Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung

afi Alliance for Financial Inclusion
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Certified Expert in Financial Inclusion Policy

Unit 2: Consumer Empowerment and Market Conduct

Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung

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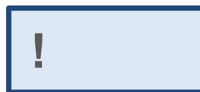
Symbols

Definition

Further Reading



Key Message

Example

Exercise

Video

3. edition 09/2018

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Content

1. Introduction to consumer empowerment and market conduct (CEMC) 5

1.1. Definitions 5

1.2. Why are consumer empowerment and market conduct policies considered to be so important? 8

1.3. What does CEMC mean in practice? 12

2. Institutional framework and supervision 23

2.1. Institutional framework 23

2.2. Enhancing market conduct 25

3. Transparency and disclosure 36

3.1. Introduction 36

3.2. An empowering transparency and disclosure regime 37

3.3. Implementation 46

4. Responsible Lending 50

4.1. Why is responsible lending important? 51

4.2. Key features of a responsible lending regime 53

4.3. Responsible lending initiatives 58

5. Avenues for Help and Redress 63

5.1. Introduction 63

5.2. Internal dispute resolution 70

5.3. External dispute resolution 71

5.4. Depositor protection 74

5.5. Support for over-indebted consumers 75

6. Financial Literacy, Capability and Education 78

6.1. Introduction 78

6.2. Understanding financial literacy, capability and education 79

6.3. Why are they important in CEMC regimes? 83

6.4. Who should develop and promote financial literacy, capability and education initiatives? 85

6.5. Key elements of a successful financial education strategy 87

7. Exercise solutions 92

Abbreviations

ADR	Alternative Dispute Resolution
AFI	Alliance for Financial Inclusion
BNM	Bank Negara Malaysia
CBA	Central Bank of Armenia
CBL	Central Bank of Liberia
CEMC	Consumer Empowerment and Market Conduct
CEMCWG	AFI Consumer Empowerment and Market Conduct Working Group
FCA	Financial Conduct Authority (UK)
FCB	Financial Capability Barometer
FPC	Financial Policy Committee (UK)
FSA	Financial Supervisory Authority
FSCP	Financial Services Consumer Panel (UK)
FSMP	Financial Sector Masterplan (Malaysia)
FSP	Financial Services Provider
MAS	Money Advice Service (UK)
MC-RBS	Market Conduct Risk-Based Supervision
MFO	Microfinance Opportunities
OECD	Organization for Economic Co-operation and Development

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Learning Outcomes

Unit 2 of the e-learning course "Certified Expert of Financial Inclusion" complements Unit 1 by focusing on the consumer perspective of Financial Inclusion.

This Unit will help you to develop a clear understanding of issues and good practices in consumer empowerment and to be able to design, improve, and review regulatory and/or institutional policies related to market conduct and supervision practices.

Section 1 introduces the concept of consumer empowerment and market conduct (CEMC) and the issues it raises for financial services regulation in practice. Section 2 describes the institutional and supervisory framework required to support CEMC policies. Section 3 outlines the transparency and disclosure requirements necessary to empower and protect consumers. Section 4 deals with responsible lending practices for credit products within a CEMC framework. Section 5 explains the avenues for help and redress for consumers. Section 6 covers the importance of financial literacy, financial capability and financial education.

After working through this Unit you will have obtained the knowledge and skills listed below:

- Development of a broad understanding of the consumer empowerment and market conduct issues;
- Familiarization with the terminologies used in relation to CEMC;
- Understanding of the various policies, models and supervision structures that assist in ensuring responsible market conduct and empowering consumers;
- Ability to identify the key components to be considered by a financial services provider (FSP) and the processes to be followed by financial service providers to ensure transparency and disclosure amongst consumers;
- Ability to articulate the essential features of a responsible lending product/ service/ delivery channel;
- Ability to assess suitability of financial products and services to specific markets;
- Ability to differentiate among the various help and redress avenues that are available to consumers;
- Understanding the differences among financial literacy, capability and education and their importance; and
- Ability to list the essential components of a strategy on financial education.

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1. Introduction to consumer empowerment and market conduct (CEMC)

Initial scenario

You work in the policy-making division of a Central Bank responsible for regulating financial products and services. The bank has been asked to develop a draft policy framework to support and facilitate financial inclusion, which also promotes sustainable growth and competition within the financial services industry and the fair, responsible treatment of consumers. Increasingly, economies – developed and developing – around the world are utilizing approaches based on 'consumer empowerment and market conduct (CEMC)' to shape financial services markets. But not everyone at the Bank is clear about what the terminology means; how it differs from other recognized concepts, such as consumer protection; and what it means for regulators. Your division head has asked you to prepare a briefing to define CEMC, identifying the key principles of this approach to financial services regulation and the factors you need to take into account in considering how such a policy would apply in your country's financial services market.

1.1. Definitions

Since the global financial crisis that started in 2007, many countries have – out of necessity - revisited their approach to regulating financial markets. What went so wrong? How did the crisis take so many governments, regulators and consumers by surprise? How can regulators keep track of what financial services providers (FSPs) are doing without over-burdening them with regulations that may stifle innovation and growth? More importantly, how can regulators encourage FSPs to curb their risk appetite without triggering a 'flight to quality' that exacerbates financial exclusion, leaving some groups excluded from financial products and services?

These are the questions that governments and regulators have been tackling. Increasingly, policies focusing on CEMC are being viewed as the solution to these difficult policy questions.

Consumer empowerment

Consumer empowerment and market conduct (CEMC) refers to policies and practices designed to promote stable and inclusive financial services via two interconnected pillars:

- **Empowering** consumers to make more informed financial decisions via the provision of information, education and effective avenues for redress; and

- **Protecting** consumers via effective regulation, supervision and enforcement of market conduct by FSPs.

It is widely agreed by proponents of CEMC policies that the twin elements of empowerment and protection are critical for their success. Moreover, CEMC policies are viewed not only as a means of increasing protection for consumers but also for promoting healthy competition and contributing to financial and economic stability.

> ⇨ ***Consumer empowerment*** *enables consumers to make more informed financial decisions via the provision of information, education and effective avenues for redress.*

> ⇨ ***Consumer protection*** *- Consumer protection focuses on the relationship between financial services providers and their customers.*

Consumer empowerment consists of two broad elements, which interact to create the conditions for consumers to thrive. Firstly, the resources consumers have at their disposal to make better choices. This includes a certain state of mind (confidence and willingness to play an active role), decision-making tools such as good information, and the skills to use these tools to make effective decisions that secure positive outcomes. Secondly, the institutions – for example, the competition regime, consumer protections, and regulatory organisations – that support consumers to shape markets'[1].

> ! ***Consumer empowerment places responsibility on regulators and financial services providers to make use of financial services easier, safer and of greater benefit to consumers.***

Consumer empowerment differs from financial education and consumer protection in terms of the role various actors play and the nature and intensity of engagement between the customer and provider. But whether the goal of the intervention is to empower, educate

[1] *Legal Services Consumer Panel, Empowering consumers Background paper 1: possibilities and limitations (2013).*

or protect, all reinforce each other to build customers' trust and confidence so that they can better choose and use financial services they value.

Market conduct

***Market conduct** – the market conduct of a financial services provider (FSP) is defined as the manner in which it designs its products and services and manages its relationship with clients and the public, including the use of intermediaries (representatives or agents).*

Market conduct is influenced by 3 factors:

- The institutional framework in which the market operates – including legislation, regulations, infrastructure and institutions;
- Supply-side factors – factors that impact on the conduct of a FSP including established organizational culture, internal governance, understanding of best practice, and incentive/reward structures; and
- Demand-side factors – including consumers' trust in financial firms; their expectations of how FSPs will treat them and what financial products and services will deliver; their understanding of financial products; and their confidence in and ability to make sound choices and decisions about the use or non-use of financial products and services.

Market conduct policies are used by regulators to shape, enhance and balance three factors, i.e., the institutional framework, as well as supply-side and demand-side factors, to create a more sustainable, fair and sound financial ecosystem for consumers.

Consumer protection

Consumer protection is a central and essential component of consumer empowerment policies. In a regulatory regime focused on CEMC a regulator's responsibility does not stop with assuring that financial products and services are available to consumers. It must also ensure the quality of those goods and services so that consumers can trust and have confidence in FSPs.

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Indeed, the OECD notes that: "Consumer confidence and trust in a well-functioning market for financial services promotes financial stability, growth, efficiency and innovation over the long term."[2]

Likewise, financial literacy, financial education and financial capability policies are also essential to achieve consumer empowerment. If consumers are to engage confidently and successfully they must feel able to make informed choices and sound decisions about their use, or non-use, of financial products and services. Confident consumers are better able to engage in markets in a way that influences the conduct of FSPs and incentivizes fair, responsible behaviour.

> **!** ***In practice, consumer empowerment policies do not, by any means, replace policies aimed at protecting, informing and educating consumers. Rather, it draws them together into a single agenda, maximizing the potential for these different strands of policymaking and practice to work together and add value to each other***

1.2. Why are consumer empowerment and market conduct policies considered to be so important?

Consumer empowerment and market conduct (CEMC) policies are considered to be important in at least two areas: for financial services markets, and for financial inclusion.

Importance for financial services markets

CEMC regulation is viewed by policymakers and regulators – across the world and in relation to a range of different markets – as offering potential to improve outcomes for individuals, in general, and, in particular, those who are vulnerable, but also as a route to supporting economic growth by promoting and stimulating healthy competition while, at the same time, reducing the cost and burden of regulation.

These efforts support the ability of consumers to assume greater individual responsibility for sound financial planning and to make financial decisions with

[2] *OECD, G20 High-Level Principles on Financial Consumer Protection (2011)*

confidence... [this] in turn contributes to financial stability by facilitating more efficient allocation of resources and risk in and through the financial system[3]

This emphasis on both empowering and protecting consumers has grown, at least in part, as a result of the recent global financial crisis. While consumer protection has often been a priority for regulators, alongside financial stability, the developments in financial services - which ultimately created the conditions for the financial crash – have highlighted the need for *'strengthened, dedicated proportionate policy action to enhance financial consumer protection'*.[4] The OECD highlights the rationale for this renewed emphasis on consumer protection as the increasing transfer of responsibility for opportunities and risks to individuals and households in relation to financial services, increasing complexity and rapid technological change, combined with low levels of financial literacy and access to basic financial services in many countries.

At the launch of the AFI CEMC Working Group (CEMCWG), in April 2011, it was acknowledged that expansion and innovation in products, services and technology have, undoubtedly, delivered many economic benefits –globally expanding the reach of financial services and bringing more consumers, including some who have historically struggled to access the market, into financial services. Nevertheless, the CEMCWG also recognized that the causes and effects of the recent global financial crisis clearly demonstrated the risk that innovation can disregard legitimate consumer needs and expectations of fair and responsible treatment by financial services firms. As a result, some consumers remain excluded from the market altogether, while others have access only to poor quality financial products or FSPs that do not treat them fairly.

As a result, renewed emphasis on consumer empowerment is often referred to as an attempt to re-balance the focus of financial services regulation towards 'demand-side' factors – i.e. consumer needs, behaviours and outcomes. This is viewed as both essential and timely.

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[3] *Bank Negara Malaysia, Financial Stability and Payment Systems Report 2006 (Governor's Statement) (2007).*

[4] *OECD, G20 High-Level Principles on Financial Consumer Protection (2011).*

Attention to the consumer demand-side is timely because informed consumers who are prepared to exert an ability to choose between competing suppliers are necessary to stimulate FSPs to innovate, improve quality and compete in terms of price. In making well-informed choices between suppliers, consumers not only benefit from competition, but they initiate and sustain it. For consumers to engage effectively in the market and use their ability to vote with their wallet, they need to be able to move quickly and with the minimum constraint between service providers.[5]

In addition, if FSPs are able to exploit consumers, this will not only inflict reputational damage to the providers themselves but, potentially, will also result in a lack of consumer trust in the market, including the regulatory framework.

In Southeast Asia, Bank Negara Malaysia (BNM), the Central Bank of Malaysia, adopted a strategic, long-term approach to CEMC in the wake of the Asian financial crisis. The example described further down clearly demonstrates the importance of this approach in re-establishing stability, resilience, competition and specially trust in financial services by 'leveling the playing field' between FSPs and their customers.[6] While CEMC policies suggest greater scrutiny of FSPs activities and, perhaps, more intrusive monitoring and supervision, at the launch of the CEMCWG it was emphasized that the purpose is not to stifle innovation, but to ensure that it is consistent with and responsive to real consumer needs while still delivering enhanced access, choice and benefits. CEMC refers, then, to an emphasis on re-aligning and re-balancing market conduct with consumer needs, rather than replacing one with the other.

The CEMCWG notes that while efforts were made following the global financial crisis to create greater consistency in prudential regulation between different countries, approaches to and standards for market conduct regulation still vary widely among different jurisdictions. This creates difficulties for consumers who are active in financial markets in different countries and poses a particular threat in the context of increasing

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[5] *OECD, Enhancing Competition in telecommunications: protecting and empowering consumers Ministerial Background Report (2008).*
[6]*Alliance for Financial Inclusion, Empowering and protecting financial consumersBank Negara Malaysia's consumer and market conduct framework (2011).*

cross-border shopping. It also reduces opportunities for knowledge-sharing and capacity-building among countries at different stages of implementing the CEMC agenda.

Importance for financial inclusion

At the launch of the CEMCWG, BNM noted that the solutions to financial inclusion require policymakers and financial services regulators to pursue both of the twin pillars of CEMC: *"The solutions that we are looking for will lie both in empowering consumers to make more informed financial decisions, and in strengthening the market conduct practices of financial institutions through effective regulation and enforcement… one without the other is wholly inadequate."*

CEMC policies deliver two important linked outcomes in relation to financial inclusion. First, they increase the potential for FSPs to extend access and choice to groups that are currently underserved or unserved via, for example, new products and services, alternative delivery channels or innovative technologies. Second, they have the potential to improve the quality of products available in the market to ensure that financial inclusion delivers meaningful benefit to consumers. Without this approach, consumers engaging with financial services for the first time are at significant risk of falling prey to poor quality or unsuitable products, resulting in erosion of income due to unexpected costs and charges, punitive terms and conditions, over-indebtedness, loss of savings, damage to their credit history, and repossession of goods and assets.

In 2015, while addressing the International Forum for Financial Inclusion, Christine Lagarde, Managing Director of the International Monetary Fund, argued that integrating financial inclusion policy and practice into wider consumer empowerment policies enables regulators to balance *"opportunity and innovation in financial markets with safeguards to prevent excesses on both the supply and the demand side."* In the same speech, Christine Lagarde emphasized that financial inclusion – and the empowerment that access to financial services provides for vulnerable citizens – is also a key requirement for wider financial stability and consequently economic growth, noting that *'countries with higher levels of inequality tend to have lower and less durable growth*.

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Consumer empowerment and market conduct (CEMC) policies are considered to be important in at least two areas. On one hand, for financial services markets because CEMC policies can improve outcomes for individuals, support economic growth by stimulating healthy competition and reduce the cost and burden of regulation. On the other, for financial inclusion because CEMC policies increase access to financial services and their quality.

1.3. What does CEMC mean in practice?

Governments, regulators, FSPs and consumers, all have an important role to play in the successful implementation of the CEMC agenda.

The role of governments

Governments are, to a large extent, the architects of a successful CEMC framework. It is their role to create the right legislative and institutional framework for regulators, FSPs and consumers to operate within. For example, in Liberia, Malaysia, United Kingdom and Bangladesh the governments embarked on significant legislative reforms in response to the global financial crisis in order to influence the character and culture of financial services regulation as well as protect and promote financial stability.

In May of 2014, the Central Bank of Liberia (CBL) committed to implementing an effective CEMC regulatory framework. In 2017, a comprehensive CEMC regulation for commercial banks was developed and issued to the market. The regulation, among others, defines the standards for all key areas of consumer protection including redress mechanisms, marketing, disclosure and transparency and financial literacy and education. The regulation also requires a Code of Ethical Standards for the banking industry. The Central Bank of Liberia also developed a Code of Ethics for banks to support the existing consumer protection regulation. The framework is currently being reviewed with relevant stakeholders and the revised version is expected to be finalized and published before the end of the year. The CEMC regulation was also recently amended to reflect effective disclosure and transparency standards relating to truth in lending. Moreover, steps have also been taken to strengthen redress mechanisms. With regards to national CEMC efforts, the CBL has drafted two frameworks

geared towards the overall implementation of the reforms: 1. National Financial Education Strategy for Liberia; and 2. Financial Consumer Protection Framework[7].

In Malaysia, the Government committed to a decade-long programme of financial reform following the Asian financial crisis, designed to improve financial stability and market resilience through CEMC initiatives. To achieve this, the Financial Sector Masterplan (FSMP) 2001-2010 was launched in 2001. Bank Negara Malaysia (BNM), in charge of implementing the plan as the main financial system regulator, attributes this radical approach to financial sector reform to:

> *'the foresight of the Malaysian government in recognising that consumer empowerment and protection would require reforms and regulations that went beyond Malaysia's already comprehensive consumer protection law (1999) and consumer welfare policy (2002)*[8]

The rationale behind the FSMP was that protecting and empowering financial services consumers in Malaysia required sound regulatory standards for market conduct, a dyna*mic consumer education programme, and a robust infrastructure.*

Currently, Malaysia is implementing a new strategic plan known as the Financial Sector Blueprint 2011-2020, aimed at making the financial system the support that the country needs in order to become a high value-added, high-income economy.

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[7] *AFI Data Portal/ Maya Declaration Central Bank of Liberia Maya*

[8] *Alliance for Financial Inclusion, Empowering and protecting financial consumers Bank Negara Malaysia's consumer and market conduct framework (2011).*

In response to the global financial crisis, which hit United Kingdom banks and consumers hard, the UK government initiated radical reforms of the legal and institutional framework for financial stability and market conduct. The rationale for this was a belief that the crisis resulted from:

> *…the failure of financial institutions to manage themselves prudently and of regulators to spot the risks that were building up across the system as a whole.*[9]

The new framework was designed specifically to ensure that market conduct received the same emphasis as prudential regulation and financial stability. The Financial Services Act 2012 created three separate bodies to oversee the financial system:

- Financial Policy Committee (FPC), located within the Bank of England, providing macro-prudential regulation pursuing the stability and resilience of the financial system as a whole;
- Prudential Regulation Authority, an operationally independent subsidiary of the Bank of England, tasked with providing micro-prudential or firm-specific regulation; and
- Financial Conduct Authority (FCA) – a specialist regulator responsible for market conduct regulation for the financial system.

In the previous - tripartite – system, whereby a single institution was responsible for financial stability, prudential regulation and conduct regulation, the UK government believed that market conduct had not always received the emphasis necessary to protect consumers and ensure effective markets.

[9] *HM Treasury, A new approach to financial regulation: building a stronger system (2011).*

✓ Bangladesh Bank, the Central Bank of Bangladesh, jointly with Microcredit Regulatory Authority of Bangladesh, committed under the Maya Declaration to formulate a comprehensive consumer protection guideline by 2015. In June of 2014, Bangladesh Bank updated its progress noting that the "Guideline on customer services and complaint management" was issued and had been circulated in 2014; hence banks were required to implement that guideline accordingly and meet all CEMC provisions. The implementation status of the guideline is being monitored regularly by the regulator[10].

In addition to establishing an effective institutional framework for CEMC regulation, national governments also have a key influence on both the demand-side and supply-side factors that impact on the function and operation of financial services markets. As a result, they must:

- Offer leadership and establish clear expectations of what financial services are expected to deliver both to consumers and the wider economy, setting appropriate objectives for financial markets and for financial regulators;
- Ensure financial regulators have sufficient skills, capacity and resources to implement the CEMC agenda effectively;
- Provide sufficient scrutiny powers to financial regulators while still maintaining the political independence and institutional integrity; and.
- Promote and support initiatives aimed at achieving financial capability among consumers.

! ***Market conduct public policy goals create an enabling environment in which consumers (particularly disadvantaged and low-income segments of society) are confident they will benefit from the outcomes of the collective actions of all financial markets participants***

The role of regulators

[10] *AFI Data Portal/ Bangladesh Bank and Microcredit Regulatory Authority of Bangladesh Maya Declarations*

While one of the desirable outcomes of a CEMC approach to financial services regulation is to reduce regulatory cost and burden this does not, by any means, indicate that regulators have less of a role to play in markets where consumers are empowered. In fact, the opposite is true:

The role of regulators in providing leadership by setting standards and expectations, monitoring activity and establishing an effective deterrent to poor conduct is a critical aspect of empowering consumers. Regulators who are aiming to promote consumer empowerment must also ensure that the environment exists for consumers to make sound and confident choices about financial products and that they have effective avenues of help and redress should things go wrong.

The role of regulators within a CEMC regime includes:

- Providing leadership and 'set the tone' for FSPs to follow, including influencing FSPs organizational culture and ensuring that incentives and rewards are aligned with fair and responsible conduct;
- Creating an environment in which consumer empowerment can thrive and deliver meaningful benefits to consumers, especially those entering the financial services system for the first time;
- Establishing an effective balance between competition and consumer protection to ensure that innovation is not stifled;
- Recognizing the limitations to consumer empowerment, particularly for some groups of consumers and in relation to certain product categories and develop a risk-based approach to conduct regulation, able to take account of risks associated with particular FSPs, products and consumer groups;
- Establishing an organizational culture in which regulatory staff have a clear, shared understanding of their organization's vision, mission and values, and are equipped with the skills, capacity and resources necessary to make them a reality;
- Keeping up-to-date with the changing external environment, including new and approaching risks, and with technological developments, especially digital financial services, that create new risks for consumers as well as opportunities for greater digital financial inclusion;
- Ensuring that consumers are aware of their rights, responsibilities and avenues for redress;

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- Addressing consumers' needs for information and financial education, and taking their current knowledge, capabilities and experience into account in its approach to regulation;
- Creating a transparency and disclosure regime that promotes consumer trust and confidence in FSPs, their products and the financial markets, and helps consumers to shop-around and make informed decisions;
- Establishing a supervision and enforcement regime that offers 'credible deterrence' to poor conduct;
- Engaging and collaborating with other relevant stakeholders, nationally and internationally, to share best practice and insight; and
- Generating and sharing an understanding of consumer needs and experience, and insights into their behaviour.

In 2016, the CEMCWG issued the "Market Conduct Supervision Of Financial Services Providers - A Risk-Based Supervision Framework", Guideline Note # 21, to elaborate a supervision framework for financial supervisory authorities (FSAs), in developing and emerging countries, with a particular policy focus on the financial inclusion of low-income populations. The framework presented the Market Conduct Risk-Based Supervision (MC-RBS) Framework, which is based on an approach traditionally used by prudential supervisors. The MC-RBS framework describes the principles, concepts and core processes that FSAs may use to supervise the market conduct of FSPs, including any type of regulated financial institution that provides financial services to retail customers such as deposits, credit and money transfers. This guideline note is helpful for policymakers and regulators who design their own market conduct supervision frameworks, guidelines and standards for financial consumer protection.

The CEMCWG "Market Conduct Supervision of Financial Services Providers – A Risk Base Supervision Framework", Guideline Note # 21, presents principles, concepts and core processes that may be used for market conduct supervision. In particular, the framework identifies the following components:

1. Seven categories of policy outcomes and corresponding inherent risks: Inclusiveness and Competitiveness, Suitability, Transparency and Marketing Risk, Professional Ethics and Standards, Due Care, Safety and Security, and Compliance.

2. The concept of significant activities within a FSP.

3. Four internal controls to mitigate the risks of significant activities: risk measurement, policy development, policy implementation and information management.
4. Four internal controls to mitigate market conduct risk at the institutional level: dispute resolution, corporate governance, internal audit and responsible crisis management.
5. A scoring system for calculating the overall market conduct risk of an FSP.
6. An impact assessment of FSPs.
7. A supervisory strategy for FSPs.

The role of financial services providers (FSPs)

In many respects, a CEMC regime requires FSPs to be more proactive in considering the way their business operates and its impacts on consumers.

Rather than just following established rules, there is a greater expectation that FSPs will use their judgment to determine what constitutes good market conduct

The responsibilities of FSPs in a CEMC regime include:

- Establishing an organizational culture that supports good market conduct, incentivizing and rewarding the fair and responsible treatment of customers and ensuring they have appropriate resources, skills and capacity to deliver positive outcomes for consumers;
- Keeping the consumer at the heart of all aspects of their business, including their product offering, sales process and delivery channels, transparency and disclosure regimes, data security and complaints process;
- Taking responsibility for the actions of third parties that engage with consumers on their behalf, including advisors, sales representatives, debt collectors and agents;
- Establishing strong mechanisms for gaining insight into customer experience via, for example, consumer research, stakeholder engagement and internal and external customer feedback mechanisms;
- Considering how to engage with consumers as part of a process of ‘co-creation’, whereby consumer feedback is used to inform product development and business processes, and products are ‘tested’ with consumers as part of the development process;

- Harnessing technological innovation to enable them to extend their reach and range, reduce the cost of information provision and interaction with customers, enable better understanding of and responsiveness to customers and make products more accessible and affordable;
- Particularly in the context of financial inclusion, FSPs are encouraged to develop products or delivery models tailored to the needs of specific groups of consumers; and
- Engaging in self-regulation offering opportunities to share and establish best practice standards and promote consumer trust and confidence in the sector.

In India, the Reserve Bank of India introduced a regulation in 2006 allowing banks to use the services of third-party, non-bank agents to extend their services right to people's doorsteps, to address the needs of 650 million 'under-banked' people. By 2013, over 220,000 banking correspondents were visiting consumers 'at the bottom of the income pyramid', especially those living in remote locations.

The role of consumers

A central tenet of a CEMC approach to regulation is that consumers should be able – and willing – to make informed choices about financial products and services. As a result, they have a key role in driving effective competition and influencing market conduct. Consumers' expectations of and trust in FSPs and their financial capability, therefore, have a key impact on the success of CEMC policies and initiatives.

To foster competition and liberalization in the financial services industry, Malaysia's FSMP called for building a strong foundation: a marketplace in which consumers make informed financial decisions, have confidence in the market, understand and exercise their rights, and have legal recourse to address problems. Building on the FSMP success, Malaysia is currently moving forward with the CEMC agenda with the implementation of the Financial Sector Blueprint 2011-2020.

There are, however, limitations to the extent of what consumers can achieve on their own. Constraints include the absence of an enabling legislative regime or institutional framework, low levels of financial confidence and capability and lack of trust in financial

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services. In addition, it is widely recognized that consumers display innate behavioral traits that mean they will not always act in an economically rational way.Indeed, research evidence indicates that vulnerable groups are least likely to be able to exercise their consumer rights and market influence to drive healthy competition.[11] CEMC policies and initiatives need to address all of the dimensions of consumer empowerment, including:

- Confidence in the market;
- Trust in the regulator;
- Ability to understand and identify financial needs;
- Ability to choose, compare product offerings and shop around;
- Ability to use financial products and services effectively and appropriately; and
- Willingness and ability to complain about poor service and, when needed seek redress.

Consumers should be able – and willing – to make informed choices about financial products and services. However, vulnerable groups are least likely to be able to exercise their consumer rights. Therefore, CEMC policies and initiatives need to address all of the dimensions of consumer empowerment.

Empowerment Through Financial Inclusion, Address to the International Forum for Financial Inclusion by Christine Lagarde, Managing Director, International Monetary Fund (2014).

Bank Negara Malaysia, The Financial Sector Masterplan 2001-2010 (2001).

UK Government, Financial Services Act 2012 (2012).

[11] *Legal Services Consumer Panel, Empowering consumers Background paper 1: possibilities and limitations (2013).*

CGAP, Financial Inclusion 2.0: India's Business Correspondents (2013).

World Bank Group, Good Practices for Financial Consumer Protection 2017 Edition (2017).

OECD, G20 High-Level Principles on Financial Consumer Protection (2011).

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Chapter 1: Exercise 1

Complete the following sentences:

1. Consumer empowerment places responsibility on __________ and ______________ to make use of financial services easier, safer and of greater benefit to consumers.

2. _______________ are used by regulators to shape, enhance and balance three factors , i.e., the institutional framework, as well as supply-side and demand-side factors, to create a more sustainable, fair and sound financial ecosystem for consumers.

3. Consumer empowerment and market conduct (CEMC) policies are considered to be important in at least two areas: for financial services markets and for ____________.

4. Regulators who are aiming to promote ________________ must also ensure that the environment exists for consumers to make sound and confident choices about financial products and that they have effective avenues of help and redress should things go wrong.

5. Rather than just following established rules, there is a greater expectation that ________________will use their judgment to determine what constitutes good market conduct.

6. _____________ groups are least likely to be able to exercise their consumer rights. Therefore, CEMC policies and initiatives need to address all of the dimensions of consumer empowerment.

Solutions: Please refer to the last chapter.

2. Institutional framework and supervision

Initial scenario

Your Division Head is interested in finding out more about how a CEMC framework could be introduced in your country. You have been tasked with preparing a paper that identifies the key organizations, legislation and regulatory policies required to implement a CEMC approach to regulation. You will need to think through the model of CEMC that would work best in your financial services market and map this model against existing organizational, regulatory and policy frameworks to identify both gaps and areas of synergy.

2.1. Institutional framework

The magnitude and complexity of the task associated with implementing CEMC policies is indicated in the OECD's early thinking on the conditions required to reinforce and integrate consumer protection within other regulatory and financial capability policies:

> *This calls for legal recognition of financial consumer protection, oversight bodies with necessary authority and resources to carry out their mission, fair treatment, proper disclosure, improved financial education, responsible business conduct by financial services providers and authorized agents, objective and adequate advice, protection of assets and data including from fraud and abuse, competitive frameworks, adequate complaints handling and redress mechanisms and policies which address, when relevant, sectoral and international specificities, technological developments and special needs of vulnerable groups.*[12]

> **!** ***The implementation of a CEMC policy requires an institutional framework able to deliver two key outcomes:***
>
> - ***Responsible behaviour and sound business practices among financial services providers (enhancing market conduct), and***
> - ***Broad access to affordable, high quality financial services for all segments of society (empowering consumers).***

[12] *OECD, G20 High-Level Principles on Financial Consumer Protection (2011).*

It is important that the development of this institutional framework is informed by:

- A clear vision of the outcomes the framework is aiming to achieve, the process required to get there and where CEMC policies are located within wider economic policy objectives;
- A sound and consistent legal framework that applies across the financial sector;
- A consultative approach involving a range of stakeholders, including government ministries and agencies, business associations and chambers of commerce, industry trade associations, consumer associations, consumer activists, financial institutions and other key stakeholders; and
- Sound market intelligence, gained through market and consumer research, government and industry data, print and social media commentary, and complaints data.

***Malaysia - Financial Sector Masterplan (FSMP)*[13]**

The Malaysian Financial Sector Masterplan, has been described as 'the cornerstone' of Malaysia's CEMC framework. Its goal was to make Malaysia's financial system more resilient and competitive. The Masterplan was organized into three phases:

- *Strengthening the skills and capacity of domestic financial institutions and creating a foundation for consumer protection;*
- *Promoting greater competition by improving the efficiency of the financial system, including opening new bank branches, expanding the ATM network and offering a wider range of financial products; and*
- *Integrating Malaysia's financial system with the global economy.*
- *The plan included a number of recommendations to support consumer empowerment and protection in an increasingly market-oriented financial system:*

[13] *Alliance for Financial Inclusion, Case study Empowering and protecting financial consumers Bank Negara Malaysia's consumer and market conduct framework (2011).*

> I. *To initiate an active and structured consumer education programme to educate consumers about retail products and services and their rights and responsibilities as consumers.*
> II. *To make the performance of banking and insurance institutions and the profile of new products more transparent.*
> III. *To establish legal redress for consumers.*
> IV. *To expand the operations of the Banking Mediation Bureau and the Insurance Mediation Bureau.*
> V. *To introduce anti-trust regulation.*
> VI. *To establish a deposit insurance fund.*

There are various models and approaches to delivering a CEMC institutional framework, which can involve multiple organizations or be driven by a single key player. Regardless of the model or approach that is pursued, clear leadership and accountability is essential, alongside a clear and agreed division of responsibility between and/or within organizations to avoid policy gaps or duplication of effort.

2.2. Enhancing market conduct

Regulatory authorities can enhance market conduct in a number of ways:

- ***They can set standards of conduct, using a principle or rules based approach to regulation;***
- ***They can regulate products, firms and people;***
- ***They can ensure compliance with CEMC regimes through market oversight; and***

They take remedial and enforcement action to present a credible deterrent to poor conduct among FSPs.

Setting standards

A CEMC approach to financial services regulation requires regulators to set and communicate standards of conduct that FSPs are expected to follow. In some countries

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this role is undertaken by a central supervisory authority (e.g., Bank Negara Malaysia or the Reserve Bank of India, as central banks of their respective countries), which is responsible for wider monetary policy, and financial stability including prudential regulation. This is particularly likely to be the case in developing economies where financial inclusion is a key government objective.

By contrast, in the UK, following the global financial crisis, the Financial Services Act 2012 dismantled the previous 'tripartite' system of regulation, whereby financial stability, prudential regulation and conduct regulation were the responsibility of a single body – the Financial Services Authority – and created three separate entities, one of which has sole responsibility for market conduct in financial services. The Financial Conduct Authority (FCA) is operationally independent of Government and the Bank of England and works co-operatively with the Bank of England under a Memorandum of Understanding.

United Kingdom - Financial Conduct Authority (FCA)

The FCA, which became operational in 2013, has an overarching, strategic objective of 'ensuring that the relevant markets function well.' It's strapline is 'We aim to make financial markets work well so that consumers get a fair deal.' It has three operational objectives:

- *Consumer protection: to secure an appropriate degree of protection for consumers;*
- *Market integrity: to protect and enhance the integrity of the UK financial system; and*
- *Competition: to promote effective competition in the interests of consumers in the markets for regulated financial services or series carried out by regulated investment exchanges.*

A key intention of creating an organisation focusing solely on market conduct is to ensure that it receives sufficient regulatory attention and resources, rather than become a 'poor relation' to market stability and prudential regulation. It is also intended that this body is to develop sufficient oversight

> *with legal faculties to be enabled to be proactive at identifying risks and acting swiftly before consumer detriment arises.*[14]

CEMC regulatory approaches generally tend to fall across a spectrum ranging from specific rules to general principles. Each approach has associated pros and cons.[15]

Rules-based approach		**Principles-based approach**	
Advantages	***Disadvantages***	***Advantages***	***Disadvantages***
• Clarity and uniformity across providers; • Easier for FSPs and consumers to understand; and • Requires less high-level supervision.	• Requires resources for off-site supervision and compliance monitoring; • Rules can be inflexible; • Rules don't anticipate every situation; and • Tends to stifle innovation.	• Lighter touch, less resource intensive; • More market sensitive; and • Encourages thoughtful solutions rather than box-ticking.	• More difficult for FSPs to be sure they are compliant; • Requires flexible supervision and greater supervisory capacity; • Requires a 'mature' industry; and • Lack of uniformity in FSPs response may confuse consumers.

As AFI notes, however, *'In practice, it is rare to find a principles-based model without rules, or a rules-based model that is not grounded on principles.'* Two of the countries with quite advanced approaches to CEMC regulation – Malaysia and the UK – have implemented a

[14] *Financial Conduct Authority, The FCA's approach to advancing its objectives 2015 (2015).*

[15] *Alliance for Financial Inclusion, Policy Note Consumer protection Leveling the playing field in financial inclusion (2010).*

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principles-based approach, but use guidelines to communicate more detailed requirements and expectations to FSPs.
BNM communicates market conduct requirements to FSPs in the form of guidelines which regulate both the provision of financial products and some aspects of the way that financial products and services are provided. Conduct guidelines relate to product transparency and disclosure, fees and charges, credit card marketing, complaint management and debt collection practices.

In the UK, the FCA expects FSPs to follow 11 principles of good conduct; for example, firms must conduct business with integrity, due skill, care and diligence, they must observe proper standards of market conduct, and they must deal with regulators in an open and cooperative way. To help FSPs interpret and apply these principles to their business, the FCA also produces a Handbook, which sets out all of the legal instruments and rules, and provides guidance for firms.

Arguably, a principles-based approach is more likely to result in culture change within FSPs because it requires them to use judgment and innovation to determine whether their market conduct will be acceptable to the regulator, rather than follow rules. A principles-based approach also facilitates a more flexible, less resource intensive, risk-based approach to supervision, rather than devote resource to monitoring compliance with rules.

While determining the right approach and level of regulation is key to achieve the balance of protecting consumers without stifling innovation through over-regulation. This balance will be unique to each jurisdiction, based on the type, nature and maturity of the financial services industry; the needs, expectations, and financial capability of its consumers; and the degree of information asymmetry between firms and customers. In an over-regulated market, the size of the market will contract and consumers will be pushed into the informal sector, where they have no formal protection at all. Achieving this balance requires regulators to have a detailed and sophisticated understanding of the market and the ability to respond to the needs of all participants.

Uniformity and consistency across financial markets is also important in ensuring that consumers understand what to expect and feel able to trust providers. Consistency can best be assured via a single market conduct regulator for all financial products. Where this is not possible, similar products offered by different FSPs should be subject to the same

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conduct regulation and where regulatory responsibility is split among a number of regulators close co-ordination and collaboration is required to avoid regulatory arbitrage.[16]

Regulating products, firms and people

Regulatory authorities can also ensure high standards, or at least a guaranteed minimum standard, of conduct within a CEMC regime by acting as 'gatekeepers' for products, firms and people operating within the market.

Product approval – while an onerous task for regulating authorities – ensures that products do not enter the market unless they meet certain pre-determined standards.
Light-touch approaches to product approval – if preceded by a clear communication of expectations for FSPs to develop strong internal oversight and control systems – can help strike a balance between preserving quality without stifling innovation, and are less resource intensive.

Malaysia – Product notification process

Under its CEMC regime, BNM moved away from a product approvals regime as part of a broad regulatory philosophy that 'what is not prohibited is allowed'. The old regime has been replaced with a product notification process which ensures that the Bank is aware of every product that is developed and launched. BNM has authority to intervene and take corrective action should they feel that products do not reach appropriate standards, and to recall products that are resulting in consumer detriment or that present a risk to financial stability.[17]

It is also possible to assure quality standards for financial services consumers by setting minimum standards for firms – and individuals – seeking to enter the market.

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[16] *Alliance for Financial Inclusion, Policy Note Consumer protection Leveling the playing field in financial inclusion (2010).*
[17] *Alliance for Financial Inclusion, Case study Empowering and protecting financial consumers Bank Negara Malaysia's consumer and market conduct framework (2011).*

✓ **United Kingdom – Authorization and registration of firms and individuals**

All financial services firms offering 'regulated activities' in the UK, with a few exemptions, must be authorized or registered by the Financial Conduct Authority, FCA. Firms applying for authorization have to meet a range of requirements before they are allowed to operate in the market. The review process includes scrutiny of the firm's business plans, risks, budgets, resources, systems, controls and whether key staff have the necessary qualifications, experience and ability to carry out their roles effectively. Unless they meet these requirements they will not be authorized.

The FCA also expects key individuals responsible for specified 'controlled functions' within firms to fulfil certain requirements. These 'approved persons' must:

- Meet the requirements of the FCA's 'fit and proper' test and follow its principles;
- Comply with the Statements of Principles and Code of Practice, which explain the behaviour expected of Approved Persons; and
- Report anything that could affect their ongoing suitability to fulfil their role.

Controlled functions include:

- Being a director of a regulated firm;
- Overseeing a firm's systems and controls; and
- Being responsible for regulatory compliance.

Consumer protection in Mobile Financial Services

Regulators also play a critical role in consumer protection when it comes to the provision of financial services through mobile devices, i.e. mobile financial services (MFS), which has proven to be highly effective in truly advancing financial inclusion. By defining policy and appropriate regulations for the MFS industry regulators must ensure they are properly equipped to support improved client protection practices by providing appropriate regulations and ensuring these policies are properly enforced.

Regulators must also strike an appropriate balance between protecting consumers and creating an enabling environment for MFS to be viable. They must also ensure they are not "over regulating," as this may prevent vulnerable and underserved consumers from accessing services from well-regulated providers.

When designing the regulatory framework, regulators should take into account that MFS provide multiple benefits to consumers, including greater access, convenience, reduced costs and security. However, due to their technical nature, these services can pose new threats. Regulation should therefore ensure both minimum proportionate risk standards while at the same time allowing for innovation. In addition, regulators should ensure that mandated rules are enforceable and that the financial authority has the capacity to provide appropriate supervision and oversight.[18]

Market oversight

Ensuring compliance with CEMC regimes requires a high degree of market oversight. Monitoring and supervision are key elements of this, but regulators should not overlook other important sources of market oversight to ensure they have a comprehensive perspective on how well the market is working across product categories and for different groups of consumers.

Compliance-based supervision, generally associated with a rules-based approach to regulation, requires regulated firms to comply with a specified set of rules and the role of the regulatory authority is to monitor compliance. Under this supervisory model, all firms are supervised in the same way, according to the same set of rules. The model necessitates a relatively high degree of supervisory capacity, especially to facilitate off-site visits to FSPs to check compliance.

Capacity for supervision is limited; however, regulatory authorities must ensure that they are using this resource to best effect. AFI argues for the application of a risk-based supervision regime as part of a CEMC approach to regulation. This is based on a model traditionally seen in prudential supervision, whereby resource is targeted towards firms and activities that present the greatest risk to financial stability. Risk-based supervision models used in prudential regulation cannot be directly transferred to conduct supervision, because issues that present the most risk to consumers' well-being are not necessarily those that pose a threat to financial stability. Risk-based supervision, in the context of a

[18] *AFI Mobile Financial Services Working Group (MFSWG) -currently Digital Financial Services Working Group (DFSWG)-, Consumer Protection in Mobile Financial Services Guideline Note No 13 (2014).*

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CEMC regulatory regime, focuses on the social impact of the relationship between FSPs and their customers, and requires a specific framework.

South Africa – Exemption to customer identification regulation

The South African government decided to introduce an exemption to the Financial Intelligence Centre Act, which requires that FSPs confirm the identity of their client before allowing them to open an account. This was acting as a barrier to financial inclusion because many of the poorest people in South Africa did not possess the documents required to prove their identity. The exemption allows providers to open accounts without requiring such verification but, instead, set strict limits on transactions based on a risk analysis to reduce potential exposure to fraud and the risk of money laundering.

The key elements of a risk-based supervision model for market conduct are that it:

- Is forward looking;
- Focusses on evaluating both present and future risks;
- Identifies emerging problems; and
- Facilitates early intervention and prompt action.

Goals and Objectives of MC-RBS[19]

MC-RBS is derived from, and intends to serve, overall market conduct policy. Market conduct policy goals, meanwhile, are broader and seek to achieve a sound financial system for the larger society. Important working definitions of overarching market conduct policy goals and market conduct public policy goals before setting up an MC-RBS framework:

- **Overarching market conduct policy goals** include ensuring the fair treatment of customers and building confidence and trust in financial markets, which in turn

[19] *AFI Consumer Empowerment and Market Conduct Working Group (CEMCWG), Market conduct supervision of financial services providers A Risk-Based Supervision Framework Guideline Note No 21(2016).*

can lead to financial inclusion, sustainable and financially inclusive economic growth and financial stability.

- **Market conduct public policy goals** create an enabling environment in which consumers (particularly disadvantaged and low-income segments of society) are confident they will benefit from the outcomes of the collective actions of all market participants. These outcomes include an inclusive and competitive marketplace, suitable products, proper transparency and marketing, proper ethics and professional standards, due care, safety and security and an enabling legal environment.

The central aim of a market conduct risk-based supervisory framework (MC-RBS) is to:

'… assess the significant risks to an FSP fulfilling its market conduct outcomes, to prioritize supervisory actions that prevent risk for escalating and take early corrective actions. If market conduct policy goals represent a set of outcomes that can be achieved through the collective actions of all market participants, MC-RBS goals are outcomes that are within the control of an individual FSP.'

In addition to supervision, regulatory authorities should also seek market oversight through other channels, including:

- Market and consumer research;
- Thematic reviews relating to particular product categories or consumer groups;
- Mystery shopping;
- Print and social media monitoring;
- Complaints data;
- Stakeholder engagement, including industry bodies and trade associations, and liaison with consumer groups and, where possible, consumer advocates and activists;

United Kingdom - Financial Services Consumer Panel (FSCP)

Under the 2012 Financial Services Act the FCA is required to set up a Panel to represent the interests of consumers. The Financial Services Consumer Panel (FSCP) is an independent statutory panel set up to advise and challenge the FCA, representing the consumer interest at all stages of the regulatory process. The FSCP also takes an interest in wider issues relating to consumers where it believes it can achieve beneficial change on behalf of consumers. A key role of the Panel is to ensure that the FCA does not gain its market oversight solely from regulated firms.

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Remedial action and enforcement

In order to present a credible deterrent to poor conduct among FSPs, regulatory authorities need sufficient power to take remedial action and enforcement. For example, in Malaysia, BNM can direct FSPs to moderate, withdraw, and refund prohibited fees and charges.[20] Enforcement actions available to the UK's Financial Conduct Authority include withdrawing a firm's authorization, prohibiting individuals from carrying on regulated activities, or issuing fines against firms and individuals.[21]

Financial Conduct Authority, The Enforcement Guide (2014).

Alliance for Financial Inclusion, Case study Empowering and protecting financial consumers Bank Negara Malaysia's consumer and market conduct framework (2011).

Financial Conduct Authority, The FCA's approach to advancing its objectives (2015).

AFI Consumer Empowerment and Market Conduct Working Group (CEMCWG), Market conduct supervision of financial services providers A Risk Based Supervision Framework Guideline Note No 21 (2016).

Bank Negara Malaysia, Financial Sector Blueprint 2011-2020 (2011).

Chapter 2: Exercise 1

1. *What are the two key outcomes that an institutional framework for the implementation of a CEMC policy requires?*
2. *How can regulatory authorities enhance market conduct?*

[20] *Alliance for Financial Inclusion, Case study Empowering and protecting financial consumers Bank Negara Malaysia's consumer and market conduct framework (2011)*

[21] *Financial Conduct Authority, The Enforcement Guide (2014).*

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3. *What kind of market conduct enhancement approach does the 'Financial Services Consumer Panel' (FSCP) in the UK pursue?*
4. *Give two examples how regulatory authorities can enforce compliance with principles and rules set down in a CEMC policy?*

Solutions: Please refer to the last chapter.

3. Transparency and disclosure

Initial scenario

The Central Bank where you work has accepted that a CEMC approach to financial services regulation would promote the interests of consumers, FSPs and financial stability. However, it is a big step for both regulatory authorities and FSPs to understand the requirements that would be placed upon them within such a regime. It is now your task to explain the important role of transparency and disclosure within a CEMC regime, the key elements that are necessary to maximize consumer empowerment and the implementation factors to be considered.

3.1. Introduction

When buyers and sellers come together in a transaction, information is power. Consumers of financial services, especially new customers, lack information about the financial system and financial transactions. Increasingly, on the other hand, the financial providers servicing these customers try to access a great deal of information about the customer and the market. As financial products and services are offered by more sophisticated providers, the information gap between financial institutions and their customers grows even wider.[22]

Appropriate sales and marketing conduct drives consumer confidence in markets where trust is king. There are various ways of ensuring that the market behaves ethically and for the greater good. These may include market-led actions through self-regulation or even consumer organizations. In most developing and emerging countries, governments play a significant role in promoting good sales and marketing practices. However, to ensure consumer confidence and a stable market, responsibility must be assigned to specific market conduct regulatory agencies.[23]

[22] *Alliance for Financial Inclusion, Policy Note Consumer protection Leveling the playing field in financial inclusion (2010).*
[23] *AFI Consumer Empowerment and Market Conduct Working Group (CEMCWG), Consumer Empowerment and Market Conduct Sales and Marketing Practices Guideline Note No 7 (2013).*

CEMC policies have a vital role to play in addressing the information imbalance between FSPs and their customers. This can be achieved, in part, by healthy competition between FSPs, assuming the market is disciplined and provides sufficient information to customers to help them make choices. Limitations on the scope for the market to meet customers' information needs leaves a gap to be filled by consumer protection policies, including setting standards for FSPs to achieve in terms of transparency and disclosure and initiatives aimed at promoting financial education, capability and confidence.

This chapter looks at the role of transparency and disclosure policies in a CEMC regime.

Transparency *- in a business or governance context- means honesty, openness and accountability.*

Disclosure - *refers to the act of making a fact or facts known. In relation to financial services regulation it refers to making available all material information that is relevant to the consumers in making a decision about whether and how to use a financial product or service.*

3.2. An empowering transparency and disclosure regime

Transparency and disclosure regulations are essential to support sound decision-making by financial services consumers. A regulatory system that drives best practice in consumer-focused transparency and disclosure also promotes trust and confidence in FSPs and the wider market. These are not only essential components of consumer empowerment and financial inclusion but also contribute to competition and innovation.

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Consumers who demand information play an important role in ensuring transparency among financial institutions. Transparency in the market encourages institutions to compete on the basis of better products and services and lower costs.[24]

The goal of transparency and disclosure regulations in a regime aimed at empowering consumers and promoting fair, responsible market conduct is that all consumers are afforded equal protection when they are making decisions about financial products and services. Transparency and disclosure regulations typically cover:

- Pre-agreement quotes and disclosure in advertisements and brochures;
- Standards for contractual disclosure;
- Standards for post-contractual disclosure.[25]

Pre-contractual disclosure *- refers to making available adequate information about financial products and services to place potential customers in a position to assess whether a product or service is suited to their needs and circumstances.*

Contractual disclosure *– refers to making available adequate information for customers who are taking out a financial product or service to fully understand the nature and terms of the contract they are entering in to. Such features may include the customer's rights and obligations under the contract, the circumstances in which the terms of the contract can change, when the customer would be considered to be in breach of the agreement, and when the contract would be terminated or considered void.*

[24] *Alliance for Financial Inclusion, Policy Note Consumer protection Leveling the playing field in financial inclusion (2010).*
[25] *AFI Consumer Empowerment and Market Conduct Working Group (CEMCWG), Consumer Empowerment and Market Conduct Transparency and Disclosure Guideline Note No. 6 (2013).*

Post-contractual disclosure *– refers to making available adequate information to customers who have entered into a contract with an FSP to ensure that they are fully informed regarding the status and performance of the product, interests, fees or charges that have been applied, and any changes to the product's terms and conditions.*

Adequate disclosure practices ensure that consumers may be able to begin their decision-making process with clear and accurate information about the nature, purpose and key risks of the product. Consumers need to be given all of the details they need to understand the terms and conditions of the product or service they are purchasing in an appropriate and accessible format, with regular and timely information on the status of the product or service throughout its lifetime, including any changes in terms, conditions or performance.

To fully support consumer empowerment and maximize the potential for financial inclusion to be a positive, empowering experience, regulators should require FSPs' transparency and disclosure practices to meet certain minimum criteria.

Criteria for transparency and disclosure practices of FSPs:

Comprehensive

- ***Apply to all stages of the contractual process***
- ***Apply to all financial products in the market***
- ***Apply to written and verbal disclosures***

Accessible

- ***Language***
- ***Channels***

Relevant

- ***Product-specific***
- ***Covering all the key terms and conditions***

Consistent

- ***Presented in a common format***

Empowering

- ***Providing tools to help consumers shop around***

Comprehensive

The contractual process consists of three stages. Accordingly, disclosure practices should refer to all three contractual stages[26], as shown below:

Pre-contract disclosure	Contractual disclosure	Disclosure over the term of the agreement
• Advertisements, brochures and pre-agreement disclosure must include information to assist consumers in assessing the true costs and risks relating to a financial product or service, including any related fees and charges (based on current contracts).	• The contract must disclose all important features of a financial product or service, including consumer rights, obligations and risks. •	The outstanding balance must be disclosed periodically, including any interest, fees or charges paid by the client.

The sales and marketing information that consumers receive prior to taking out a financial product plays a huge role in shaping their understanding and expectations of the product. Within a CEMC regime, FSPs are required to ensure that sales and marketing processes are in the public interest. Unfair, deceptive and aggressive sales practices should be banned and sales staff should be highly trained to ensure that they are able to provide clear and accurate information to customers. Feedback from consumers and other stakeholders is a key source of information for FSPs as to the information needs of customers, the conduct of sales staff and the quality of sales materials and contractual information.

[26] *AFI Consumer Empowerment and Market Conduct Working Group (CEMCWG), Consumer Empowerment and Market Conduct Transparency and Disclosure Guideline Note No. 6 (2013).*

Sales and marketing information provided via advertisements must be of the same high quality as other promotional material. Clear regulatory standards must be in place to ensure that advertising for financial products is not misleading, and provides a clear, comprehensive and balanced perspective on the main features of the product.

Malaysia – Advertising standards

To prevent misleading advertising and promote high standards in sales and marketing information BNM has compiled a set of 'best practice' standards for the advertising of financial products and services.[27] These include:

- Advertisements and promotional materials in any media should be written in plain language and must be clearly understood by consumers.
- A product or facility shall not be described as 'free' or 'no cost' if some maintenance fees or other charges apply.
- Advertisements must disclose clear, accurate and relevant information about the features, risks, costs, benefits and penalties of a product.
- Terms and conditions, disclaimers and notes should be of sufficient font size and prominence to be legible.
- Advertisements should highlight relevant information from a product's terms and conditions.
- Advertisements must not obscure important facts.
- Advertisements must not create a false impression about a financial institution or its products and services.

It is also important that transparency and disclosure requirements apply, in a comparable form, to both bank and non-bank financial products and services. In countries where bank and non-bank financial service providers are regulated separately this can be complex and requires collaboration and coordination with other regulators and public bodies. The aim is to extend and harmonize transparency and disclosure requirements across all financial

[27] *Alliance for Financial Inclusion, Empowering and protecting financial consumers Bank Negara Malaysia's consumer and market conduct framework (2011).*

services, so that consumers can expect the same level of protection in relation to all products and providers. Several countries, including Malaysia and the UK, have – over time – brought all FSPs together within the same regulatory regime in order to maximize market influence and oversight and offer comprehensive protection to consumers.

Setting regulatory standards for verbal disclosure by retail agents is as critical in an empowering regulatory environment as written disclosure. While standards in verbal disclosure are more difficult to monitor, consumers must be able to rely on the same high standards in relation to verbal disclosure as they can with written disclosure. This requires FSPs to invest in training programmes, to ensure that all customer-facing staff have the necessary knowledge and skills to communicate honestly and accurately with consumers. Crucially, it also requires FSPs to take responsibility for the disclosures made on their behalf by third party agencies, including advisors, sales agents and debt collectors. FSPs must demand the same high standards of third party agencies that they demand from their own staff and must commit the capacity and resource required to assess third parties' training and experience, set clear contractual standards for third parties to follow and monitor performance.

Accessible

Documents – including all sales and marketing material, product disclosure information and contractual information - must be understandable and written in a language in which consumers conduct their everyday business, not just in the official national language. The terminology used must be appropriate to the target consumer group's level of financial capability. A glossary of terms should be provided to help customers understand new and complex terminology.

Information must be disclosed in writing or in an electronic format – for example, by email or text message – where appropriate. Regulation should require FSPs to make information available to consumers in a range of formats, based on consumer needs, and provide guidance on minimum standards for disclosure in all formats.

Relevant

Transparency and disclosure requirements need to cover all financial products and services offered by FSPs, including financial advice. The table below gives some disclosure examples for three common financial products:

Financial product / service	Disclosure
Credit	▪ Interest rates (consistent format); total cost of credit ▪ Repayment rate, frequency and format ▪ The impact of fluctuating interest rates on repayment levels and the total cost of credit ▪ Other fees and charges (e.g. early settlement fees, cancellation fees, guarantor fees, default/penalty charges and interest ▪ Key consumer risks and obligations
Deposit and savings products	▪ Interest rates ▪ Product features ▪ Key terms and conditions ▪ Other fees and changes
Insurance	▪ Key product features ▪ Total premiums ▪ Key terms and conditions ▪ Consumer risks and obligations ▪ Payment terms ▪ Benefits payable ▪ Excess charges ▪ Other fees charges and exclusions related to the product.

United Kingdom - Retail Distribution Review

The Retail Distribution Review (RDR) was launched by the Financial Services Authority, which preceded the current conduct authority, the Financial Conduct Authority, in 2006. The aim of the review was to make the retail investment market work better for consumers. A key element of the rules introduced following the review, alongside an increase in the minimum level of professional qualification for financial advisors, was improved transparency

of charges and services, and the removal of commission paid to advisors and platforms by FSPs. The purpose of this was to make investment costs clearer to customers and ensure that the advice consumers received was not distorted by commission payments being made to advisors by FSPs, of which the customer may not be aware.

An initial review of the impact of these new rules, conducted two years after implementation, indicated not only a positive impact on the sales process but also a reduction in costs. Product bias was found to have reduced, with a decline in sales of products that, prior to the RDR, attracted higher commission for advisors and an increase in sales of products paying lower or no commission. In addition, product and platform costs had fallen, although the cost of financial advice had remained broadly the same.[28]

Product bundling – which makes it difficult both for consumers to assess the value of the product to them and for sales staff to assess whether the bundled products are suitable to meet the customers needs – should, as far as possible, be discouraged within a CEMC regime.

Disclosing information on the cost of a product is not enough to enable consumers to make effective and confident choices in the financial services market. A separate mandatory disclosure form must include disclosure of all of the key terms and conditions relating to the product or service before the consumer enters into a contract or transaction with an FSP. These terms and conditions must be clearly defined in the disclosure requirements in order to give the customer a complete picture of the total cost of a product or service and important features and risks relating to it. Consumer rights, obligations and options for redress should also be disclosed and communicated clearly.

Consistent

Regulators should prescribe a compulsory format for FSPs to use when disclosing information about financial products and services. This ensures that consumers receive

[28] *Financial Conduct Authority, Post-implementation review of the Retail Distribution Review – Phase 1 (2014).*

adequate and accessible information and, crucially, in relation to consumer empowerment initiatives, can compare information across different products and providers. The disclosure format should require FSPs to provide a minimum level of information that must be provided to consumers at the pre-contract, contractual and post-contractual stage.

Consumers and other stakeholders should be consulted on the content and style of the disclosure format at the design stage, and feedback sought on the relevance, comprehensiveness, accessibility and use-ability of the information.

The compulsory format should require FSPs to disclose all key information about the product including, for example, pricing, fees and charges, premiums, potential yields from deposits and investments, risks, key terms and conditions.

Empowering

If consumers are to be empowered to shop around and make effective comparisons between different products and providers, regulators must promote tools to help consumers with comparative shopping.

To maximize the comparability of the information available to consumers relating to different FSPs' products and performance, regulators should require such FSPs to report key information that can be used to construct comparison tables. Regulators should publish and update comparison tables on a regular basis.

Peru – Interest rates drop due to publishing

When daily newspapers in Peru began publishing cost information about financial services, interest rates dropped by as much as 15% in six months[29].

[29] *Alliance for Financial Inclusion, Policy Note Consumer Protection Leveling the playing field in financial inclusion (2010).*

It is much more difficult for consumers to compare FSPs on the basis of service quality, despite the fact that service quality has been found to be a key driver of switching in some markets.[30] The UK FSCP commissioned research to assess the potential for comparable, firm-level information relating to FSPs reputation and conduct to facilitate consumers to act as 'co-regulators' in improving the way firms treat their customers. Similar information provided in other UK markets, such as telecommunications and food standards, indicates its potential to drive up standards as firms compete on reputation as well as price.[31] In the UK, the FCA and the Financial Ombudsman Service already publishes firm-level data relating to customer complaints and Ombudsman decisions.

Customers should also be provided with clear information about complaints processes and the avenues of help and redress available to them, including the availability of consumer help and information, debt advice and counselling and options for dispute resolution. The role of help and redress as part of a CEMC regime is explored more fully in Chapter 5.

3.3. Implementation

The successful implementation of a transparency and disclosure regime depends mainly on the following four factors:

- ***Understanding customer needs***
- ***Consultation and engagement with stakeholders***
- ***Supervision, monitoring and enforcement***
- ***Financial capability-***

Understanding customer needs

Successful implementation of a transparency and disclosure regime relies, to a large extent, on FSPs understanding of the market and the needs of the target customers. This is especially important in the contexts of insights provided by behaviour economics, which illustrate clearly that traditional assumptions about how consumers behave in markets are

[30] *OECD, Enhancing Competition in telecommunications: protecting and empowering consumers Ministerial Background Report (2008).*
[31] *Financial Services Consumer Panel, Position Paper: Consumers as Co-regulators* (2015).

flawed and that, in reality, consumers do not always act in a predictable, rational way. Gaining a clear understanding of how consumers make choices and decisions and – critically – how these behaviours interact with sales, marketing and product information is essential for both regulators and FSPs if the transparency and disclosure rules are to maximize opportunities for consumers to make optimum decisions about financial services.

Alongside this, FSPs also have a responsibility to maintain a high degree of market insight – via market and customer research, including techniques like mystery shopping which provide a more in-depth insight into the customer experience; stakeholder engagement; media monitoring, and customer feedback. This will help them to revise and target their approach to information provision.

FSPs also need to invest in high quality training for sales staff and agents to enable them to understand customers' needs, assess the suitability of products, explain the key features of the product in a way that is clear and accessible to the customer and address questions relating to both the benefits and the risks associated with the product.

Consultation and engagement

Ongoing and inclusive consultation and engagement with stakeholders is essential to ensure that disclosure rules and arrangements for implementation are adequate and reflect the real, lived experience of consumers and consumer organizations. Regulators should also encourage complementary industry initiatives such as well-enforced codes of conduct, consumer awareness and education initiatives. [32] This is likely to require collaboration with professional bodies and industry trade associations, as well as consumer organizations and representatives, to communicate expectations, promote standards and identify breaches.

Supervision, monitoring and enforcement

A critical element of effective regulation is striking the right balance between design and implementation considerations. Even a gold-standard disclosure regime will not deliver the

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[32] *AFI Consumer Empowerment and Market Conduct Working Group (CEMCWG), Consumer Empowerment and Market Conduct Transparency and Disclosure Guideline Note No. 6 (2013).*

outcomes if it is designed to achieve without sufficient resources to supervise the market and monitor compliance, and without enforcement powers to tackle and disincentivize non-compliance.

Financial capability

Without effective and targeted financial capability initiatives, information disclosure cannot achieve its desired outcome of empowering consumers to choose and use financial products and services. Governments, regulators and FSPs all have responsibilities for providing and promoting financial capability programmes to help consumers understand the information they are given in relation to financial products and services. Consumer organizations, advice agencies and civil society organizations should be strongly encouraged to contribute to such initiatives to extend their reach, ensure they are targeted effectively and encourage consumers to trust and engage. See Chapter 6 for further detail on the potential for financial literacy, capability and education initiatives within a CEMC regulatory regime.

Barrow, P., Just Enough: Empowering Fixed-Line Telecommunications Consumers through a Quality of Service Information System CCP Working Paper 07-2 (2007).

OECD, Enhancing Competition in telecommunications: protecting and empowering consumers Ministerial Background Report (2008).

Johnstone, J. and Kozakova, A., Imperfect Markets (2006).

Lambrecht, A., Skiera, B., Paying Too Much and Being Happy About It: Existence, Causes and Consequences of Tariff- Choice Biases (2006).

Financial Services Consumer Panel, Position Paper on Consumers as Co-regulators (2015).

Chapter 3: Exercise 1

1. *Why should regulators get involved in addressing the information imbalance between FSPs and their customers?*

2. *List the four implementation factors that need to be considered when designing an empowering transparency and disclosure regime.*
3. *In the following example, which of the five disclosure criteria have been considered by the bank? - A bank has developed a new loan product for small enterprises. Based on market research and interviews with members of the target group the bank has produced a product flyer in all three of the local languages. The flyer explains the loan conditions in plain words and gives examples of interest payments for different loan amounts. The interest rate is quoted as effective annual interest rate so that clients can compare the costs to other bank loan products. Moreover, loan officers have been trained to explain the product to customers verbally. The bank also ensures that borrowers understand the loan contract and that they get updated information about the status of their loan during the repayment period. All information is available on paper and electronically.*

Solutions: Please refer to the last chapter.

4. Responsible Lending

Initial scenario

India's micro-finance suicide epidemic

By Soutik Biswas

BBC News, Medak, Andhra Pradesh

16 December 2010

In his grotty, two-room brick home, all that remains of Ketadi Ramchandra Moorthy is a laminated colour photograph sitting on the cold cement floor.

Two months ago, the 40-year-old carpenter dropped dead after a heart attack at a bus station in Hyderabad, some 70km (43 miles) away from his rural home in the south-east Indian state of Andhra Pradesh. He had travelled to the city to beg friends for cash to pay loans he had taken over the course of a year from private micro-credit firms. A broken man, he had been heading back empty-handed to Gajwel village in Medak district.

A government report said Mr Moorthy had suffered a heart attack "due to pressure put by the micro-finance institutions for repayment".

"He was so stressed out that he just collapsed and died," says his wife, K Karuna, 36.

More than a third of the 30 million households that have taken micro-credit in India live in Andhra Pradesh. The majority of the borrowers are women.

Borrower's revolt

But the small loan has turned out to be a big curse for many in the state. More than 80 people have taken their own lives in the last few months after defaulting on micro-loans, according to the government. This has triggered the worst ever crisis in India's booming micro-finance industry.

Scenting votes, opposition politicians have encouraged borrowers to halt repayments - micro-finance companies have given out 80bn rupees ($2bn; £1.3bn) of loans in Andhra Pradesh. Banks, in turn, have stopped lending to micro-finance companies and fear they may not recover some $4bn in loans.

"Multiple lending, over-indebtedness, coercive recovery practices and unseemly enrichment by promoters and senior executives [of micro-credit companies] has led to this situation," says Vijay Mahajan, chairman of India's Microfinance Institutions Network.

India's micro-finance crisis mirrors the 2008 subprime mortgage meltdown in the US, where finance companies threw cheap and easy loans at homebuyers until prices crashed and borrowers were unable to sell their homes or pay their debts. But the difference in India is that the borrowers are even poorer, with zero social security. (…)

4.1. Why is responsible lending important?

The international focus that responsible lending currently receives is a relatively new phenomenon. While it has been a key element of financial inclusion debates for some time, it was the recent global financial crisis that started in 2007 that shone a spotlight on significant and systemic failings in consumer protection relating to consumer credit in mainstream financial markets.

Consumer credit is a vital element of national and global economies. Levels of household debt are growing rapidly across the world, especially in transitioning and developing economies. Regulatory intervention to promote responsible lending is important for:

- Promoting economic efficiency;
- Consumer protection; and
- Financial stability.

Access to safe, affordable and fair credit products made available via responsible lending practices is also a key aspect of the financial inclusion and consumer empowerment agenda, with potential to provide vulnerable and disadvantaged people with resources to change their circumstances and invest in their future.[33]

Responsible lending is a central element of a healthy, well-functioning market for financial services and financial inclusion. Experience around the globe indicates that self-regulation and voluntary codes of practice tend not to provide adequate protection against irresponsible lending. It falls to regulators, therefore, to stipulate the standards of conduct required of lenders and to monitor their performance against these standards

From a consumer empowerment perspective, responsible lending practices can:

[33] *Empowerment Through Financial Inclusion, Address to the International Forum for Financial Inclusion by Christine Lagarde, Managing Director, International Monetary Fund (2014).*

- Help address behavioural biases in consumers' decision-making and prevent lenders exploiting these biases;
- Encourage lenders to apply greater access to information and experience to assess appropriate levels and types of borrowing for different groups of consumers;
- Promote the voice of consumers with limited choice and/or bargaining power in the credit market; and
- Protect vulnerable consumers from exploitation in the form of, for example, aggressive or predatory sales practices, unfair contract terms and conditions, encouragement to enter into loans they cannot afford.

Practices identified by *Consumers International* as being particularly harmful to consumers include:[34]

- Opaque marketing practices making it difficult for consumers to compare products;
- Complex products and features that are difficult for consumers to understand;
- Several practices related to the provision of high cost short-term credit, e.g. payday loans;
- Inappropriate credit limit increases without checking affordability;
- 'Equity stripping' where consumers are intentionally or negligently given access to credit that they are unlikely to be able to repay allowing the lender to take possession of security or collateral secured against the loan; and
- Bundled services with the provision of credit, e.g. payment protection insurance, that are not relevant to or do not offer any benefit to the consumer.

The importance of credit to both individual consumers and the wider economy requires that lenders not only comply with general consumer protection legislation and regulatory requirements but also take specific steps to ensure that they are lending responsibly.

[34] *Consumers International, Responsible Lending: An international landscape (2013).*

4.2. Key features of a responsible lending regime

The key features of a responsible lending regime should cover the following 11 aspects:

- ***Industry standards***
- ***Information disclosure***
- ***Sales and marketing***
- ***Product design and features***
- ***Suitability and affordability***
- ***Post-contractual information***
- ***Data security***
- ***Unauthorised transactions***
- ***Identifying and responding to financial distress***
- ***Dealing with customers in financial difficulty***
- ***Vulnerable customers***

Industry standards:

- Lenders should ensure that systems, controls and governance arrangements are in place to confirm that customers will receive a fair outcome when taking out a consumer credit product and throughout the whole product lifecycle, wherever the interaction with the customer takes place.
- Lenders and any associated agents should have an obligation to operate in the best interests of the customer and to comply with relevant consumer protection and regulatory regimes.
- Lenders' business practices should incentivize customer service not sales.
- Lenders should be responsible and accountable for the actions and conduct of authorized agents and third parties.
- Customers should have access to effective complaints mechanisms and avenues for dispute resolution and redress.

Information disclosure:

- Products should be presented and marketed in promotional information and advertising, across all channels, in a manner that is fair, clear and not misleading. These materials should include comparable information on the total or true cost of credit, including the impact of any fees or charges, and warnings about what will happen should the borrower be unable to keep up with scheduled repayments.

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- Information that is made available to potential borrowers should include standard, basic information about the product and the contract so that the customer can assess the suitability of the product for their needs and, crucially, can shop around and make comparisons with other products and providers.

Sales and marketing:

- Customers should not be subject to aggressive or predatory sales practices, or targeted with products that are unsuitable for them. Particular concern has been expressed in relation to high-cost short-term credit, especially where credit is provided by an agent in the borrower's home.
- Credit products that are made available to customers remotely – for example, online or via mobile financial services, should be subject to a 'cooling-off' period to give borrowers time to consider their decision and cancel the contract without penalty.

Product design and features:

- Product design and account management should facilitate responsible lending.
- Products should be simple and easy to understand without opaque features or terms and conditions that make it difficult for the customer to fully comprehend what they are signing up to. Products should meet a comprehensibility test, including a requirement that additional complexity must deliver genuine consumer benefit.
- Where there is concern about high interest rates, competition authorities should investigate whether markets are competitive and, if required, take action to promote competition. If the market fails to keep rates at a reasonable level, regulators may consider the use of rate caps.
- Other fees and charges should be able to meet a 'reasonableness test'.
- Consumers should not be encouraged to borrow more to maintain preferential rates or offered unsolicited increases in their credit limit.
- Consumers should not be inappropriately encouraged to roll-over short-term loans in a way that is unsustainable, unaffordable or otherwise harmful to them.
- Lenders default position should be that repayments are allocated first to balances that cause the highest interest rate or are most effective in reducing overall costs.
- Product bundling should be banned. Consumers should always have the right to buy ancillary products from alternative providers and lenders should be required to clearly communicate this to the consumer.

- Consumers should always have the right of early repayment. Early repayment compensation, if any, should be calculated transparently and fairly. Consumers should be informed about their right to early repay and the amount of the expected compensation already at the pre-contractual stage.

Digital Credit in Emerging

Mobile phone technology has a potential to extend financial access dramatically, in particular to low income households who previously had limited or no access to formal financial services. This potential digital platform for delivery of financial services has larger outreach than traditional brick and mortar bank branches (including ATMs) due to the ubiquity of mobile devices and a much larger distribution network through agents.

However, the effectiveness of digital platforms and delivery channels to foster full financial inclusion depends on their ability to evolve beyond the offer of money transfer and payments services to additional financial services - savings, credit and insurance - offered in an appropriate, reliable, affordable and secure manner. To harness the digital finance potential, mobile network operators (MNOs) have teamed up with financial service providers (FSPs) to extend digital financial services that include micro savings and credit. However, recent crises driven by aggressive lending to lower-income consumers in several markets (India, Morocco, Nicaragua, Bosnia, and South Africa) have shown how it is important to develop sufficient market conduct regulatory and supervisory systems alongside innovative products such as digitally-delivered credit.

The delivery of small loans through digital means (hereafter referred to as "digital credit") offers significant potential benefits to lower-income consumers, as well as likely gains in financial deepening and broad-based economic development. Credit plays an obviously important role in helping households and very small businesses manage their finances, deal with shocks and swings in income/revenue, and capitalize on opportunities. Digital delivery of credit, when it is done carefully and responsibly, can result in substantial cost savings and improved credit risk

management, as well as potential for diversification of product offerings and fuller financial inclusion[35].

Suitability and affordability:

- Depending on the product, lenders should assess factors such as the customer's financial capability, needs and circumstances before lending to them.
- Consumers should only be offered credit which is affordable and which is suitable for their needs. Affordability checks should take account of the borrowers income, total outstanding borrowing, current and future expenses, living requirements and relevant personal circumstances, such as number and circumstances of dependents.
- The suitability of the product should be based on an assessment of the borrower's ability to repay the loan at the current rates and should interest rates increase during the lifetime of the contract. It should be possible for borrowers to be able to repay credit without incurring significant financial difficulty or experiencing significant adverse circumstances.

Post-contractual information:

- Lenders should provide borrowers with regular updates on the status of their loan, where appropriate, including the amount repaid and the total amount outstanding.
- Lenders should always inform customers of any changes to the terms and conditions applying to their loan, including changes to interest rates or fees, and the implications of these changes for repayment levels and the total outstanding balance.

Data security:

- Lenders should maintain the security of customers' data but may share information about the day-to-day running of a customer's account, including positive data, with credit reference agencies where appropriate. Customers must

[35] Consumer Empowerment and Market Conduct Working Group (CEMCWG), Digitally Delivered Credit Policy Guidance Note and Results from Regulators Survey Guideline Note No. 17 (2017).

be informed when information on their account will be shared with third parties and how it will be used.

Unauthorised transactions:

- Lenders should have procedures in place to deal with unauthorised transactions.
- Where lenders suspect customer fraud, the onus of proof should be on the lender.

Identifying and responding to financial distress:

- Product design processes should assess risks that may impact on the customer's ability to repay so that products do not encourage or result in unsustainable borrowing.
- Lenders should implement systems to identify signs of financial distress so that they can offer help to customers at an early stage before they fall into significant financial difficulty.
- Firms should ensure that all customer-facing staff and agents are trained to respond sympathetically and constructively with people in financial distress.

Dealing with customers in financial difficulty:

- Borrowers who fall into financial difficulty should receive fair treatment and appropriate support to help them deal with their debts in the most suitable way for them.
- Customers in financial difficulty should be provided with clear information outlining the support available to them and, where appropriate, should be signposted to free, impartial advice.
- Borrowers in financial difficulty should not be subject to harassment or undue pressure to make repayments.
- Where customers in financial difficulty are making repayments on their account as part of an agreed plan, they should not be subject to unnecessary contact.
- Lenders should offer a period of 'breathing space' to borrowers who have fallen into financial difficult, during which time charges and interest penalties are frozen, , to give them time to seek advice and make attempts to resolve their situation.
- Lenders should apply an appropriate degree of forbearance to customers in financial difficulty, and should base decisions about how far to pursue an account on whether this would constitute a fair customer outcome.
- Lenders should implement a rigorous due diligence process on third parties used for debt collection and enforcement action, ensuring that the third party maintains

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the same standards of conduct as the lender, and monitoring performance on a regular basis.

Vulnerable customers:

- Lenders should have policies and procedures in place to identify and support vulnerable consumers.
- Product design and sales processes should take into account the needs of vulnerable consumers and their ability to make an informed decision about the product.
- Lenders should ensure that staff and agents are trained to identify and respond appropriately to vulnerable consumers.
- Vulnerable consumers whose accounts are in arrears should not be subject to debt collection or enforcement action.

4.3. Responsible lending initiatives

According to FinCoNet the types of responsible lending initiatives include the following:[36]

- **Consumer engagement**– measures to encourage consumers to identify and select a suitable product or credit limit, e.g. disclosure or thruth-in-lending requirements.
- **Industry based requirements (business conduct)** – measures required of industry (the credit provider and any associated intermediary) to assess or determine whether a product or products is suitable or affordable for a consumer or class of consumer, or restrictions to prevent them from lending irresponsibly.
- **Regulatory controls (product intervention)** – measures taken by a jurisdiction to restrict certain product designs to address systemic unsuitability (e.g. price controls such as interest rate caps, or the restriction or banning of certain products or product features).

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[36] *FinCoNet International Financial Consumer Protection Organisation, FinCoNet report on responsible lending Review of supervisory tools for suitable consumer lending practices(2014).*

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Uganda

Regulatory regimes in many countries place clear requirements on lenders to ensure that all sales, marketing and advertising material for credit products are 'clear and not misleading'. In Uganda, these standards are set out in the Bank of Uganda Financial Consumer Protection Guidelines 2011[37]. These guidelines have four key objectives:

- Promote fair and equitable financial services practices by setting minimum standards for financial services providers in dealing with consumers;
- Increase transparency in order to inform and empower consumers of financial services;
- Foster confidence in the financial services sector; and

Provide efficient and effective mechanisms for handling consumer complaints relating to the provision of financial products and services.

Belgium[38]

Standards to be adhered to in the advertising of consumer credit in Belgium are clearly prescribed at a number of levels, to ensure that the information consumers receive empowers them to make confident, informed and effective choices about borrowing. The Belgian Consumer Credit Act 1991 sets out a general obligation on lenders to be clear and not misleading in their advertising of products. Further, the act requires that any mention of interest rates in advertisements or contractual information must be set out in a standardized form to include: the borrowing rate, the total cost, the total amount of credit, and the annual percentage rate. The act also prescribes other factors relating to minimum font size or minimum level of clarity/audibility, as appropriate.

[37] *Bank of Uganda Financial Consumer Protection Guidelines, 2011.*

[38] *FinCoNet International Financial Consumer Protection Organisation, FinCoNet report on responsible lending: Review of supervisory tools for suitable consumer lending practices(2014).*

United Kingdom

In 2015, the FCA introduced price controls on providers of high-cost short-term credit - such as payday loans – to protect consumers against excessive charges[39]. Under these controls, providers of high-cost short-term credit must adhere to the following:

- An initial cost cap of 0.8% per day – interest and fees charged must not exceed 0.8% per day

of the amount borrowed;

- A £15 cap on default fees – if borrowers default, fees must not exceed £15. Firms can
  continue to charge interest after default but not above the initial rate; and
- A total cost cap of 100% – borrowers must never pay more in fees and interest than 100% of what they borrowed.

In addition to regulatory interventions outlined above there are also a number of **international voluntary initiatives** focused on responsible finance in general or responsible lending in particular.

Responsible Finance Forum

The International Finance Corporation (IFC) co-founded the sector-wide Responsible Finance Forum (RFF) in 2010 with the German Federal Ministry for Economic Cooperation and Development (BMZ) and the Consultative Group to Assist the Poor (CGAP). IFC's Responsible Finance Advisory plays a global convening role and coordinates participants from the financial sector, bilateral and multilateral donors and broader international community through

[39] *Financial Conduct Authority, Price cap on high cost short term credit (2015). https://www.fca.org.uk/firms/price-cap-high-cost-short-term-credit*

the G20 Global Partnership for Financial Inclusion. IFC collaborates globally to implement client protection principles.

The Smart Campaign

The Smart Campaign is a global effort to help microfinance institutions with tools and resources they need to deliver transparent, respectful, and prudent financial services to all clients. The Campaign Steering Committee is comprised of respected leaders in the microfinance industry from a diversity of regions and institutions including the Consultative Group to Assist the Poor (CGAP) at The World Bank, Deutsche Bank Social Investment Group, the World Savings Bank Institute, WWB Colombia, KfW (Germany), Ujjivan (India), CARD Bank (Philippines), the Microfinance Centre (Eastern Europe & Former Soviet Union), and Fonkoze (Haiti). The Smart Campaign is housed at Accion's Center for Financial Inclusion.

The Client Protection Principles, encouraged by The Smart Campaign, are the minimum standards that clients should expect to receive when doing business with a financial service provider. They include the following areas: appropriate product design and delivery, prevention of over-indebtedness, transparency, responsible pricing, fair and respectful treatment of clients, privacy of client data and mechanisms for complaint resolution.

Responsible lending initiatives fall into three categories: consumer engagement, industry based requirements (business conduct) and regulatory controls (product intervention). There are also a number of international voluntary initiatives focused on responsible finance in general or responsible lending in particular.

Appleyard, L. Centre on Household Assets and Savings Mangement, What is responsible lending and borrowing? (2013).

FinCoNet International Financial Consumer Protection Organisation, FinCoNet report on responsible lending Review of supervisory tools for suitable consumer lending practices (2014).

Financial Conduct Authority, Consumer Credit Sourcebook (2018).

Office of Fair Trading, Irresponsible lending - OFT Guidance for Creditors (2011).

New Zealand Government Minister of Commerce and Consumer Affairs, Responsible Lending Code (2017).

Financial Ombudsman Service (Australia), Responsible Lending Obligations and Maladministration in Lending (2011).

World Bank, Responsible Lending Overview of Regulatory Tools (2013).

The Lending Standards Board, (2016).

Chapter 4: Exercise 1

With reference to the Initial Scenario of this Section, what should, in your opinion, be the 5 most important responsible lending features for a consumer loan product aimed at poor households in a developing country?

Solutions: Please refer to the last chapter.

5. Avenues for Help and Redress

Initial scenario

Complaints against UK banks remain near record levels

May 26, 2016

Huw Jones, Andrew MacAskill

LONDON (Reuters) - Complaints against financial services firms in Britain are at their third highest level on record despite a crackdown on bad behaviour by regulators and new laws since the financial crisis to protect customers from misselling. The number of complaints about packaged bank accounts more than doubled and the complaints about pension plans surged by a quarter, the Financial Ombudsman said on Thursday. "It's been another year of big numbers," Chief Ombudsman, Caroline Wayman said. "We mustn't lose sight of the lives and livelihoods behind every complaint."

The level of complaints and number still being upheld are being closely watched by Andrew Bailey, the Bank of England Deputy Governor. He takes up the reins in July at the Financial Conduct Authority (FCA), which regulates sales practices at lenders and Bailey said this month that improving culture at banks will be a top priority. (…)

5.1. Introduction

A reliable and robust help and redress mechanism is a core component of an effective consumer protection framework. Developing one primarily involves establishing internal and external complaint–handling procedures that ensure disputes between consumers and FSPs are dealt with fairly and expeditiously. A complaint–handling mechanism should therefore be independent, transparent, free of charges, easily accessible and effective. There are several tools that regulators and FSPs can use to develop effective help and redress mechanisms. The types and combinations of mechanisms will depend on a country's legal and regulatory framework, the size and maturity of its financial sector and the products, market players and other characteristics unique to a particular country or institution.[40]

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[40] *AFI Consumer Empowerment and Market Conduct Working Group (CEMCWG), Consumer Empowerment and Market Conduct Help & Redress for Financial Consumers Guideline Note No. 9 (2013).*

For consumers to have maximum confidence in their ability to engage effectively with financial services markets and their likelihood of being treated fairly by FSPs it is essential for them to be able to feel confident of receiving help and redress should things go wrong. Even in the best-regulated environment there will be times when consumers are disadvantaged in their dealings with financial services firms as a result of, for example, information asymmetries or unforeseen circumstances.

***Information asymmetry** refers to a situation where providers of financial products and services have more or better information than consumers*

A comprehensive, well-functioning consumer protection regime is essential to empowering consumers as part of a CEMC regime. Consumer protection is also essential for a well-functioning and stable financial system to:

- Promote consumer trust and confidence in FSPs enabling them to make sound choices, shop around and, ultimately, drive competition and high standards of conduct; and
- Enable FSPs to operate on a level playing field, removing the 'first mover dilemma' by requiring all FSPs to comply with the same rules.

The extent of the information asymmetry between financial consumers and FSPs, exacerbated by the growing sophistication of financial products and services and fast-paced technological developments in delivery mechanisms, makes it likely that specific consumer protection legislation and regulatory frameworks will be necessary.

> *General consumer protection laws often fail financial consumers. Consumer protection laws that originate from concerns about product or food safety often fail to adequately protect consumers of financial services.*[41]

As a result, financial consumer protection regimes are to be especially designed to respond to the particular needs, risks and pace of the financial services market.

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[41] *Alliance for Financial Inclusion, Policy Note Consumer protection Leveling the playing field in financial inclusion (2010).*

In 2005, the Peruvian government passes a Complementary Law to the Consumer Protection Law for Financial Services, making specific provisions to address gaps in consumer protection. The Complementary Law established additional provisions relating to issues such as transparent pricing, the publication of accurate information on interest rates and bank fees, a requirement for all banks to provide official formulas for calculating interest and interest rate simulation programs on their websites, and requiring each financial institution to establish a customer service body to ensure quality of service for consumers.

While breaches in consumer protection laws can be addressed through the courts, this is a daunting, expensive and slow process for consumers. As a result, an effective apparatus for alternative dispute resolution – whereby consumers can get their complaints resolved without recourse to the courts - is a crucial aspect of CEMC regulation, ensuring that consumers can enter the market with confidence that they are protected should something go wrong. The key elements of such a regime are:

- ***internal, firm-based dispute resolution***
- ***external dispute resolution***
- ***depositor protection***
- ***support for over-indebted consumers.***

Alternative Dispute Resolution (ADR)

Alternative Dispute Resolution (ADR) – *refers to the use of methods such as arbitration or mediation to resolve an issue without recourse to the courts.*

Alternative Dispute Resolution (ADR) generally refers to processes or systems that help people to resolve disputes relating to a product or service without having to go to court. ADR methods may include arbitration, mediation, and conciliation. In most cases, ADR is a relatively quicker and cheaper way of resolving complaints. The existence of an ADR system can also increase consumer confidence, as people can readily seek redress if they

are facing issues with a particular product or service.[42] The agencies involved in providing help and redress to financial consumers are a rich source of consumer and market insight, creating a valuable role for feedback mechanisms among these agencies, regulatory authorities, FSPs and their trade associations.

The AFI CEMCWG surveyed ADR mechanisms for financial services in 11 AFI member jurisdictions. Almost all of the countries surveyed had a form of ADR provided for under a specific legislation. The exceptions were Bangladesh, where the legislative basis for ADR is implied through a number of separate Acts; and Tanzania, where the ADR mechanism is still under development. Fewer countries, however, had specific ADR systems for financial services-related disputes. For example, in the Philippines, the ADR systems cover a wide range of disputes including commercial and construction. Moreover, some jurisdictions had a dedicated financial services ombudsman.

ADR services covered a range of activities, such as providing information to consumers, mediation, arbitration and conciliation. In most countries, regulators mandated complaint-handling procedures for FSPs, and these were sometimes used to inform policymaking.

	Information	Complaints Handling	Mediation/ Conciliation	Arbitration
Armenia	✔	✔		✔

[42] *Alliance for Financial Inclusion, Alternative Dispute Resolution AFI Consumer Empowerment and Market Conduct Working Group: Help And Redress Subgroup (2017).*

Bangladesh		✔		
China	✔	✔	✔	✔
Colombia	✔	✔	✔	✔
El Salvador		✔		
Malaysia	✔	✔	✔	✔
Mozambique	✔	✔		✔
Palestine	✔	✔		
Peru			✔	✔
Philippines	✔	✔	✔	✔
Tanzania		✔	✔	✔

Table 1: ADR Services

	Institution implementing the ADR system	Can the private sector be authorized as an ADR provider?	Is there a Financial Services Ombudsman (or equivalent dedicated body)?
Armenia	Office of the Financial System Mediator		✔
Bangladesh			✔
China	Central Bank	✖	✖
Colombia	Financial Regulator	✔	✔
El Salvador	Consumer Agency	✖	✖
Malaysia	Bank Negara Malaysia		✔
Mozambique			✖
Palestine	Palestine Monetary Authority	✔	✔
Peru	INDECOPI (National Institute for the Defense of Competition and Intellectual Property)	✔	✔
Philippines	Bangko Sentral ng Pilipinas	✔	✖

Table 2: ADR Implementation

ADR Schemes in Armenia

In Armenia, ADR schemes exist for different fields of activities. Based on the nature of the complaint, a complainant has the right to use any ADR scheme. However, in connection with financial products and services, the most popular ones are the Financial Arbitration

and the Office of the Financial System Mediator (FSM). These schemes cover all FSPs and provide consumers with access to out-of-court resolution to their complaints against firms. Consumers can also bring their complaints to the Central Bank of Armenia (CBA), although it has no jurisdiction over disputes between individual consumers and FSPs. They may also seek redress through the courts.

Financial Arbitration

The Financial Arbitration, established by the Union of Banks of Armenia, is an independent, full-fledged organization. It operates in accordance with the Law on Commercial Arbitration, Civil Procedure Code, and other laws and regulations. Individuals can use the Financial Arbitration, including private entrepreneurs, legal entities, and foreign citizens.

Complainants may only use the Financial Arbitration where an arbitration agreement is stipulated in the original contract for the purchase of the financial product or service. According to the Law on Financial Mediation, the Financial Arbitration cannot examine a case which is in the process of being dealt with by the FSM, or which has been the subject of a mandatory decision by the FSM.

According to the Law on Commercial Arbitration, the courts cannot accept a case if an arbitration agreement is in place, unless the agreement is invalid. Additionally, according to the Civil Procedure Code, a court cannot consider a case if the same matter is already being dealt with by another court.

Claimants pay an arbitration fee and case hearing costs. For property claims, the arbitration fee is 1.5% of the cost of the claim, subject to a minimum amount of 25,000 AMD (USD 50.00 approximately) and a maximum amount of 1,500,000 AMD (USD 3,000.00 approximately). For non-property claims, the fee is 50,000 AMD (USD 100.00 approximately). If an Arbitration Tribunal is formed as part of the case examination, the tribunal may charge additional fees. In most cases, the losing party will bear the costs incurred by the other party in bringing the claim.

The final decision of the Financial Arbitration is binding on both parties and cannot be appealed. It is subject to enforcement by a court.

Office of the Financial System Mediator (FSM)

The Office of the Financial System Mediator (FSM) is a statutory body established in 2009 under the Law on the Financial System Mediator. It was set up with a specific role of resolving complaints between consumers (private individuals) and financial services firms.

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Its services are free of charge for consumers. The costs are met through mandatory contributions from the industry. Consumers have the right to complain, even if this is not stipulated in a contract. Moreover, under the law, any arrangement that restricts the customer's right to appeal to the FSM is null and void.

When a consumer complains to the FSM, the FSM first checks whether the claim is being considered by the Financial Arbitration or the courts, or has already been subject to a ruling by any one of these. If either applies, the FSM will not examine the case. It will also terminate the examination if it discovers that the claim is being, or has been considered, by the Financial Arbitration or the courts.

Once it is satisfied that the claim is within its jurisdiction, the FSM helps the customer to file a written complaint against the firm. The firm has 10 days to respond. If it does not respond, or if the customer is not happy with the response, the customer can file a written complaint to a mediator from the FSM. The mediator sends the complaint to the firm and asks for any additional information. The firm has 14 days to reply. At this point, the mediator commences the investigation. Further to looking at the facts, he may ask for oral hearings, invite the opinion of an independent expert, or look at the industry's best practices. The process usually takes around two to three months.

The decision is binding on the firm if the customer accepts it. In accepting a decision, the customer must sign a written agreement within 30 business days, or the decision does not become binding. This means the parties are free to go to court. The FSM may award compensation, up to a limit of 10 million AMD (USD 20,000.00 approximately) . In 2014, the FSM decided two-thirds of cases in favor of the complainants.

Promoting public awareness of ADR mechanisms

Under the Law on Financial Mediation, the CBA has made rules that require FSPs to inform consumers about their rights to an independent ADR. Financial firms are required to include information about FSM in contracts, as well as place a bulletin in their place of business, and on their website. The explanatory bulletin explains when and how to apply for mediation through the FSM, in the event the consumer has a complaint that is not resolved to his or her satisfaction by the provider. It also has to cover Financial Arbitration. Firms should also provide the customer with a copy of the bulletin at the time they make a complaint. The CBA also promotes the FSM, for example, through its website.

In addition, the FSM publishes an annual report that includes information about claims rejected and upheld, and a list of financial organizations that failed to co-operate with its investigations. It also publishes a monthly consolidation of precedents, which does not name individual complainants.

5.2. Internal dispute resolution

Internal dispute resolution *– is a process or set of procedures that a service provider uses to resolve customer complaints.*

Within many CEMC regimes, the first port of call for customers who are unhappy with the treatment they have received at the hands of an FSP would be to complain directly to the firm, asking the issues to be resolved and, where appropriate, issue redress.

- ***Every FSP should have a designated contact point for customers, with clear procedures for dealing with complaints regardless of the channel through which the customer makes contact.***
- ***FSPs should maintain up-to-date records of all the complaints they receive.***
- ***FSPs should develop internal dispute resolution policies and practices, including clear timelines for processing and response to complaints, and customer access.***

While regulatory authorities may not be directly involved at this stage of the help and redress process, CEMC regulators have an important role to play in setting conduct standards for FSPs to achieve. In fact, making FSPs responsible for dealing with complaints in the first instance provides an incentive for them to address dissatisfaction among their customers and an opportunity for them to use market intelligence gained from complaints to inform internal business processes such as product design and delivery mechanisms. Evidence shows that where regulators require FSPs to deal with complaints about their products and services this increases their willingness and capacity to do so successfully.

The SuperIntendency of Banking, Insurance and Private Pensions Funds (SBS) in Peru does not deal directly with complaints but does supervise the consumer protection policies and practices that FSPs put in place. In 2008, nearly 99% of almost 400,000 complaints were successfully handled by FSPs.

Regulatory authorities can further incentivize FSPs to respond effectively to complaints by collecting and publishing data relating to complaints received, and whether and how quickly they are resolved. Making this kind of data public provides a platform on which FSPs can compete on the basis of reputation and also provides information for the media, consumer organizations and consumers themselves, to support customers to shop around.

Compiling and publishing data on FSPs response to complaints and making it available at product level is one of the World Bank's good practice principles for consumer protection.[43]

Use of a FSP internal dispute mechanism should not preclude a consumer's use, at a later stage, of an independent dispute resolution mechanism and internal complaints procedures should not discourage customers from doing so.

5.3. External dispute resolution

Where customers are unable to resolve their complaint directly with the FSP concerned it is important that they have other avenues for dispute resolution. A central element of a successful CEMC regulatory regime is access to a cost-effective, timely and comprehensive redress scheme.

External dispute resolution aims to resolve issues without recourse to the courts.

Financial Ombudsman Schemes

Ideally, consumers will have access to an independent complaints body, such as an ombudsman, because this promotes impartiality and trust in the system.

Ombudsman *refers to an official appointed to investigate individuals' complaints against a company or organization, especially a public authority*

In Malysia, while BNM deals with consumers' complaints relating to fraud and violations of consumer rights the Bank realised that a cost-effective, simple and easily accessible dispute resolution process is 'essential for treating

[43] World Bank, *Good Practices for Financial Consumer Protection* (2012).

customers fairly'. Malaysia's Financial Mediation Bureau (BPK) is an independent body providing objective and timely resolution of disputes, claims and complaints about services from financial institutions. The service is free of charge and promises to deal with complaints within three months.[44]

Not only does the Ombudsman provide a valuable service for consumers but, evidence shows, the knowledge that an independent external agency will address unresolved complaints provides an incentive for FSPs to improve their internal complaints-handling processes. This is particularly the case where FSPs are charged for complaints that the Ombudsman receives about them.

The UK's Financial Ombudsman service is funded by levies and case fees that the FSPs covered by the scheme are required to pay by law. The service is free for consumers. The levy that firms pay ranges from £500 (USD 380.00 approximately) per year for a small firm to over £300,000 (USD 228,000.00 approximately) for a high street bank or major insurance company. The Ombudsman deals with the first 25 complaints it receives about the firms it covers without additional charge but FSPs are required to pay an additional case fee – of £550 (USD 418 approximately) or £650 (USD 494.00 approximately) - for each subsequent complaint that it receives about the firm.

Financial Ombudsman Services should be free to consumers and it is important that their decisions are binding on FSPs.

The technical complexity of different financial products and services, and the specialist expertise required to deal with complaints might make it more practical to have multiple independent dispute resolution bodies each overseeing a particular sector. Where this is the case, close cooperation between the separate agencies is important to identify patterns at firm level. Good practices principles in consumer protection developed by the World Bank state that these independent complaints bodies should compile and publish

[44] *Alliance for Financial Inclusion, Case study Empowering and protecting financial consumers Bank Negara Malaysia's consumer and market conduct framework (2011).*

data on the complaints they receive, by product, to provide opportunities to identify patterns and trends, and to facilitate learning by industry.

Industry Complaints Schemes

Industry complaints schemes, operated by self-regulatory trade associations can, if necessary, be an alternative to an independent Ombudsman or work alongside them. These schemes can be useful and cost-efficient, because the organisation already has a high level of relevant technical expertise. In addition, these associations can have a high degree of influence because they are membership organizations and can remove membership from FSPs that do not comply with their codes of practice.

The UK financial services sector is characterized by a plethora of self-regulatory trade associations. These include:

- The Lending Standards Board
- The Financial and Leasing Association
- Consumer Credit Association
- Consumer Finance Association
- The Association of British Insurers
- The Building Societies Association
- The British Bankers Association
- The Council for Mortgage Lenders
- The UK Cards Association
- Payments UK

These organizations have their own Code of Practice and some deal with complaints from consumers in relation to potential breaches of the Codes.

The drawback of these schemes, especially as an alternative to an independent Ombudsman that covers the whole market, is that because they are voluntary membership schemes they may not cover all consumers. In addition, industry codes of practice may not be as rigorous as statutory regulation and therefore consumers may be less likely to have a complaint resolved in their favour via these routes. Further industry bodies operating on the basis of a voluntary code cannot force an FSP to accept and respond to their decision.

5.4. Depositor protection

The World Bank argues that regulatory authorities should be given legal powers to set up appropriate measures to protect depositors in the event of an FSP falling into financial distress or, ultimately, failing.[45] Any law on financial insurance or a guarantee fund should be clear on:

- The insurer;
- The classes of depositors who are insured;
- The extent of insurance coverage;
- The contributor(s) to the fund;
- Each event that will trigger a payout, and
- The mechanisms to ensure timely payout to all insured persons.

Within a depositor protection scheme, consumers including depositors, life insurance policyholders, securities and derivatives account holders, and pension fund members should enjoy higher priority than other unsecured creditors in the liquidation process of a relevant financial institution.

***Depositor protection/deposit insurance** – refers to a measure implemented to protect depositors, in full or part, from losses caused by a deposit-taking institution's financial distress or failure.*

In Malaysia, BNM set up a depositor protection scheme, administered by a government agency PIDM, in 2005. The Malaysian government decided on a deposit insurance system, rather than a blanket guarantee to provide an incentive for FSPs to practice sound risk management.

In Brazil, the creation of deposit insurance was authorized by Resolution 2197 of 1993 of the National Monetary Council. This created the 'Credit Guarantee Fund' (FGC). As the Fiscal Responsibility Act prohibits the use of public funds

[45] *World Bank, Good Practices for Financial Consumer Protection (2012).*

to finance the losses, it is funded entirely by compulsory contributions from the FSPs it covers. The warranty is limited to R$250,000[46] per depositor. More recently, the Guarantor Credit Union Fund (FGCoop) was created, offering protection to depositors of credit unions and cooperative banks. Like the FGC, the FGCoop guarantees up to R$250,000 and is funded by compulsory contributions of cooperatives and cooperative banks.

5.5. Support for over-indebted consumers

Consumers who fall into difficulty as a result of using financial products and services, especially credit, historically have been a particular policy focus and are often considered to be a potentially vulnerable group of consumers. The implications of unresolved financial difficulty and indebtedness can be severe, and include credit impairment, loss of assets, housing repossession, bankruptcy and even imprisonment. As such, over-indebted consumers require specific avenues of help and redress to help them address their financial difficulties and regain control.

⇨ ***Over-indebtedness** –a household would be considered over-indebted when its existing and expected resources are insufficient to meet its financial commitments without lowering its living standard.*

⇨ ***Debt advice** – Working with people to help them make decisions about their debts, which guides any action to be taken, or explicitly or implicitly steers to a particular course of action.*

⇨ ***Debt counselling** - the activity of giving people financial help and advice about managing debt, for example, helping them plan better ways to pay back money that they owe*

[46] R$1 is valued around 0.25 US Dollar , therefore R$ 250,000 = 62,500 USD

Debt management plan *refers to a formal agreement between a debtor and a creditor that addresses the terms of an outstanding debt. Debt management plans help reduce outstanding, unsecured debts over time to help the debtor regain control of finances.*

In a number of countries help is provided to over-indebted consumers by organizations offering services such as debt advice, debt counselling and debt management plans. These can be independent organizations, usually charities or not-for-profit organizations, as is the case in the UK, where consumers can access debt advice free of charge. They are funded by a combination of industry contributions and grants from government and are all regulated by the Financial Conduct Authority.

Alternatively, Central Banks or regulatory authorities can step in to set up credit counselling services. In Malaysia, BNM established the Credit Counselling and Debt Management Agency in 2006[47]. This was in response to an increase in the number of consumers unable to manage their financial commitments, due to an unexpected change in their circumstances or because they had over-stretched themselves.

[47] *Alliance for Financial Inclusion, Case study Empowering and protecting financial consumers Bank Negara Malaysia's consumer and market conduct framework (2011).*

Alliance for Financial Inclusion, Policy Note Consumer protection Leveling the playing field in financial inclusion (2010).

Alliance for Financial Inclusion, Alternative Dispute Resolution AFI Consumer Empowerment and Market Conduct Working Group: Help And Redress Subgroup (2017).

Alliance for Financial Inclusion, Case study Empowering and protecting financial consumers Bank Negara Malaysia's consumer and market conduct framework (2011).

Chapter 5: Exercise 1

1. *What are the key elements of an alternative dispute resolution framework needed to support a CEMC regime?*
2. *List the different forms of external dispute resolution with a brief explanation of their roles and functions.*
3. *What are the different types of support for over-indebted consumers?*

Solutions: Please refer to the last chapter.

6. Financial Literacy, Capability and Education

Initial scenario

You have been tasked with developing a plan for a national financial education strategy for your country. Your first task is to develop a clear understanding of the various terms used to describe interventions aimed at helping consumers gain the skills and confidence they need to make sound financial decisions and work out how they apply in your national context.

Following that, you need to make the case for a national financial education strategy. Who will you need to convince? What will the strategy achieve and how will it support a CEMC agenda? How will you go about establishing the need for such a strategy? How should the strategy be funded and how can you prove that this investment will deliver worthwhile outcomes? You also need to consider who should lead and implement the strategy and which key stakeholders will need to be involved. How will you gain their interest in and commitment to the strategy? What role will your key stakeholders play in the development and delivery of the strategy? The strategy will need to deliver against medium and long-term goals that require it to be sustainable. How can you prove that the strategy is delivering against its goals and making a positive contribution to levels of consumer empowerment?

6.1. Introduction

Consumers' levels of confidence and competency in understanding financial information and using it to make informed decisions about financial products and services remain a critical issue in developed and developing economies around the world. There is growing recognition that financial literacy has an important role to play in financial inclusion. Financial literacy is defined in different ways, but usually taken to mean: knowledge and understanding of personal finance concepts and the skills, motivation and confidence to make informed financial choices, and participate in economic life. A financially literate person will understand how to use financial products to meet their own financial goals, which may be very simple, like 'a safe way to pay my bills', or more complicated: 'protecting my family if I get sick', or 'borrowing money to start a business'. They will use products with confidence, but be aware of scams and other risks, and know where to go for help and advice.

In the developing world, people are excluded from formal financial services for many reasons. One common issue is that banks use jargon, or even fail to provide marketing

and product information in local languages. People do not understand what is on offer, and what they do not understand they do not trust. So they keep their money at home, or use the informal financial services with which they are familiar.

> *Most financial literacy surveys conducted worldwide, including in G20 countries, show that a majority of the population do not have sufficient knowledge to understand even basic financial products and the risks associated with the products. Most individuals do not plan for the future and fail to make effective decisions to manage their finances. As the global crisis has shown, this can have a negative impact on financial and economic stability as well as on individuals' or households' wellbeing, especially among low-income groups.*[48]

Initiatives aimed at promoting financial literacy, capability and education have gathered pace in recent years. Previously the key focus had been on enabling consumers to access new products, services and technologies. More recently, the focus has shifted towards equipping consumers with the information, skills and confidence they need to protect themselves against unscrupulous practice.

6.2. Understanding financial literacy, capability and education

To a large extent, the terms financial literacy, financial capability and financial education, are used interchangeably. It is difficult, therefore, to identify a single working definition of each of the terms. In addition, the importance of tailoring these kinds of initiatives to address the challenges of particular economies, markets and consumer groups in any case reduces the utility of a universal definition.

Financial awareness *– a knowledge of consumers' rights and responsibilities in relation to financial products and services.*

[48] *OECD, Message from Russia's G20 Presidency in Advancing National Strategies for Financial Education: a joint publication by Russia's G20 Presidency and the OECD (2013).*

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***Financial literacy -** is the ability to understand how money works in the world: more specifically, it refers to the set of skills and knowledge that allows an individual to make informed and effective decisions with all of their financial resources.*

***Financial capability** - is the combination of attitude, knowledge, skills, and self-efficacy needed to make and exercise money management decisions that best fit the circumstances of one's life, within an enabling environment that includes, but is not limited to, access to appropriate financial services*

***Financial education -** the process by which financial consumers/investors improve their understanding of financial products and concepts and, through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being.*

Measuring financial capability is recognized as an important part of financial education policy. It provides both a baseline for elaborating national strategies on financial education and a tool for monitoring its effectiveness. Thus, the Organisation for Economic Co-operation and Development (OECD) and the World Bank, major international players in financial education policies, have elaborated methodologies for measuring financial capability that many countries use. One of the main objectives of these methodologies was to create a unified approach that would help to collect globally comparable data on financial capability in different countries. The Central Bank of Armenia, in cooperation with AFI, elaborated a new financial capability measurement tool, the Financial Capability Barometer (FCB), in 2013 and 2014. The objective of the FCB is to set effective policy priorities, strategies and benchmarks for the development

of financial education programs, and to monitor the implementation of a national strategy for financial education and ensure public accountability[49].

The definitions of **financial capability** currently used by countries and international organizations do not have any major conceptual differences. For the FCB, the definition of a 'financially capable person', is used as described in Armenia's national strategy for financial education:

> *A financially capable person is a person who has the knowledge, abilities, skills and culture, which give them the opportunity to be informed, make responsible decisions about their personal finances, and take the right actions according to the situation. In terms of measurement, the level of financial capability corresponds with the knowledge, skills, attitude and behavior an individual demonstrates when making decisions about their personal finances.*

The FCB[50] adopts the World Bank's approach, which is based on four main financial capability components:

- **Knowledge** is the stock of information on any issue, topic or subject an individual obtains and retains. Knowledge, the first and most important component of financial capability, is formed through three sources: education and training, experience or information flows from various resources (e.g. relatives and friends, mass media, etc.). All these sources represent channels through which information is acquired and transferred. Some of this information will be understood and retained by the individual, while the rest is lost. Whatever is retained replenishes their stock of knowledge. Knowledge assessment within the framework of the FCB aims to identify the lack or absence of financial knowledge among different population groups based on which financial education implementers are able to develop more targeted initiatives. The content selected for the assessment of financial knowledge depends on the level of financial system development in the particular country. Countries with a developed

[49] *Financial Capability Barometer - A New Methodology for Measuring The Financial Capability Of A Country's Population, March 2017*
[50] *Alliance for Financial Inclusion, Financial Capability Barometer A New Methodology For Measuring The Financial Capability Of A Country's Population (2017).*

financial system have objectively more knowledge and information, and, depending on the number of financial services provided in the respective financial market, survey questions may cover a significantly larger range of topics than in countries with underdeveloped financial systems.

- **Skill** is defined as a person's ability to use their financial knowledge. For example, if a person knows how to calculate a compound percentage, this is knowledge, but if they are able to apply the compound percentage calculation while using a financial service, this is a skill. Knowledge and skill are usually not enough for people to manage their financial affairs appropriately. They must be prepared to take whatever steps are necessary to apply their knowledge and exercise their skills. Over the course of their lives, different circumstances lead people to develop certain perceptions and beliefs that affect their decisions when managing their personal finances.
- **Attitude** is defined as the willingness and readiness of a person to invest the time and other resources required to apply their knowledge and exercise their skills.
- The last component of financial capability is **Behavior**, which is defined as the actual application of knowledge, skills and attitude in everyday life.

Many countries have introduced financial education regimes into schools, as a way of systematically developing knowledge and skills among young people. It is also critical, however, that financial education programmes are targeted specifically towards particular consumer groups and delivered via effective channels to reach these groups.

Fiji – Financial Education Program (FinEd)[51]

The Finacial Education Program (FinEd) in Fiji is seen as a role model of best practice in the Pacific region. The FinEd programme began in 2011, with the aim of integrating learning about personal money management and investment into the curriculum for Fiji's primary and secondary schools. Implementation of the program rolled out in 2013 where every Fijian child engaged with the underlying premise *"Save, Spend Wisely and Share"* continuously in their compulsory subjects throughout their primary and

[51] *http://www.nfitfiji.com/financial-education/financial-education-for-schools/*

secondary school years. The Fijian Ministry of Education and Reserve Bank of Fiji rolled out financial education in the national school curricula, impacting almost 200,000 students annually nation-wide, 48% of whom are female. The expected outcome is a generation of young women and men leaving school, with the requisite financial knowledge, skills and confidence to be able to make responsible financial decisions which are appropriate to their circumstances, making a living in the modern money economy and contributing to community and national growth.
Modules developed for Fiji can be found on the RBF Website.

Financial Education in El Salvador[52]

In El Salvador, the public and private sectors have been working to implement a variety of financial education initiatives. Since 2008, the Financial Education Program (FEP) coordinated by the Central Reserve Bank of El Salvador, has aimed to strengthen the population's understanding of financial services so they can develop in their families the skills and confidence to make informed financial decisions.

Based on the results of a recent survey, the Financial Education Program is reorienting their attention to four areas:

- Financial education in schools using a preventive approach;
- Financial education of adults using a corrective approach;
- Training of trainers; and
- Measuring financial capacity.

6.3. Why are they important in CEMC regimes?

Financial education, literacy and capability are a vital piece of the CEMC jigsaw. Legislative and regulatory regimes can be used to build the consumer protection apparatus required for consumer empowerment. Equipping consumers with the information, skills

[52] *https://www.afi-global.org/blog/2016/10/status-financial-education-el-salvador-using-evidence-build-financial-capacity*

and knowledge they need to operate with confidence within that framework ensures that CEMC policies deliver real benefits and meaningful outcomes for customers of FSPs.

For consumers to be fully empowered they need to:

- Be aware of their rights and responsibilities in the context of financial services;
- Have a basic understanding of financial product and what they offer; and
- Be able to apply this information to their own needs and circumstances in order to make decisions and choices about financial products.

Hence, financial literacy, capability and education initiatives are critical to the achievement of financial inclusion within a CEMC regime.

> *In this context, financial inclusion is not simply about the existence of a supply side with competitive financial products and services. Instead, it aims to* ***provide the knowledge and skills necessary*** *to make effective, sustainable, and protected use of these products and services, so they can reach all segments of the population.*[53]

Some groups of consumers, in particular, need additional help to negotiate with FSPs. These groups include new entrants to the market, such as young people; women, who still experience deeply entrenched financial exclusion in many developing economies; people with mental health problems; migrant workers and people who are accessing services in a different language. A survey of financial literacy levels among students in 14 OECD countries showed that around one in seven are unable to make simple decisions about everyday spending and only one in ten were able to solve complex financial tasks.[54]

There is also an important personal and circumstantial element to financial literacy and capability needs. Consumers making financial decisions in response to key life events, unexpected changes in circumstances and, especially, in stressful situations such as following a bereavement or having fallen into financial difficulty, are especially vulnerable to making poor choices and, potentially, being exploited by unscrupulous FSPs.

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[53] *Regional Meeting Chile 2014. Financial Inclusion and Education Experiences in Latin America and The Caribbean: Lessons and Challenges Ahead (2015).*
[54] *OECD, PISA 2012 Results: Students and money Financial Literacy Skills for the 21st Century Volume VI (2014)*

A survey of AFI members conducted by CEMCWG identified low levels of financial education and literacy to be the biggest barriers to improving consumer protection and market conduct regulation and practices.[55] As a result, a number of countries have implemented strategies to improve financial capability among consumers, via financial education initiatives, often alongside efforts to increase financial inclusion and strengthen consumer protection.

> *We believe financial education supported by effective consumer protection, while not being a panacea, can lessen the magnitude of future crises by enabling individuals to effectively use financial products and services and to make sound choices to protect themselves and fruitfully participate in financial and economic activities. Such measures can also help in promoting economic recovery and growth, supporting small and medium enterprises, boosting the creation of new jobs as well as decreasing poverty.*[56]

Research by the Russian G20 Presidency and the OECD identified 45 countries at different income levels that had reached an advanced stage in the design or implementation of a national strategy for financial education and a growing group of countries that were considering developing one.

6.4. Who should develop and promote financial literacy, capability and education initiatives?

The Alliance for Financial Inclusion has noted that public bodies and government agencies, such as central banks, regulators and consumer organizations, have a crucial role in developing and implementing financial education programmes that provide consumers with the financial literacy and financial capability they need to take full advantage of the financial services market.[57]

[55] *AFI Consumer Empowerment and Market Conduct Working Group (CEMCWG), Consumer Empowerment and Market Conduct National Financial Education Strategies Guideline Note No 8 (2013).*
[56] *OECD, Message from Russia's G20 Presidency in Advancing National Strategies for Financial Education: a joint publication by Russia's G20 Presidency and the OECD (2013).*
[57] *AFI Consumer Empowerment and Market Conduct Working Group (CEMCWG), Consumer Empowerment and Market Conduct National Financial Education Strategies Guideline Note No 8 (2013).*

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Malawi's Financial Literacy Efforts[58]

The Reserve Bank of Malawi (RBM), has been increasingly proactive in the implementation of various initiatives to combat the financial literacy issues that plague the nation. One of those recent efforts includes the conduction of a National Financial Literacy Week, in collaboration with the Ministry of Finance and other key stakeholders. The aim was to promote personal finance management through a focus on budgeting, savings and investing culture among specific target groups, generating a general knowledge of services and products offered by a wide range of financial institutions, promoting awareness of the financial consumer's rights and responsibilities, and creating conscience of existing complaints and dispute resolution mechanisms and procedures for consumers of financial services.

The launch of the National Financial Literacy Week was marked by several activities that included a school quiz competition, school drama, songs, poems, and a showcase of live trading by the Malawi Stock Exchange.

The events proceedings marked a coordinated push to remedy findings of a survey commissioned in 2008 by the government to assess the demand-side of financial services and products in Malawi. That study, which was carried out by FinMark Trust, revealed a general lack of awareness among citizens of financial products and services, in particular personal and household finance management practices. The survey also found that fewer Malawians had access and were using available financial services and products. While 45 percent had access to financial services, approximately 19 percent of the adult population had access to banking products while only three percent of adults accessed insurance services. The assessment established the limited access and usage of financial services due primarily to the issue of an overall lack of awareness. This lack of awareness focused on limited knowledge and skills to access and use services and products offered by the wide range of financial services providers. Furthermore, consumers lack confidence and understanding of their rights and responsibilities when dealing with financial

[58] *https://www.afi-global.org/blog/2014/04/rbm-takes-action-fight-financial-literacy-problems-malawi*

services providers. This point highlighted the need for a comprehensive and robust financial awareness program in the country.

The independence of financial services regulators affords them a unique and impartial perspective on the role of financial education within the financial inclusion and consumer empowerment agendas. As such, they have significant credibility as leaders of national strategies for financial education and to ensure that they complement other CEMC policies and fulfill their potential. Their independence and impartiality also puts them in a strong position to bring together other interested stakeholders, especially private and civil agencies, and engender support for financial education programmes without creating a conflict of interest.

Strong leadership of national financial inclusion strategies is critical to ensure effective co-ordination, delivery, evaluation and ongoing improvement. This clarity over roles and responsibilities also helps to make best use of resources and avoid duplication of efforts. Leadership of a national financial education strategy needs to offer[59]:

- Focus;
- Momentum;
- Effective co-ordination to ensure is implemented and reviewed and modified as necessary;
- Credibility and influence with important stakeholders and potential partners;
- Ability to devote resources to leadership and co-ordination; and
- Ideally, should be independent with no products or services of its own to sell.

6.5. Key elements of a successful financial education strategy

While there is no 'one size fits all' approach to financial education that will meet the needs of all consumers, across all financial sectors, in all economies, significant recent scrutiny of this issue by organizations including the World Bank, the OECD, AFI and the G20

[59] *AFI Consumer Empowerment and Market Conduct Working Group (CEMCWG), Consumer Empowerment and Market Conduct National Financial Education Strategies* Guideline Note No. 8 (2013).

Countries, has identified some broad principles of good practice that favor effective financial education strategies:

- Involving, engaging and coordinating with stakeholders, including FSPs, industry associations, regulators, consumer organizations, the mass media and other potential partners.
- Including both population-wide and targeted programmes.
- Ensuring a clear separation between financial education and marketing of financial products and services.
- Ensuring effective outreach activities to reach consumers who are most in need of support.
- Ensure the programmes reflect consumer needs and priorities and are available via multiple channels.
- Regularly assessing the quality of financial education to ensure it is meeting consumer needs.
- Measuring the impact of financial education programmes.

Nigeria – women's financial inclusion

Nigeria's commitment to AFI's Maya Declaration was to finalise a national strategy for financial inclusion, and reduce the percentage of financially excluded from 46.3% in 2010 to 20% by 2020. Nigeria's National Financial Inclusion Strategy was adopted in 2012. While the strategy did not include specific financial inclusion for women, its policy recommendations were of particular importance to women, and a working group was set up to focus on financial inclusion issues for women, youth and people with disabilities. Under the strategy, the Micro, Small and Medium-sized Enterprise (MSME) Development Fund, established in 2014, has an explicit target to issue at least 60% of its loans to women. Data collected in Nigeria is disaggregated by gender and is obtained from financial services industry players using a template to ensure consistency. Nigeria has also demonstrated substantial

progress in reforming legal and regulatory frameworks in support of women's financial inclusion.[60]

- *For consumers to be fully empowered they need to be aware of their rights and responsibilities in the context of financial services; have a basic understanding of financial products and what they offer; and be able to apply this information to their own needs and circumstances in order to make decisions and choices about financial products.*
- *Financial literacy is focusing primarily on knowledge and skills acquisition, essential pre-requisites to financial capability. Financial capability, however, is not just what you know, but whether you have the willingness, confidence, and opportunity to act.*
- *Financial literacy, capability and education initiatives are critical to the achievement of financial inclusion within a CEMC regime.*
- *Public bodies and government agencies, such as central banks, regulators and consumer organizations have a crucial role in developing and implementing financial education programmes.*
- *Strong leadership of national financial inclusion strategies is critical to ensure effective co-ordination, delivery, evaluation and ongoing improvement.*

There is no 'one size fits all' approach to financial education strategies, however some broad principles of good practice include the following elements: engaging stakeholders; implementing population-wide and targeted programmes; ensuring a clear separation between financial education and marketing of financial products and services; reaching out to consumers who are most in need of support; ensuring

[60] *Alliance for Financial Inclusion and Women's World Banking,* *Nigeria confronts a challenging financial inclusion gender gap A case study of policy change to support women's financial inclusion (2016).*

programmes reflect consumer needs and priorities and are available via multiple channels; regularly assessing the quality of financial education and measuring its impact.

OECD, Improving Financial Literacy: Analysis of Issues and Policies (2005).

OECD, Advancing national strategies for financial education (2013).

OECD, Measuring Financial Literacy: Questionnaire and Guidance Notes for Conducting an Internationally Comparable Survey of Financial Literacy (2011).

Chapter 6: Exercise 1

Re-read the Initial Scenario at the beginning of this Section and answer some of the questions raised there:

1. *To make the case for a national financial education strategy, who will you need to convince?*
2. *What can the strategy achieve and how can it support a CEMC agenda?*
3. *Who should lead and implement the strategy?*
4. *Which key stakeholders will need to be involved and how will you gain their interest in and commitment to the strategy?*
5. *How can you prove that the strategy is delivering against its goals and making a positive contribution to levels of consumer empowerment?*

Solutions: Please refer to the last chapter.

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7. Exercise solutions

Chapter 1: Exercise 1

Complete the following sentences:

1. Consumer empowerment places responsibility on _________ and _____________ to make use of financial services easier, safer and of greater benefit to consumers.

2. ______________ are used by regulators to shape, enhance and balance three factors, i.e., the institutional framework, as well as supply-side and demand-side factors, to create a more sustainable, fair and sound financial ecosystem for consumers.

3. Consumer empowerment and market conduct (CEMC) policies are considered to be important in at least two areas: for financial services markets and for ___________.

4. Regulators who are aiming to promote _______________ must also ensure that the environment exists for consumers to make sound and confident choices about financial products and that they have effective avenues of help and redress should things go wrong.

5. Rather than just following established rules, there is a greater expectation that _______________will use their judgment to determine what constitutes good market conduct.

6. ____________ groups are least likely to be able to exercise their consumer rights. Therefore, CEMC policies and initiatives need to address all of the dimensions of consumer empowerment.

Solution:

1. Consumer empowerment places responsibility on regulators and financial services providers to make use of financial services easier, safer and of greater benefit to consumers.

2. Market conduct policies are used by regulators to shape, enhance and balance three factors, i.e., the institutional framework, as well as supply-side and demand-side factors, to create a more sustainable, fair and sound financial ecosystem for consumers.

3. Consumer empowerment and market conduct (CEMC) policies are considered to be important in at least two areas: for financial services markets and for financial inclusion.

4. Regulators who are aiming to promote consumer empowerment must also ensure that the environment exists for consumers to make sound and confident choices about financial products and that they have effective avenues of help and redress should things go wrong.

5. Rather than just following established rules, there is a greater expectation that financial services providers will use their judgment to determine what constitutes good market conduct.

6. Vulnerable groups are least likely to be able to exercise their consumer rights. Therefore, CEMC policies and initiatives need to address all of the dimensions of consumer empowerment.

Chapter 2: Exercise 1

1. *What are the two key outcomes that an institutional framework for the implementation of a CEMC policy requires?*
2. *How can regulatory authorities enhance market conduct?*
3. *What kind of market conduct enhancement approach does the 'Financial Services Consumer Panel' (FSCP) in the UK pursue?*
4. *Give two examples how regulatory authorities can enforce compliance with principles and rules set down in a CEMC policy?*

Solution:

1. Responsible behaviour and sound business practices among FSPs (enhancing market conduct), and broad access to affordable, high quality financial services for all segments of society (empowering consumers).

2. They can set standards of conduct; regulate products, firms and people; implement market oversight; take remedial and enforcement action.

3. Market oversight.

4. Withdrawing a firm's authorization, issuing fines.

Chapter 3: Exercise 1

1. *Why should regulators get involved in addressing the information imbalance between FSPs and their customers?*
2. *List the four implementation factors that need to be considered when designing an empowering transparency and disclosure regime.*

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3. In the following example, which of the five disclosure criteria have been considered by the bank? - A bank has developed a new loan product for small enterprises. Based on market research and interviews with members of the target group the bank has produced a product flyer in all three of the local languages. The flyer explains the loan conditions in plain words and gives examples of interest payments for different loan amounts. The interest rate is quoted as effective annual interest rate so that clients can compare the costs to other bank loan products. Moreover, loan officers have been trained to explain the product to customers verbally. The bank also ensures that borrowers understand the loan contract and that they get updated information about the status of their loan during the repayment period. All information is available on paper and electronically.

Solution:

1. Information imbalances between FSPs and their customers can only partly be solved by healthy competition between FSPs. Limitations on the scope for the market to meet customers' information needs leaves a gap to be filled by consumer protection policies.

2. Understanding customer needs; consultation and engagement with stakeholders; supervision, monitoring and enforcement; and financial capability.

3. Comprehensive, Accessible, Relevant, Consistent and Empowering.

Chapter 4: Exercise 1

With reference to the Initial Scenario of this Section, what should, in your opinion, be the 5 most important responsible lending features for a consumer loan product aimed at poor households in a developing country?

Solution:

Below is a list of 12 key features which are considered to be very important for a consumer loan product aimed at poor households in a developing country. Compare your own list to the list below and check if they match. Important aspects that you should have covered in your list are: simple product design; responsible sales practices; credit affordability check; fair treatment of delinquent borrowers; and respect for vulnerable clients.

- *Lenders' business practices should incentivize customer service not sales.*

- *Customers should have access to effective complaints mechanisms and avenues for dispute resolution and redress.*
- *Customers should not be subject to aggressive or predatory sales practices or targeted with products that are unsuitable for them.*
- *Product design and account management should facilitate responsible lending.*
- *Products should be simple and easy to understand without opaque features or terms and conditions that make it difficult for the customer to fully comprehend what they are signing up to.*
- *Depending on the product, lenders should assess factors such as the customer's financial capability, needs and circumstances before lending to them.*
- *Consumers should only be offered credit which is affordable and which is suitable for their needs. Affordability checks should take account of the borrowers income, total outstanding borrowing, current and future expenses, living requirements and relevant personal circumstances, such as number and circumstances of dependents.*
- *The suitability of the product should be based on an assessment of the borrower's ability to repay the loan at the current rates and should interest rates increase during the lifetime of the contract. It should be possible for borrowers to be able to repay credit without incurring significant financial difficulty or experiencing significant adverse circumstances.*
- *Borrowers who fall into financial difficulty should receive fair treatment and appropriate support to help them deal with their debts in the most suitable way for them.*
- *Borrowers in financial difficulty should not be subject to harassment or undue pressure to make repayments.*
- *Product design and sales processes should take into account the needs of vulnerable consumers and their ability to make an informed decision about the product.*
- *Lenders should ensure that staff and agents are trained to identify and respond appropriately to vulnerable consumers.*

Chapter 5: Exercise 1

1. *What are the key elements of an alternative dispute resolution framework needed to support a CEMC regime?*

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2. *List the different forms of external dispute resolution with a brief explanation of their roles and functions.*
3. *What are the different types of support for over-indebted consumers?*

Solution:

1. Internal, firm-based dispute resolution; external dispute resolution; depositor protection; and support for over-indebted consumers.

2. Financial Ombudsman Schemes: official appointed to investigate individuals' complaints against a company; free complaints handling service to consumers; decisions are binding on FSPs. - Industry Complaints Schemes: self-regulatory trade associations; free complaints handling service to consumers; these associations can have a high degree of influence because they are membership organizations and can remove membership from FSPs that do not comply with their codes of practice.

3. Debt advice (help people to make decisions about their debts), debt counselling (giving people financial help and advice about managing debt); debt management plan (formal agreement between a debtor and a creditor that addresses the terms of an outstanding debt).

Chapter 6: Exercise 1

Re-read the Initial Scenario at the beginning of this Section and answer some of the questions raised there:

1. To make the case for a national financial education strategy, who will you need to convince?

2. What can the strategy achieve and how can it support a CEMC agenda?

3. Who should lead and implement the strategy?

4. Which key stakeholders will need to be involved and how will you gain their interest in and commitment to the strategy?

5. How can you prove that the strategy is delivering against its goals and making a positive contribution to levels of consumer empowerment?

Solution

1. The launch of a national financial education strategy is primarily a task of the government, in particular of the Central Bank and other financial sector regulators; maybe also public bodies responsible for education. Other stakeholders that may have to be convinced to participate are consumer organizations, FSPs, industry associations and the mass media.

2. The national financial education strategy is crucial for consumer empowerment. Financial literacy, capability and education initiatives are part of the strategy and contribute substantially to the achievement of financial inclusion.

3. Public bodies and government agencies are most suited to lead and implement the strategy because they have the necessary mandate and resources. Moreover, people trust them because they are neutral and interested in public welfare.

4. Key stakeholders to be involved, apart from public bodies, government agencies and regulators, are: FSPs, industry associations, consumer organizations, and the mass media. To gain the interest and commitment of FSPs and industry associations it is probably best to apply a "carrot and stick" approach, i.e. a combination of regulatory obligations (e.g., a financial literacy levy) and incentives (e.g., good reputation). With regard to consumer organizations and the mass media, it should not be difficult to gain their interest and commitment as long as the planning and implementation process is inclusive, participatory and transparent.

5. There must be neutral and transparent monitoring and evaluation, i.e. regular assessments of the quality of financial education measures and impact research.

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