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Financial Consumer Protection, including Financial Education and Literacy

Contribution

CUTS International

Sixth Intergovernmental Group of Experts on Consumer Law and Policy (IGE Consumer)

CUTS Submission on Financial Consumer Protection, including Financial Education and Literacy

Introduction

India has made tremendous progress in bringing its citizens into the formal financial system over the last few years. There have been many recent developments in the country's financial inclusion scenario, especially through financial inclusion initiatives by the Government of India, such as Pradhan Mantri Jan-Dhan Yojana (PMJDY), social security schemes viz. Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY), Pradhan Mantri Suraksha Bima Yojana (PMSBY), Atal Pension Yojana (APY), Pradhan Mantri Kisan Maan Dhan Yojana (PM-KMY), Pradhan Mantri Shram Yogi Maan Dhan Yojana (PM-SYM) and Pradhan Mantri Mudra Yojana (PMMY). These have changed the financial inclusion landscape as these initiatives are bringing the excluded sections into the financial mainstream and ensuring access to various financial services for the excluded sections.

The country's financial system is broadly classified into formal (organised) and informal (unorganised) financial systems. The formal financial system comes under the purview of the Ministry of Finance (MoF), Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI) and other regulatory bodies. While the informal ones are the individual money lenders, such as neighbours, relatives, landlords, traders, store owners, and so on; groups of persons operating as funds or 'associations' and partnership firms consisting of local brokers, pawn brokers and non-banking financial intermediaries, such as finance, investment, chit fund companies.

In India, the spread of banking in rural areas has helped in enlarging the scope of the formal financial system. However, as the economic and the financial system kept growing in size and complexity, it led to the widening distance between the needs of the country and the present legal and regulatory arrangements. Several expert committees, from time to time, have pointed out various discrepancies like regulatory gaps, overlaps, inconsistencies, etc., and the need for revisiting the financial sector legislations to rectify them.

Approach taken by the financial sector in India is primarily based on the doctrine of *caveat emptor* (let the buyer beware). Other than protecting from fraud and provisions to ensure full disclosure, consumers are generally left alone. Thus the vulnerability of consumers coupled with inadequate financial literacy is hovering over the financial regulation space in India.

The following reflects the wide range of problems (indicative and not exhaustive) that are haunting Indian consumers in the financial sector:

- Inadequate infrastructure, particularly in remote areas, to access financial products;
- Unscrupulous methods of recovery being used by lenders;
- Unbridled credit card interest rate and other charges;
- Builders taking gullible apartment buyers for a ride on high costs, delays and hidden charges;
- Migrants are facing high costs, inadequate information, and delays in the remittance of funds to India, although such remittances are a big export earning for the country
- Multi-level marketing firms duping citizens through false promises, procuring funds and disappearing;
- Investors in the capital market face a range of problems;
- Violation of data privacy
- Hidden or inflated charges or fees
- Unfair contract terms and conditions (including unfair variation of contract terms, interest rates, or charges)
- Undisclosed level of financial risk passed to the consumer
- Contract terms not explained clearly at the point of sale or lost in gobbledygook
- After-sale customer service falling below expectations
- Aggressive or invasive sales techniques
- Breach of contract by the service providers
- Failure to deliver the service
- Exclusion from service etc.

Current Framework for Financial Consumer Protection

Over 60 Acts and multiple rules and regulations currently govern the financial sector. There is no exclusive legislation governing consumer protection for financial services. An aggrieved customer can approach either the consumer courts set up by the Consumer Protection Act, 1986 or may also resort to mechanisms set up by product and services-specific regulators. The consumer protection responsibilities for financial services are embedded in multiple regulators. India has six primary regulators- RBI, SEBI, Insurance Regulatory and Development Authority (IRDA), Pension Fund Regulatory and Development Authority (PFRDA), Employees Provident Fund Organisation (EPFO) and Forward Markets Commission (FMC).

In addition, the National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), and National Housing Bank (NHB) are also involved in regulation and supervision as subsidiaries of the RBI. As many as six Ministries of the Government of India and State Governments have an implicit or direct role (as in the Ministry of Corporate Affairs case).

The current regulatory approach to customer protection in India can be divided into two complementary *ex-ante* approaches: mandated information disclosure and financial literacy and education. These approaches are predicated on the principle of *caveat emptor* or ‘buyer beware’. In addition, there are *ex-post* mechanisms for grievance redressal to enable wronged customers to be compensated by financial services providers.

Regulatory Initiatives for Consumer Protection

The RBI is India's central bank and regulatory body responsible for regulating the Indian banking system. It is constantly making efforts to protect the interest of consumers. For greater effectiveness and a more focused approach, several committees were appointed on aspects of customer service in banks. It also introduced the Banking Ombudsman Scheme on June 14, 1995, for the customers of banks, which has been reviewed periodically to retain its relevance as an apex level complaint redressal mechanism for customers of banks.

The RBI has also launched the Ombudsman Schemes to include the customers of non-banking financial companies and Pre-paid Payment Instrument Providers. The Scheme has evolved as an apex-level complaint redressal mechanism for customers of entities regulated by the RBI. It provides a cost-free and expeditious redressal of complaints relating to deficient services by eligible entities covered under respective Schemes.

The RBI also created a dedicated Customer Service Department in 2006 that was later renamed the Consumer Education and Protection Department (CEPD), which acts as the nodal department in the Reserve Bank for grievance redressal of complaints received from the public. The department continues to provide a level playing field between suppliers and consumers of financial services, easing the imbalances emanating from information asymmetries, inadequate disclosures and unfair treatment. Besides, the Charter of Customer Rights, put in place by the RBI in December 2014, comprising broad overarching principles to be adopted by banks, has been playing an important role in protecting the interests of their customers.

Various other financial regulators have their redressal mechanisms in place. For instance, IRDA mandates the creation of insurance ombudsmen and requires that all insurance companies have internal grievance redressal mechanisms. For consumers of securities, SEBI has a complaint redressal mechanism called SEBI Complaints Redress System (SCORES).

However, one needs to wonder about the effectiveness of such an ombudsman in protecting the interest of consumers. For instance, according to the Annual Report of the RBI ombudsman schemes 2020-21,[1] out of 2,73,204 complaints received by the RBI's banking ombudsman during the year 2020-21, a mere 59 complaints saw an award being passed. The vast majority were dismissed or settled. The Ombudsman rejected nearly half the 120687 complaints it received, terming them as 'non-maintainable'. 'Maintainable' complaints fall within the specified grounds for a complaint under the Ombudsman Scheme 2006. It is primarily felt that the lack of representation of the Ombudsman from the consumer's point of view results in the large-scale rejection.

Financial Literacy and Education

While looking at the literacy scenario, according to the Standard & Poor's Ratings Services Global Financial Literacy Survey, conducted in 2014 across 144 countries with over 150,000 adults, Indian adults' financial literacy was lower than the worldwide average, BRICS nations and South Asian nations. The country was ranked 121 out of 144 countries in the global financial literacy ranking.[2] The survey highlighted that only 24 percent of Indian adults are financially literate.[3] The survey tested their knowledge of four basic financial concepts - numeracy, risk diversification, inflation, and compound interest (saving and debt).

Likewise, National Centre for Financial Education (NCFE) carried out an All-India Financial Inclusion and Financial Literacy Survey[4] in 2019 with the help of an external surveying agency to find out the status of financial literacy in India. A sample of 75000 adults aged 18 to 79 was interviewed in 14 national/regional languages using a household questionnaire.

A multi-stage sampling technique was adopted for selecting districts, blocks/wards, villages, households, and respondents during the survey. The survey revealed that only 27.18 percent of respondents achieved the minimum target score in each of the components of financial literacy prescribed by the OECD-INFE Policy Handbook on National Strategies for Financial Education [i.e. a minimum of 3 in Financial Attitude (out of 5), 6 in Financial Behaviour (out of 9) and 6 in Financial Knowledge (out of 9)] as compared to 20 percent in 2013.

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1 RBI Ombudsman Scheme Annual Report 2020-21, Consumer Education & Protection Department, RBI. Accessible at <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/OMBUDSMANSCHEMES120122D2F38DF50CDB4565969EAF7B12FBDE37.PDF>

2 Global Financial Literacy Ranking. Accessible at <https://theatlas.com/charts/VJDhtA8Xe>

3 Financial Literacy around the World, Insights from The Standard & Poor's Ratings Services Global Financial Literacy Survey. Accessible at <https://gflec.org/wp-content/uploads/2015/11/3313-Finlit_Report_FINAL-5.11.16.pdf>

4 National Strategy for Financial Education: 2020-2025, RBI, 17 March 2021. Accessible at <https://m.rbi.org.in/scripts/PublicationReportDetails.aspx?UrlPage=&ID=1156#CH1 >

It further highlighted that though there has been an improvement over the period, further efforts are needed to improve financial literacy among women. It also underlined the need for focused attention among rural India and the group of age ‘50 and above’ that needs more financial education.

Regulators have been promoting financial literacy and education schemes to improve consumer outcomes, but much more needs to be done. For instance, the RBI announced the National Strategy for Financial Education to promote inclusive growth, financial inclusion and financial education. It also produces many comics, handbooks, booklets, etc., available on its website in many regional languages to spread information and make the public aware.

Shortcomings

While these form the basic facts of India’s current financial consumer protection and education landscape, there are some fundamental gaps, such as the lack of mechanisms to deal with conflicts of interest inherent in regulators in their dual functions of prudential regulation and consumer protection. Besides, an increasing inter-regulatory conflict arises from a rapidly evolving financial sector.

Despite all the initiatives the regulators and government take, there are many shortcomings. More importantly, the ‘buyer beware’ approach should not be allowed forward, and the regulators must place the burden upon financial firms to do more in the pursuit of consumer protection. Besides, a greater degree of independence of regulators needs to be ensured, along with a need to ensure their accountability. They should be bound to explain their actions to regulated entities and the public. Lack of transparency in the functioning of the existing agencies coupled with inadequate powers makes these regulators less attractive in case of a complaint. A well-aware consumer prefers going to a consumer forum as it saves time and money and paves the way for better accessibility, compensation and costs.

More robust consumer protection and better financial education are essential pillars of financial stability, and financial education alone is insufficient to protect consumers and empower them. Strong consumer protection in financial markets is required because consumers are often unable to understand certain financial products' complexity and risks. They are poorly equipped to identify cases when inappropriate financial products are mis-sold deliberately and often for various reasons. They fail to properly assess or understand potential financial consequences when things do not turn out as expected or planned.

Way Forward

- There is an urgent need for a robust consumer protection mechanism, setting clear rules for financial institutions regarding their dealings with retail customers and addressing financial exclusion. While experts have recommended reforms such as introducing suitability requirements, simple and standard financial products, moving to seller beware principles, and various mechanisms to enable financial inclusion for poor and small enterprises, much more needs to be done.

- The increasing availability and use of financial instruments, when juxtaposed with a multiple set of regulators/regulations, strengthens the argument for having one regulator for the financial sector in India, i.e. cognate sectors, such as banking, non-banking financial services, stock markets, chit funds, hire purchase etc. clubbed under the rubric of 'financial sector'. One of the advantages of having one regulator for cognate sectors is that it results in efficient use of resources (human, financial, etc.) and ensures the covering of grey areas. Therefore, adopt and implement an omnibus Financial Consumer Protection Act. Such law must consider successful and not-so-successful practices implemented by various states and comparable jurisdictions. It should establish a new national single financial consumer protection mechanism (regulator), having state units/regional offices, thus covering the entire country.
- Need to strengthen national campaigns for financial literacy. The digitalisation of financial products and services and the consequent need to strengthen digital financial literacy have become pertinent. Ensure that consumers are aware of their potential exposure to digital crimes and their rights and responsibilities. Digital literacy needs to be improved among older populations in particular.
- Need to strengthen the existing grievance redressal mechanism. Currently, the redressal forums have highly technical and burdensome procedures that consumers must follow. Often complaints get rejected by the Ombudsman either because of not properly representing or not being able to provide complete information in the complaint.
- Present grievance redressal mechanism in the financial sector comprises an internal system of service providers and then the Ombudsman in some services like banking, insurance, etc. The internal grievance redressal mechanism needs overhauling to make it independent of service providers and fully accountable. Service providers should consider appointing at least one independent member in the internal grievance redressal mechanism.
- Consumer participation in financial services regulation is highly desirable because of its crucial role in inclusive economic development and consumer protection. The present level of consumer participation in the financial sector is not satisfactory, and the regulators should promote consumer participation from the planning process to the implementation. Informed and inspired consumers can be effective partners in the growth of the financial sector.