely serious. But Barclays were not involved in this on their own. And while they were certainly not the best of the bunch, there are other firms at a similar level of seriousness.”

Tracy McDermott (Lead of investigation team**)**

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- The industry is “a massive cesspit”.

Vince Cable (UK Business Secretary)

- “Financial crime is easier to get away with in this country than practically any other sort of crime.”

Ken Clarke (UK Justice Secretary)

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- “It goes to the culture and the structure of banks: the excessive compensation, the shoddy treatment of customers, the deceitful manipulation, a key interest rate and today, news of yet another…mis-selling scandal.”

Guardian.co.uk 29 June 2012

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- The scandals – a reflection of effectiveness, or ineffectiveness, of the UK's new financial architecture?

  What of financial services regulation elsewhere?

  Financial services top the list of consumer complaints (about 50%) in almost all countries.

www.businessweek.com/2012.03.06/financial services

Banks: Too Big to Fail, Bail (or Jail)

Prevailing pre-crisis paradigm: deregulation of financial activities and financial innovation are unconditionally beneficial. Paradigm sustained by misconceptions, prejudice and deceit:

- The system is efficient, resilient and self-correcting.
- Financial institutions act rationally to ensure their survival.
- Dealings between financial firm and retail consumers of financial products and services are private and parochial.

- Policy makers in developed countries have sufficient prescience and adequate policy tools to contain fall out when over-inflated asset bubbles burst.
- Most significant threats to financial stability stem from volatile “emerging market economies”.
- Self-governing, i.e., active, assertive and capable consumers who continuously search, compare, switch and complain, adequate to sustain a competitive financial services market.

Williams T. (forthcoming)

Effective Containment of Systemic Risk

1. Strong focus on structure, functions, and jurisdictional boundaries of regulatory agencies overseeing the financial services sector.

- Role and form of regulatory agency directly charged with monitoring and preventing systemic risk;
- Role of central banks *vis-à-vis* prudential regulatory and supervisory bodies;
- Creation of institutional mechanisms for stronger protection of retail investors and consumers;
- Resolution authority for orderly unwinding of financial conglomerates.

2. Regulatory Oversight of presently unregulated or under-regulated financial markets and institutions.

- One of the main causes of recent crisis – uncontrolled accumulation of financial risk in the “shadow banking system” operating entirely outside governmental supervision;
- Direct government regulation and supervision of OTC derivatives markets, hedge funds and other private investment vehicles;
- Greater oversight of mortgage brokers and credit rating agencies.

3. Strengthening existing regulations, enhancing quality of enforcement and compliance.

- Enhance capacity to manage complexity and global nature of financial products, institutions, and activities;
- Capital adequacy regime to limit leverage, enhance liquidity, and better align capital with risk profiles;
- Enhanced regulatory and supervisory oversight of financial institutions deemed of systemic importance;
- Firewalling retail banking;
- Prior regulatory approval for complex financial products.

4. Strengthening global regulatory and supervisory cooperation and coordination to monitor cross-border markets for potential accumulation of systemic risk and deal effectively with such risk on a timely basis.

Need for effective yet politically feasible in the face of problems of sovereignty and national differences

5. Embedded industry wide self-regulation

Governments:

- Lack sufficient knowledge of problems, unable to design solutions and identify non-compliance (information failure);
- Unable to design appropriate and effective legal policy instruments (instrument failure);
- Unable to motivate compliance by individuals and corporations (motivational failure).

- **Need for collective responsibility and liability of all financial service providers and their management.**

6. Consumer information and education – developing self-governing (i.e., active, assertive and capable) consumers.

- Difficult, even with basic services (saving, borrowing, insurance).
- Virtually impossible with new investment products.

Consumer organisations/representatives have to actively engage in determining and monitoring the new financial architecture.

Need for specialised consumer organisations with expertise in financial services?

Financial Services Inclusion

Use of formal accounts varies widely across regions, economies and individual characteristics. Account penetration:-

- Only 50% of adults (2.5 billion) with a formal account
- 89% in higher income economies
- 41% in developing economies

Much of the deficit is in the developing economies:-

- 46% of men; 37% of women
- Persistent 6-9% gender gap

Similar pattern for use of accounts and use of electronic transactions (ATM, debit cards, checks & electronic payments)

Removing physical, bureaucratic and financial barriers needed to extend use of formal accounts.

Lack of use due to:-

- 65% no money to place in account
- 25% banks and accounts too expensive
- 20% banks too far away
- Missing documentation
- No trust in banks
- Using accounts of others (cited more by women)
- Excessive paperwork

Formal borrowing and insurance are relatively rare in the developing world:-

- More than 11% have an outstanding loan for emergencies or health-care needs, but more than 80% use only informal sources of credit.

- Of adults in developing countries working in farming, forestry or fishing, only 6% have crop, rainfall or livestock insurance.

Financial Information, Education, Literacy & Capability

- Confusion between information and education
- New financial products cannot be understood by consumers even with financial education
- Financial education often consists of little more than disguised product marketing that exacerbates consumer’s behavioural biases
- Stakeholders have diverse objectives in financial education

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- “The financial inclusion community as a whole does not have a common definition or goal for financial education. This lack of an agreed-upon definition makes difficult the process of creating financially capable populations.”

- “MFIs, corporations, NGOs, and SACCOs (savings and credit cooperatives) each come to me with different goals, some impossible to achieve.”

John Gitau, CEO, Kenya Financial Education Center

- **“MFIs** want me to teach their clients quickly so that they can improve on their loans repayments and increase saving. They are not keen on me teaching investment … They want me not to dwell on costs but emphasize benefits.

- **Corporations** … want their staff to be taught how to budget their money to avoid impecuniary disruptions that affect working morale. But they don’t want me to emphasize savings because with savings comes investing and financial freedom that threatens employment indispensability.

- **NGOs** want me to teach everything that can create economic empowerment among their customers. To them, demonstrating effectiveness in money use attracts more donor funding.

- **SACCOs** (savings and credit cooperatives) want their members empowered, especially in investment and saving. However, they want to spend as little as possible for training … and most of the time they don't seem to care whether the members have learned or not… management decides what training is suitable for members in a top-down approach, members appear lost in the training, almost wondering what financial literacy is all about.

(M)any students, whether they are staff of corporations, clients of MFIs or SACCO members, don't want to learn financial literacy. In addition to thinking they know how to manage their money, they wonder why they have to learn… most clients are just going through the motions. Their minds are not in the learning but in the loans they will get and what they will do with the money.

Greedy **financial education training companies** do take advantage of such misalignment. Some MFIs train their staff as trainers to teach clients. To the staff, it is doing a job. Worse still, some MFIs have the same teachers manage debt repayments from the same clients they teach. With such a set up, financial literacy becomes the baby that is swept away with the bath water.

Fair Deal for Individual Consumers

Phased Development to Match Regulatory Capacity

- Fundamental consumer protection rules for low income consumers with low access to formal financial services.
- "Next generation" measures to be implemented when markets develop, competition increases, products more diverse and complex, regularity capacity deepens.
- Regulatory options to promote consumer protection principles of transparency, fair treatment and effective redress.
- Improvement of industry standards and consumer financial capability (consumer information & education).

3 Core Consumer Protection Principles:-

- Transparency – customers know what they are getting.
- Fair treatment – customers are treated fairly and not sold inappropriate/harmful financial products.

- Effective redress – customer complaints are resolved fairly.

Transparency rules – prices, terms & conditions, key risks

- Clear, comprehensive disclosure of relevant terms & conditions before, during and after sale;
- Specify types of information (such as interest rate or effective lending rate, fees, total of payments, default provisions, other terms and conditions);
- How information is to be presented (format, timing, and location of disclosures; language, font, and other attributes; uniformity across providers or products); and
- Specify *how* providers are to disclose information to customers.

Fair treatment – rules to ensure fair treatment and avoid harmful products and practices

- Ethical staff behaviour.
- Acceptable selling practices.
- Treatment of client data.
- Rules against deceptive advertising.
- Fair debt collection rules.
- Appropriate products tailored to customers’ circumstances.

Fair treatment – rules to ensure fair treatment and avoid harmful products and practices

- Rules to prevent reckless lending.
- Rules to address incentives that promote overselling.
- Pricing – limit interest rates and fee.
- Barriers to switching - closure fees, large prepayment penalties, unnecessary product tying, or loss or delay of getting mandatory savings back.
- Data privacy, security, and accuracy.

Effective redress – Errors, Complaints, Abuses

- Recourse process offered by the provider, such as internal complaints departments or consumer advocates.
- Recourse mechanisms beyond the provider may be provided directly by regulators, ombudsmen schemes, mediators, courts (small claims and other), tribunals, or civil society organizations.
  These options may be mandatory or voluntary.

Implementing, Monitoring & Enforcing Consumer Protection Regulations.

Regulators need clear enforcement authority, the power to undertake onsite inspection if necessary, and the ability to act on wrongdoing. Such actions can range from:-

- forcing providers to refund excess charges.
- withdraw misleading advertisements.
- to more serious sanctions, including fines and penalties. public notice of violations, restraining orders.
- withdrawal of the offending provider's license to operate.

Conclusion

- **UNCTAD & the UN Guidelines** have both contributed immensely to consumer protection in the developing world – policies, law, education and capacity building.

- Need for a revision to serve the current needs of consumers.

- Critical to have a section on financial services dealing with systemic risks, financial inclusion and a fair deal for individual consumers.

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Thank you

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