Session 10: Financial Consumer Protection

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Agenda

• Challenges faced by consumers

• What financial consumer protection (FCP) frameworks achieve and how they benefit consumers and industry

• Main components of a FCP framework

• Digital financial services & FCP

• Potential actions to include in an NFIS

• Key technical resources
Challenges faced by consumers

- Financial products are complex and difficult to understand for average consumers

- Financial products and services can be costly, with the costs difficult to assess and compare

- Consumers do not obtain financial products regularly, so are often unfamiliar with structure of products and language of contracts

- Financial innovations raise new issues for consumers (e.g. mobile banking, digital finance)

**Negative impacts**

- Consumers choose inappropriate products, leading to harm to welfare
- Consumers have lower trust in financial institutions
- Consumers turn to informal means to save, borrow, and conduct financial transactions
- Consumers are less likely to use financial products and services
- Negative impacts on formal financial sector, financial stability, and broader economic growth
What do financial consumer protection (FCP) frameworks achieve?

• Goal of FCP framework is to reduce the inherent imbalance of power, resources, and information between financial institutions and average consumers
• Set clear rules of conduct for financial service providers regarding their retail customers
• Aim to ensure that consumers:
  ➢ Receive information to enable them to make informed decisions
  ➢ Are not subject to unfair or deceptive practices, and
  ➢ Have access to recourse mechanisms to resolve disputes
Benefits for both consumer and industry

- Helps to maintain the **benefits of financial intermediation** for consumers
- **Increased trust** and strengthened reputation of the financial sector among consumers
- Deepening of the financial market (increased usage of products, numbers of products and providers, etc.)
- Transparent environment and **level playing field** for responsible providers
- **Fair competition** based on “real” attributes of products, promoting (beneficial) financial innovations
- May help reduce non-performance rates, **promoting stability** of individual providers and the broader financial sector
- Decreases **shadow economy**
What are the main financial consumer protection concerns in your markets?
Main Concepts of a FCP Framework

- Legal framework
- Supervision and enforcement
- Disclosure and transparency
- Fair treatment and business conduct
- Dispute resolution

Financial Consumer Protection Framework
FCP Framework: Legal Mandate and Institutional Models

**Sector-oriented model**
A supervisor for each sector (e.g. banking, insurance, securities market)

**Functional (operational) model**
A supervisor for specific activities (e.g. payment services, investment services, deposit taking, credit provision)

**Goal-oriented model**
A supervisor for each goal (e.g. prudential supervision, data protection, business conduct supervision, anti-trust & competition)

Legal framework should have an explicit and clear legal mandate for consumer protection.
Greater flexibility to address issues that are typical of the financial sector and allows for complementarity with other regulatory frameworks such as prudential regulation.

**Good Practices:**
- Either a comprehensive standalone legal framework for financial consumer protection (e.g. Canada, Mexico); *OR*
- Separate Laws to address specific products and services (e.g. Laws on credit products/services in Australia, SA).

**Industry Benefits:**
- More certainty as to what rules are applicable to them.
- Financial sector peculiarities can be further taken into consideration.
FCP Framework: Legal Framework

- Specific legal framework for financial consumer protection in place in 89% of jurisdictions
- Most common approach is to embed consumer protection within financial sector laws
  - e.g. Malaysia’s 2010 Financial Services Act includes provisions on misleading and deceptive conduct
- 21% of jurisdictions have a standalone financial consumer protection law
  - e.g. New Zealand’s 2013 Financial Market Conduct Act
- Many jurisdictions follow several approaches, which can lead to gaps or overlapping / conflicting provisions

<table>
<thead>
<tr>
<th>LEGAL FRAMEWORK APPROACH</th>
<th>ALL</th>
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<tbody>
<tr>
<td>Standalone financial consumer protection law</td>
<td>21%</td>
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<tr>
<td>Consumer protection provisions within other financial sector laws (e.g., banking law)</td>
<td>76%</td>
</tr>
<tr>
<td>General consumer protection law with explicit references to financial services</td>
<td>34%</td>
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FCP Framework: Supervision

- Broader than consumer protection;
- Focus on various aspects of conducting business; and
- Covers both consumer protection issues and topics such as remuneration schemes, market manipulation, competition.

- Focus on interactions with customers;
- Consumer usually narrowly defined (e.g. a natural person, MSMSE);
- Touches upon issues directly affecting consumers such as pricing, product suitability, product regulation.

No internationally standardized definitions
FCP Framework: Supervision

Financial Consumer Protection Supervisory Activities

# of responding jurisdictions that undertake financial consumer protection supervisory activity

- Drafting or providing inputs into regulation: 88
- Off-site inspection of FSPs: 82
- On-site inspections and investigations of FSPs: 81
- Collection of data from FSPs on the # of complaints received: 74
- Market monitoring: 65
- Thematic reviews: 56
- Collection of data from FSPs on rates and fees for financial services: 55
- Mystery/incognito shopping: 33
- Interviews, focus groups, and research with consumers: 32
FCP Framework: Disclosure & Transparency

Advantages:

- Better understanding of the financial services and products offered
- More comparability between financial services and products
- More competition and better quality
- More confidence in the formal financial sectors
- Informed decisions by consumers - less risk of “side effects” (e.g. over-indebtedness)

Rules should be in place for institutions to have adequate materials and procedures aiming to provide consumers with appropriate information on the key features and risks of the relevant financial services/products.

The information should be standardized and comparable whenever possible.

It should provided in a manner that allows consumers to take independent, informed decisions.
Disclosure Requirements, by Stage of Customer Relationship

<table>
<thead>
<tr>
<th>STAGE</th>
<th>COMMERCIAL BANKS</th>
<th>OTHER BANKS</th>
<th>FINANCIAL COOPERATIVES</th>
<th>ODTIs</th>
<th>MCI</th>
<th>NBEIs</th>
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<tbody>
<tr>
<td>At advertisement stage</td>
<td>81%</td>
<td>74%</td>
<td>71%</td>
<td>73%</td>
<td>65%</td>
<td>72%</td>
</tr>
<tr>
<td>At shopping stage</td>
<td>79%</td>
<td>70%</td>
<td>61%</td>
<td>65%</td>
<td>63%</td>
<td>70%</td>
</tr>
<tr>
<td>At precontractual stage</td>
<td>90%</td>
<td>87%</td>
<td>76%</td>
<td>80%</td>
<td>75%</td>
<td>89%</td>
</tr>
<tr>
<td>At contractual stage</td>
<td>95%</td>
<td>92%</td>
<td>82%</td>
<td>88%</td>
<td>87%</td>
<td>93%</td>
</tr>
<tr>
<td>Upon request</td>
<td>2%</td>
<td>2%</td>
<td>0%</td>
<td>2%</td>
<td>2%</td>
<td>3%</td>
</tr>
<tr>
<td>Number of responding jurisdictions</td>
<td>118</td>
<td>61</td>
<td>69</td>
<td>56</td>
<td>52</td>
<td>60</td>
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Principles/Good Practice:
• Balanced rules should be in place regarding contractual terms and conditions, product suitability, product regulation, and fair practices, in order to ensure that consumers are treated fairly and offered a product or service appropriate for them.

Debt-collection done in a fair and still efficient manner

Compensation of staff and agents: minimizing conflicts of interest

Customer Mobility: information, no unduly limitations, cooling-off period.

Lower risk related to unfair, abusive practices

Prohibition of unfair, deceptive, abusive, unbalanced terms and conditions

Providers (staff and intermediaries) ensuring that sales practices will not be mis-dealing, aggressive and discriminatory

Products being offered and advices being provided after gathering sufficient information – Suitability

75% of surveyed jurisdictions prohibit the use of any term or condition that is unfair, excessively unbalanced, or abusive (FICP 2017)
Consumers should have access to both internal (within providers) and external (out-of-court) dispute resolution mechanisms to seek redress, which should be effective, adequate, easy to access, and professional.

The overall legal framework should include measures requiring financial service providers to have an IDR mechanism and provide for the relevant institutional arrangements for an efficient EDR mechanism with adequate powers.

**Advantages:**
- Increase confidence in the formal financial system.
- Higher client retention as unsatisfied consumers will be heard and the institutions will have a change to resolve their issues.
- More information on issues in the market via complaints data analysis.
  * Effectiveness and efficiency of EDR schemes vs. Justice system.*
Products and issues frequently addressed by ADR entities

- Disputes most commonly addressed by ADR entity, by **product**:
  1. Consumer loans
  2. Credit cards
  3. Mortgages
  4. Debit cards
  5. Deposit accounts

- Disputes most commonly addressed by ADR entity, by **issue**:
  1. Excessive interest or fees
  2. Unclear interest or fees
  3. Mistaken/unauthorized transactions
  4. ATM transactions
  5. Fraud
Financial consumer protection is especially important in an environment where new financial products and services are increasingly being delivered through new distribution channels, by non-financial firms, and using new business models and technologies.

**New financial products**
e.g. e-money/mobile wallets, mobile micro insurance; digital credit; bundled products (air-time and insurance; air-time and credit)

**New distribution channels**
e.g. new ways of delivering financial services, such as electronically through mobile phones, smart cards, PCs, via agents and other intermediaries

**New service providers and business models**
e.g. mobile network operators (MNOs) providing financial services, big data/alternative data
FCP concerns in the new DFS environment

How is DFS different from conventional finance?
- High speed of transactions
- Remote nature of service
- Automated decision-making
- Limited written records of accounts and transactions
- Involvement of unregulated and/or non-financial entities
- Important role of intermediaries
- Rapidity of innovation
- Significant scale and volume of offered services and related risks

FCP issues with specific importance to DFS:
- Electronic disclosure
- Product suitability/over-indebtedness
- Liability for intermediaries
- Privacy and data protection
- Recourse mechanisms
- Protecting clients’ funds
- Consumer responsibilities
- Financial capability/digital literacy
- Regulatory framework (gaps)
Disclosure and transparency

**Issues Raised by DFS**

- Disclosure of terms and conditions via digital channels/electronic formats less comprehensive, more difficult to read, limited live interaction
- For example, key facts statements when product is offered through mobile phones
- Disclosure via digital channels may be more difficult to store and access at later times
- Periodic statements for mobile money accounts?

**Good Practices for FCP**

- Allow for disclosure in electronic format, short message services (SMS) for transaction receipts for mobile money, etc.
- Expand disclosure rules to apply to digital channels/products, with adaptations as necessary
  - Layered KFS info via mobile phones, standardized icons
  - Access to more comprehensive info at later stage
  - Cooling-off periods
- Require digital record keeping of consumer transactions (for consumer and supervisor)
**Good Practices for FCP**

- Monitor market and analyze consumer complaints data to identify unfair practices w/r/t DFS
- Limit unfair practices, balancing needed flexibility for innovation
- Develop balanced rules regarding product suitability, particularly for digital credit products
- Require clear disclosure for bundled products
- Make providers legally liable for actions and omissions of agents
- Consider alternative mechanisms to protect funds, such as custodial accounts, ring-fencing, etc.

**Issues Raised by DFS**

- Aggressive sales practices that take advantage of behavioral biases, such as unsolicited loans offered via SMS (“push” ads)
- Automated credit decisions based on alternative scoring models, with potential for discrimination
- Limited assessment of product suitability when product delivered via digital channels
- Bundling (mobile credit + insurance) limiting consumer choice
- Misbehavior of agents
- Security of funds in digital stored value, deposit-like products
Common NFIS Policy Areas

- Digital payments/innovative products: 12 NFISs
- Financial capability/education: 18 NFISs
- Financial infrastructure: 9 NFISs
- MSME/Ag finance: 8 NFISs
- Insurance: 4 NFISs
- Distribution channels/access points: 15 NFISs
- Financial consumer protection: 16 NFISs
- Savings/pensions: 4 NFISs
- Measurement and data: 3 NFISs
- Microfinance/access to credit: 3 NFISs
## Sample NFIS action items for FCP

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<thead>
<tr>
<th>Legal and Institutional</th>
<th>Disclosure and Transparency</th>
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<tr>
<td>• Implement a comprehensive FCP framework (Nigeria)</td>
<td>• Issue KFS and other disclosure requirements for core retail financial products (Zambia)</td>
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<tr>
<td>• Clarify mandates of agencies relevant to FCP and establish information sharing (Paraguay)</td>
<td>• Promote development of user-friendly price transparency websites (Paraguay)</td>
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<td>• Ensure appropriate mechanisms for market conduct supervision of DTIs, credit unions, and MFIs (Jamaica)</td>
<td>• Require standard methodologies to calculate and disclose total costs and returns (Pakistan)</td>
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<tr>
<th>Fair Treatment and Business Conduct</th>
<th>Internal and External Dispute Resolution</th>
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<tr>
<td>• Issue regulation that address responsible lending, cooling-off periods, collection practices, sales practices, and treatment of dormant accounts (Zambia)</td>
<td>• Issue complaints-handling requirements for FSPs (Zambia)</td>
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<tr>
<td>• Issue guidance to clarify what constitutes abusive debt collection practices (Paraguay)</td>
<td>• Establish independent EDR scheme for consumers of DTIs, credit unions, and MFIs (Jamaica)</td>
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<td></td>
<td>• Ensure consumers are aware of their rights and dispute resolution procedures (Brazil)</td>
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World Bank’s Good Practices for Financial Consumer Protection

- Set of good practices based on international benchmarks, such as
  - Principles and recommendations released by the Basel Committee, IOSCO, IAIS, and OECD
  - Laws, regulations, implementation experiences from both developed countries emerging economies
- 35+ diagnostic reviews conducted in four continents using Good Practices
- Includes chapters on deposit and credit, insurance, securities, and pensions
- New 2017 edition (1) expands on supervision and implementation, (2) incorporates DFS, and (3) adds annex on retail payment services
Focus areas of diagnostic review for FCP

- **Institutional Arrangements**: Are the necessary institutional arrangements in place to ensure thorough, objective, timely, and fair implementation and enforcement of these rules?

- **Legal & Regulatory Framework**: Does the law provide clear consumer protection rules regarding financial products and services?

- **Transparency & Disclosure**: Are consumers provided with the right information to make informed financial decisions?

- **Business Practices**: Are financial institutions prohibited from employing abusive business practices against their customers?

- **Dispute Resolution Mechanisms**: Do financial institutions deal with complains in a fair, expeditious and transparent way? Is there an independent, transparent, accessible third party body to deal with disputes between consumers and their financial institution?

- **Financial Literacy**: Are strategies and initiatives undertaken to improve the financial knowledge and behaviors of consumers of all ages?
Thank you!

Questions?
Key technical resources

- G-20 High-Level Principles on Financial Consumer Protection and Effective Approaches
- Report on Responsible Lending, FinCoNet, 2014
- Developing a Key Facts Statement for Consumer Credit, World Bank, 2018
- Establishing a Financial Consumer Protection Supervision Department, World Bank, 2014
- Guide to setting up a Financial Services Ombudsman Scheme, INFO Network, 2018
- From Spreadsheets to Suptech – Technology Solutions for Market Conduct Supervision, World Bank, 2018
Key technical resources on DFS & FCP

- Consumer Experience and Protection Working Group, ITU-T Focus Group Digital Financial Services, 2017
- Managing the Risk of Fraud in Mobile Money, Mobile Money for the Unbanked, 2012
- ePayments Code, Australian Securities and Investment Commission, 2016
- Code of Conduct for Mobile Money Providers, GSM Association (GSMA), 2014
- Mobile Privacy Principles, GSMA, 2011
- Responsible Digital Finance, Responsible Finance Forum V, 2014
- Online and mobile payments: Supervisory challenges to mitigate security risks, FinCoNet, 2016
- Recourse in Digital Financial Services: Opportunities for Innovation, CGAP, 2015
- Responsible Digital Payments Guidelines, Better than Cash Alliance, 2016
- Consumer Protection in Digital Credit, CGAP, 2017
- Deposit Insurance and Digital Financial Inclusion, CGAP Brief, Oct 2016
- Digitalization of short-term, high-cost consumer credit: Guidance to supervisors, FinCoNet, 2018
- Practices and Tools Required to Support Risk-Based Supervision in a Digital Age, FinCoNet, 2018