*Financial Consumer Protection**

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Madam Anne Le Lorier, First Deputy Governor, Banque de France, Senior executives from the Banque de France, Shri G. Padmanabhan and Smt. Deepali Pant Joshi, Executive Directors and my other colleagues from the Reserve Bank of India, Principal and the staff at College of Agricultural Banking, Pune, participants to the seminar, ladies and gentlemen! At the outset, I extend a warm and hearty welcome to all of you, and especially to our guests from France, I say '*bienvenue*'. I am pleased to be here this morning to flag off a journey of joint-learning, discovery and exploration by RBI and BdF on a subject that has engaged the time and attention of governments, regulators, policy-makers, academics, NGOs, consumers, etc. for the past three years and more and which quite aptly is also the theme of this Seminar – 'Consumer Protection'. We are privileged to have the First Deputy Governor, Madam Anne Le Lorier here and are sure that the seminar deliberations would be enriched by her presence. The seminar has been structured to cover various dimensions of consumer protection with separate sessions on building consumer awareness, customer rights and duties, emerging regulatory approach for consumer protection (Twin Peaks), legal aspects of consumer protection, etc. In view of the growing use of IT in the financial sector, the seminar would also devote time to deliberate on consumer protection issues in retail and electronic payment systems and the impact of information technology on consumer protection. We also have sessions devoted to the co-operative sector and to linkages between financial inclusion/literacy and consumer protection. Keeping in mind the exhaustive seminar schedule, I feel that my role here today is to set the tone for the Seminar and this; I intend to do by presenting a few random thoughts on various dimensions of consumer protection.

Introduction

2. It is, indeed, deplorable that in spite of access to financial services being universally recognised as an important ingredient to the growth and prosperity of people and nations, over half the adult population in the world remains 'unbanked'. In the wake of the Financial Crisis and widespread discontent among the poor and the vulnerable sections of the society, access to financial services, their governance and their development have emerged as the prime objective for policy makers in rich and poor countries alike. We must appreciate, however, that the dimensions of consumer protection in the rich and poor countries are very different. While the focus in developed countries is more on protection of consumers' rights, in the developing world, provision of access to financial services to the consumers is the immediate priority. Consumers are not some endangered species in need of protection and the issue of consumer protection is not limited to specific acts of consumption. The consumer as depositor, saver and borrower is not just another link in the chain, but the central actor in the financial marketplace and as such, he is most impacted by the ill-effects of macro and micro-economic problems that have gripped the financial sector.

3. Let me raise a fundamental issue here. The financial services sector is essentially driven by commercial intent and the actions of service providers

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and the issue of consumer protection should be taken care of by competitive market forces. Why are we then discussing the issue of financial consumer protection? It is because the barriers to entry for the service providers in the financial sector, especially banking, are quite stiff. In view of regulatory restrictions on number of market players, consumers are forced to receive services from a limited set of service providers. Furthermore, in view of rampant information illiteracy, the self regulating market behaviour does not work especially for the poor and vulnerable and hence, ensuring consumer protection becomes a regulatory obligation.

4. In addressing the issue of financial consumer protection, the important thing is to be able to identify the section of consumers who are most vulnerable. Who are these consumers and what is consumer vulnerability? The Consumer Affairs Victoria, a Government agency in the state of Victoria, Australia has explained consumer vulnerability as the 'exposure to the risk of detriment in consumption due to the interaction of market, product and supply characteristics and personal attributes and circumstances'.

5. While this definition highlights a number of vulnerability elements that a consumer is confronted with, I feel that Information Vulnerability is the key challenge faced by consumers. The other vulnerability elements are more of an outcome of the information asymmetry that exists between the providers of financial services and the consumers. This information asymmetry gives rise to opportunities for consumer exploitation and hence, creates a need for protecting consumers. Let me emphasise that the problem of information vulnerability has multiple dimensions. The most common manifestation is the lack of access to information, which results in sub-optimal decision making. Information vulnerability can also arise due to limited ability of consumers to analyse the information available to them. This problem is greatly accentuated in case of the uneducated and excluded sections of the population, who neither possess the tools nor the skills to effectively utilise the available information. Another dimension is the problem of information overload, wherein the consumer is unable to distinguish the 'message' from the 'noise', thereby prompting him/her to ignore the entire information and end up in a state of what I call, 'analysis-paralysis'.

Addressing causes of Consumer Vulnerability

6. The possible solution to insulate consumers from vulnerabilities is by ensuring that the financial service providers treat their customers fairly. The financial institutions must understand what fair and equitable treatment of customers means and then align their business practices to achieve the desired outcomes. The fair treatment to customers is seen as being synonymous to consumer satisfaction and following a consumer-centric approach. Simply put, fair treatment of customers involves ensuring that the products and services offered by financial institutions are suitable for the customers and appropriate to their risk profile, pricing is transparent and non-discriminatory and that the service is delivered in a speedy, safe and secure environment. For instance, while banks are justified in levying reasonable charges for services provided, are they justified in levying charges without providing any specific service (*e.g.*, customers not conducting any transaction in the account)? An attendant aspect of consumer protection in the financial services industry is the provision of efficient grievance redressal machinery which should be 'quick' and 'just'. I will return to this aspect a little later.

7. A documented Treating Customers Fairly (TCF) policy seeks to regulate the design and marketing of financial products and services, the system of information dissemination, facility for after-sales support and the grievance redressal procedure. Effectiveness of the TCF framework in organisations would depend upon the extent to which it is integrated into the organisation's DNA. At the individual level, effective implementation of TCF requires that the TCF goals are embedded into the employee performance measurement and rewards systems.

8. Ensuring fair treatment to consumers would also mean that behavioural and cultural changes would have to be brought about in organisations. This cannot be achieved merely by ring-fencing consumer protection within the compliance function. Instead, the entire institution – right from the Board to the frontline managers – have to be responsive to this objective.

Need for a Credible and Effective Regulatory Regime

9. The presence of a credible and effective regulatory regime acts as a source of confidence and comfort in the financial system. This helps in attracting more participants to the market place, thereby making the financial system inclusive and efficient. The experience from the global financial crisis is that self-regulation, often, does not work. The presence of a strong, intrusive and hands-on regulator/supervisor gives the confidence that markets will operate as per sound principles and would be free from unfair and unethical practices. This trust forms the basis of functioning of the entire financial system and any dent in this trust can have a significant destabilising influence. The series of measures initiated by global standard setting bodies and individual regulators in the aftermath of the financial crisis clearly underscore the imperative of having a credible and effective regulatory regime. Consequently, the effort is on to leverage these regulatory initiatives to rebuild trust and confidence in the global financial system. It is now globally accepted that in order to earn the trust of the consumers/market participants, it is important that the regulatory system is seen and perceived to be fair and transparent.

Twin Peaks Approach to financial sector regulation and supervision

10. The pre-crisis financial sector regulatory and supervisory architecture across various jurisdictions placed overarching emphasis on the financial strength and soundness of banks. Commentators generally presumed that there were strong synergies between prudential regulation and consumer protection and, therefore, an integrated supervisor could take care of both objectives. However, the crisis highlighted that the integrated supervisors are more likely to give precedence to safety and soundness mandates, as these are closely intertwined with financial stability, rather than focusing on consumer protection issues. The Twin Peaks Approach helps in resolving this conflict. The Market Conduct Regulator is focused on ensuring that the institutions design the products and services in line with the customers' needs, maintain integrity of the markets and conduct their businesses keeping the primacy of the customers' interests in the forefront.

Product design, financial innovation and consumer protection

11. One of the reasons for the perpetuation of the global financial crisis was that financial innovation resulted in creation of products that were not suited to consumer requirements. Also, these products had risk profiles that were not fully understood by consumers or financial market participants. The crisis

was an instance of financial innovation growing beyond consumer expectations and hence, contributing to financial system vulnerability. Let me emphasise that the basis of all product design and financial innovation should be consumer need. Products and processes should be created only to meet specific expectations of consumers. The ability to orient the products and services to consumer expectations would determine the success and sustainability of organisations and markets.

12. As I mentioned earlier, very often financial engineering creates complex products out of inherently simple products. This is very common in the world of structured financial derivatives, where the payoff profile and risks inherent in the structure are significantly different from those of its underlying constituents. When such product design is combined with aggressive sales practices led by perverse compensation systems, it leads to mis-selling to gullible consumers. The end result is a slew of consumer disputes, resulting in loss of reputation for the financial service providers.

13. The Sergeant Review of Simple Financial Products in the UK has identified four attributes for financial products to be classified as 'simple' *viz.*,

- The products should help consumers benchmark and compare with other products in the market.
- The product must be understandable and accessible to the mass market.
- The product must not be tailored to meet individual needs, but provide consumers with confidence that the product will meet their basic needs and offer them a fair deal; and
- The product will be a viable commercial proposition for the provider.

14. Financial sector regulators/supervisors and consumer protection bodies need to keep a close watch on product design and financial innovation in order to ensure that these are oriented towards consumer needs and expectations. Market intelligence mechanism should also focus on identifying products which could, potentially, expose consumers to unintended outcomes. Individual financial service providers should also have internal frameworks for vetting new product offerings so as to ensure that they are in alignment with regulatory requirements and consumer expectations. In fact, an assessment of the financial products and services for their reasonableness and suitability to customers is going to be one of the main planks for the Financial Conduct regulators under the Twin Peaks structure.

How to ensure that the consumer voice is heard

15. Though consumers are the core around which the entire financial services business revolves, the consumers' voice is the feeblest and, very often, not heard. This inability to understand the consumer and his needs is the genesis of all consumer protection issues. There are a number of ways in which the consumer voice in the financial regulatory system could be strengthened, not just in the interests of the consumer, but also in the interests of the sustainability of the financial system.

- We have to encourage a culture of openness towards consumers, their aspirations and expectations. Our products and processes should have the inherent flexibility to adjust to changing consumer needs. Successful consumer-focused organisations inculcate the ability to constantly learn and improve, both at the individual level and at the organisational level. Success in the mission of customer service depends on the flexibility demonstrated by service providers in constantly re-learning and re-orienting their business operations based on evolving market dynamics and customer expectations.

- As I briefly touched upon earlier, having an effective communication strategy is important, including for regulators, to regain the confidence of consumers and the financial system. Importantly, we need to leverage the power of the media, including the newer channels, to get across our message of consumer awareness and protection. The media needs to be seen as an ally in generating consumer awareness and in implementing an effective framework for consumer protection.
- The institutions must have their ears to the ground so as to get a feel and understanding of evolving trends and practices. For commercial institutions, having this ability lends them a competitive edge over others as they can evolve their product offerings in line with changing trends. For regulators, this is a vital input in anticipating build up of risks and taking proactive measures.

The holy trinity – financial inclusion, financial education and consumer protection

16. Post the global crisis, financial sector regulators and policy makers have been focusing on the objective of 'financial stability' to bring back sanity and normalcy to the global financial system. That financial inclusion, financial education and consumer protection, form the three essential pillars on which financial stability rests, has been universally endorsed and accepted. Banking the unbanked, providing access to financial services, educating the consumers and creating a sense of safety in their minds are necessary for the governments and regulators alike, both in India and elsewhere. With nearly 4.5 billion people on this planet owning a mobile phone, there is a very strong likelihood of financial inclusion being pushed through the mobile phone and mobile payments medium. This is likely to be more so in the developing countries where mobile phone penetration is 8 – 10 times the penetration of the basic bank account. The lack of formal financial services infrastructure and widespread financial activity limits market exchanges, increases risks and curtails opportunities to save. Without access to formal financial services, the households are forced to rely on informal sources that are high costs. The protection, safety and security of this important class of customers cannot be wished away. In this context, the regulators and governments can play an important role by providing an efficient infrastructure for mobile payments. This framework might include regulation of low – risk money transfer services, enabling non-bank organisations to facilitate low-risk/low value transactions and wherever possible, implementing regulations at the system level (without interfering with the customer interface). On the part of banks, rather than treating mobile payments as a threat, they need to see it as an opportunity to access otherwise unprofitable low-income segments market. Banks will need strong partners and a strong platform to succeed. In India also, we have been proactively pursuing the three objectives and are even exploring the possibility of enshrining financial inclusion in the Code of Banking Practices (in India referred to as the Code of Commitments).

17. In terms of financial education, while the thrust would continue to be on the basics in terms of products, services, risk profile and suitability, we need to think ahead and look at the scenario where self –

service banking is on the rise. The evolution of ATMs in India is only the beginning of the self-service menu. We are yet to witness the full range of products and services where the customers will be helping themselves (and of course the banks) with gadgets and apps that they may not be very familiar or comfortable with. So, welcome customer education and hand holding!

Retail distribution of financial products

18. The retail distribution of financial products and services was subject to review in Australia and United Kingdom alike and the issues thrown up by these reviews have great lessons for consumer protection. The retail distribution, as is now being carried out, may not necessarily be in the best interest of the consumers. There are certain issues, particularly from the perspective of incentive structures for sale of financial products, monitoring of AML requirements, risks of mis-selling, inadequate understanding of risks by the sales persons, etc. that make it important that financial service providers and regulators to have a close look at the practices followed in retail distribution of financial products.

19. As regards regulating the activities of the financial advisers, it is very important that the people with small means get proper advise at the right time and at least cost. The regulators, perhaps, have to take this responsibility upon themselves with a view to empowering the consumers and helping them protect their life savings.

Regulation and market failure

20. There have been a number of essays, writings and chronicles on the global financial crises of 2008. Nobel Laureate Dr. Joseph Stiglitz also extensively covered these events in various articles which have been compiled and published as a book under the title 'Price of Inequality'. In his essay on 'Regulation and Market Failure', Dr. Stiglitz says and I quote ***'It is clear that our regulatory structure failed. Evidently, there was market failure, but there was also government failure. The primary reason for the government failure was the belief that markets do not fail, that unfettered markets would lead to efficient outcomes, and that government intervention would simply gum up the works. Regulators who did not believe in regulation were appointed, with the inevitable outcome that they did not do a very good job of regulating'***. This has, perhaps, been one of the most significant lessons from the financial crisis and is reflected in the fact that there is a global clamour for tightening regulation and supervision of markets and market practices. The evolving regulatory and supervisory initiatives are expected to have a significant positive impact on protection of consumer interests.

Compensation schemes and redress mechanism

21. The financial services industry must have well articulated and clearly defined compensation schemes that are easy to access, adequate in quantum and effective in implementation. The roles and responsibilities of the consumers and service providers in different situations need to be spelt out up-front. I always believe that to err is human but from an institutions' point of view, to confess is divine. If an institution is in the wrong, why should it wait for the consumer to approach it for compensation? Would it not be righteous if the bank or financial institution on its own initiates actions to undo the wrong inflicted on customers, some of whom may have not even complained? Imagine the impact such an approach would have on the faith and confidence consumers have on the financial system.

22. Another important aspect is the existence of a robust, responsive and reliable grievances redress mechanism in the banking/financial services industry, something I have alluded to earlier. The credibility of the banks' redressal systems needs to be reinforced by constant follow up by the regulator. The very fact that often bank customers find it safer and simpler to get their grievances resolved by routing them through the regulators or the Ombudsman Offices is a reflection on the quality and effectiveness of redress mechanism put in place by banks. We have a long way to go to improve the credibility of the system. People will access the redress mechanism only when they are assured of an impartial outcome. It requires a lot of courage, persistence and knowledge to pursue and follow up grievances with banks/financial institutions. It will be in our own interest to usher in a culture where people are encouraged to complain if anything is amiss. The felt attributes of consumer protection are a result of the customer care policies that banks promise to have in place. But, many a times, the same are not implemented at the ground level mainly due to ignorance and lack of sensitivity on the part of the frontline managers. Skill building and knowledge enhancement of bank staff is necessary, if we wish to have a pro-active consumer protection policy in the banking industry.

Conclusion

23. As a part of my inaugural speech I have tried to set the tone of the Seminar, by touching upon different facets and attributes of consumer protection, drawing from the global as well as the Indian experience. I am tempted to refer here to the comments made by the World Bank – IMF team in its report on the Financial Sector Assessment for India (2012) about consumer protection: ***'India has comprehensive policies and compliance mechanisms for the protection of banking consumers, and is ahead of most countries in this area. Going forward, including non-banking financial companies (NBFCs) in the mandates of the Banking Codes and Standards Body of India and of the Banking Ombudsman System (BOS), ensuring consumer protection of the entire financial system, and devising a strategic consumer awareness program, will further strengthen the system'.*** I accept this feedback with all the humility at my command, and I am fully aware that much more needs to be done to improve the consumers' lot. Even in a free market economy with competition as the necessary pre-condition, it is not necessary that the consumer is treated as the king. But what we must strive to bring about is a culture where the consumer is treated as a good human being by focusing on the values of fairness, transparency, and non-discrimination. Going forward, customer-centricity will be a must for the regulators and the regulated entities alike in the wider interest of financial stability, an essential cornerstone of which is consumer protection.

24. I hope that this joint seminar between the Banque de France and the Reserve Bank of India lays down the foundation of a long and fruitful partnership between the two institutions and that such seminars become a regular event. Considering the impressive list of experts from both institutions who are scheduled to speak over the course of the next two days, especially Madam First Deputy Governor, I am sure that the Seminar will prove to be very useful in sharing of knowledge and experience among the participants. I wish the Seminar all success and hope that our guests from the Banque de France have a pleasant stay in India and do find time to get a feel of the rich cultural cocktail that this country presents.

Ladies and gentlemen thank you for your patience. Merci

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