Safe, fair and competitive markets in financial services: *recommendations for the G20 on the enhancement of consumer protection in financial services*

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Consumers International (CI) is the world federation of consumer groups that, working together with its members, serves as the only independent and authoritative global voice for consumers. With over 220 member organisations in 115 countries, we are building a powerful international movement to help protect and empower consumers everywhere. Founded in 1960, we are fighting for a fair, safe and sustainable future for all consumers in a global marketplace.

Consumers International is a not-for-profit company limited by guarantee in the UK (company number 4337865) and a registered charity (number 1122155).

A full list of CI members can be found at www.consumersinternational.org/our-members. CI's membership includes consumer organisations in every G20 country and region.

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Executive Summary

In November 2010, G20 leaders meeting in South Korea made the following commitment in the Seoul Action Plan[1]:

> *Enhancing consumer protection:* "We asked the Financial Stability Board to work in collaboration with the OECD and other international organisations to explore, and report back by the next summit, on options to advance consumer finance protection through informed choice that includes disclosure, transparency and education; protection from fraud, abuse and errors; and recourse and advocacy*."*

According to the World Bank/CGAP, there are as many bank deposit accounts in the world as there are adults[2]. And yet, over half the adults in the world are 'unbanked'[3]. So, financial services, their governance and their development, are a key pre-occupation, for people in rich and poor countries alike; facilitating purchases, savings and investments and insuring against risk. Yet characteristics such as the complexity and high risks associated with many of the products, the rapid pace of innovation in the market and the long term nature of many transactions means that consumers need protection in order to avoid the considerable risks that these services pose.

However, it is important that consumer protection is not limited to specific acts of consumption. The consumer is not just another link in the chain, but an essential actor in the market, and as such, is at the heart of the problems that have hit the financial services (FS) sector.

The financial crisis dramatically illustrated that weak consumer protection poses a significant risk to the wider economy. In the words of Sheila Bair, the Chair of the US Federal Deposit Insurance Corporation, *"There can no longer be any doubt about the link between protecting consumers from abusive products and practices, and the safety and soundness of the financial system"*[4]*.*

At the level of the individual consumer the World Bank estimates that 150 million new consumers join the market for financial services every year, many in countries with low levels of consumer protection[5]. Moreover, weak financial consumer protection is a problem shared by consumers in countries with well-established financial services as well as consumers in countries where the sector is relatively new. One explanation may be an over reliance on consumer education, which is a necessary but wholly insufficient response to the problem. CI members in all regions report high numbers of complaints relating to almost every aspect of the service.

Consumers International is calling on the G20 to:

- Adopt the recommendations outlined in this report and commit to a regular review of their implementation
- Support the development of international standards and guidelines based on these recommendations
- Support the development of a new international organisation to share best practice and highlight bad practices that may pose a risk to other countries, and, where necessary, to support the development of standards and guidelines.

The following is a summary of CI's recommendations to the G20 on consumer protection in financial services:

1. Information design and disclosure

Consumers should receive clear, sufficient, reliable, comparable and timely information about financial service products. Failure to meet these criteria should cause a contract to be voidable. Contracts must include clear up front pricing so that consumers can appreciate the cost of the product before becoming obligated to pay. Financial service providers should be responsible for testing the quality and comprehensibility of the information provided, with additional audits conducted by national regulators.

Standard formats (such as Key Information Documents) should be used for the presentation of information about financial service products so that consumers can easily compare products.

2. Contracts, charges and practices

Many financial service products are now so complex that consumers, regulators and even the financial service providers themselves cannot understand them. This complexity needs to be managed and if necessary overly complex products should be kept off the market. Regulators should introduce a requirement of comprehensibility and prohibit products that are not comprehensible, they should require the availability of simple standard financial service products and key financial service products should be required to meet minimum standards of consumer protection.

Conflict of interest in the provision of advice and sale of financial services needs to be addressed. Financial advice to consumers should be separated from sales-based remuneration. Additionally, there should be protection against inappropriate marketing methods.

The following practices should be cause for a contract to be voidable:

- failure to gain the informed consent of the consumer
- unfair or unreasonable fees and costs charged to consumers and included in consumer contracts for financial services products
- clauses in financial service contracts that result in consumers waiving core consumer protections, and
- the sale of financial services that are unsuitable for the consumer.

3. The structure and functions of national financial consumer protection bodies

Under the UN guidelines for consumer protection, all governments have a responsibility to protect and promote consumer rights[6]. Governments should each establish a national body that has consumer protection as an explicit regulatory objective with full authority to investigate, halt and remedy violations of consumer protection law, including where necessary the right to define specific practices or products as unfair, deceptive or otherwise illegal.

The body should have effective regulatory power over every financial institution, product and provider and, in response to a serious failure to abide by consumer protection rules, it should have the power to remove an institution’s licence or, in response to lesser abuses, impose penalties sufficient to discourage repetition. The body should have sufficient funding and resources to conduct the tasks assigned to it.

The body should be independent of the industry, free from conflicts of interest and include a balance of members with industry and consumer expertise. It should be transparent and should clearly publicise occasions where it has taken action against specific practices and products or misleading financial promotions. There should be strong links with other consumer protection bodies (including representatives of consumers) to ensure that experience and expertise in consumer protection is shared. Representatives of the consumer interest should be integrated into the governance of the sector at national level.

4. Redress and dispute resolution systems

Access to dispute resolution and redress is one of the eight consumer rights. Still, there is a serious risk that such systems are being overwhelmed by the sheer number of complaints relating to financial services. This underlines the importance of preventing complaints arising through the introduction of effective upstream consumer protection.

Governments should ensure that consumers have access to adequate redress mechanisms, which are ‘expeditious, fair, inexpensive and accessible’[7]. Ideally, there should be one clearly identifiable scheme for redress per sector. Consumers should be proactively informed about the availability of such a system. Governments should also provide collective redress mechanisms, in order to reduce the demand for individual proceedings.

Findings from these redress mechanisms should be synthesised and reported to regulators in order to inform future regulation.

5. Promoting competition in financial services

The financial crisis led to a significant reduction in competition in the financial services sector which was already suffering from a high level of market concentration. Competition is an important consumer issue and CI strongly recommends that the G20 take action to promote competition as a means to enhance consumer protection in financial services.

The G20 should recognise that allowing competition law to be overridden in the interests of financial stability is counterproductive, as it results in the creation of even larger institutions and increases the probability of taxpayers needing to provide support in the future; in addition steps taken to support financial institutions which are 'too big to fail' have resulted in significant distortions of competition.

It should therefore encourage member countries to instigate independent competition inquiries into the increases in concentration and reduction of competition caused by the financial crisis and recommend that national governments apply 'public interest tests' to the disposal of their stakes in the banking sector. This should include specific objectives to make competition stronger after disposal of the stakes so that some of the increase in concentration is reversed.

Additionally, to encourage new entrants, governments and regulators should take steps, such as those pertaining to comparability of products, portability of account numbers and others outlined in the report to ease switching of accounts for consumers.

6. Measures to promote stability and safety of consumers deposits and investments

The financial crisis dramatically highlighted how new banking practices are exposing consumers to enormous risk. Rather than manage risk, the structure and practices of the financial services sector magnified risks to a level that threatened the collapse of the sector itself.

G20 leaders should agree to use leverage control to reduce risky activity rather than starve consumers and businesses of access to credit. These measures should be complemented with the use of non-operating holding company (NOHC) structures to address contagion and counterparty risk directly, including maintaining demarcation between investment banking and retail banking reducing risk of cross-contamination through legal separation of operations. Living wills should be introduced and should contain provisions for the treatment of customers so that financial institutions can fail without causing catastrophic damage to consumers or the economy.

Ratings agencies should be liable for the validity of their analyses and should be answerable to prudential supervisors.

Greater transparency and accountability in financial transactions will also help to reduce risk. Actions should include developing systems to assess consumers' capacity to take on financial commitments, giving consumers access to risk data regarding individual financial service providers and ensuring that loan assignees should be liable for the practice of the original credit granter.

Deposit protection schemes should provide cover for each separate brand and create a seamless transition of essential banking services with consumers maintaining access to deposits used for transactional banking. Any payment from the protection scheme regarding deposits held in savings accounts should be made within seven days. Measures should also be introduced to provide flexible cover for temporary high balances.

And insolvency procedures should be reformed so that the rank of creditors is changed to put depositors at the top.

7. Access to basic financial services and the role of new forms of service

Universal access to free or affordable basic financial services should be a specific aim of government policy on financial services. New innovations and technologies are already making great strides in this area, increasing access but also raising new challenges for consumer protection. Governments should seek to encourage innovation in safe, effective, low cost methods for banking inclusion whilst supporting the development of consumer protection.

With regard to the important issue of remittances, the G20 should support the development of the General Principle on Remittances (2007) with a view to introducing a stronger consumer orientation, with consumer protection as a primary objective.

8. Conclusion: ongoing international co-operation on financial consumer protection including reviews of implementation

There is now an urgent need for stronger international co-operation on financial consumer protection. The financial crisis showed that weak consumer protection in one country can now pose a risk to other countries and the global dimension of financial services means that financial market conduct regulators around the world now face similar issues and challenges.

The G20 should therefore support the establishment of a permanent international organisation to enable national financial consumer protection bodies to compare notes, share good practice and develop minimum international standards and guidelines based on the recommendations in this report, and review their implementation. The new organisation should have consultative status with other international financial regulatory bodies and actively co-operate with these organisations and with consumer organisations in the development of research, guidelines and agreements, fraud monitoring and scrutiny of industry practices.

The new organisation should have a network structure with representatives from national financial consumer protection bodies and the resources to establish a secretariat. An independent consumer panel should also be established made up of representatives from independent consumer organisations with competence in financial consumer protection to monitor advise and challenge the work of the organisation.

Introduction

There are as many bank deposit accounts in the world as there are adults[8]. And yet, over half the adults in the world are 'unbanked'[9]. So, financial services, their governance and their development, are a key preoccupation, for consumers in rich and poor countries alike. Consumers are not some species in need of protection, and consumer protection is not limited to specific acts of consumption. The consumer as depositor, saver, borrower is not just another link in the chain, but an essential actor in the market, and as such, is at the heart of the macro- and micro-economic nexus of problems that have hit the financial services (FS) sector. The consumer is thus implicated in both the retail and the wholesale markets, including the upstream processes and their regulation.

This implication is a global matter. Sheila Bair, Chair of the US Federal Deposit Insurance Corporation, aptly observed that: *"There can no longer be any doubt about the link between protecting consumers from abusive products and practices, and the safety and soundness of the financial system".* Her statement underlines the global importance of universal good practice in terms of financial consumer protection[10].

In November 2010, Consumers International (CI) welcomed the announcement by the G20 heads of government, at their summit in Seoul, that: *"we have agreed to enhance consumer protection"* (*Para 11 of the declaration*)[11]. This commitment followed a concerted campaign whereby CI's members in G20 countries lobbied their finance ministers for action on financial consumer protection (FCP).

The G20 leaders' commitment is explained in more detail in paragraph 41 of the Seoul Action Plan:

> *Enhancing consumer protection:* "We asked the Financial Stability Board to work in collaboration with the OECD and other international organisations to explore, and report back by the next summit, on options to advance consumer finance protection through informed choice that includes disclosure, transparency and education; protection from fraud, abuse and errors; and recourse and advocacy."

There are also a number of other points in the Seoul declaration with relevance to financial services including: "*macro-prudential policy frameworks, strengthen*(ed) *regulation and oversight of shadow banking"*; integrating the "*perspective of emerging economies in financial regulatory reforms*, *improving market integrity"*, prioritising action on *"exclusion from financial services"*, and a Financial Inclusion Action Plan, *"expanding opportunities for poor households and small and medium enterprises (SMEs)"* (*Paras 9 & 11*).

The arguments for action on financial consumer protection are now compelling. Financial services are almost a requirement for participation in a modern economy, enabling consumers to make purchases, save or borrow, make investments and insure against risk. However a number of factors make the need for regulation of products processes and providers in FS particularly acute. These include:

- the complexity of the products, and of product information
- the high risks associated with many products
- the fast changing nature of many of the products
- their 'virtual' non-tangible nature, and
- the long-term nature of many transactions which means that consumers do not make regular purchases, and therefore do not develop an expertise in the market.

The result is that financial services are a classic example of 'credence goods' in which the consumer makes repeated purchases on the basis of very little understood information other than the reputation of the seller[12].

Another pressing case for a greater emphasis on FCP is the rapid growth in financial services. The World Bank has estimated that 150 million new consumers of financial services join the global market every year, many of them in countries with very weak FCP[13].

In this paper, CI calls for a mechanism to establish and disseminate good practice, in the G20 and beyond. The Seoul commitments provide a good starting point for this process of reform and it is encouraging to see the commitment made by the French G20 presidency to make financial consumer protection a priority during the coming year[14].

Consumers International is pleased to note that the G20 have already committed themselves to tackle *"abuses and errors",* and promote *"recourse and advocacy"* in relation to FCP, thereby looking beyond the traditional 'caveat emptor' ('let the buyer beware') principle, which posits that providing the consumer is well-informed and products are properly described and disclosed, then the service provider has carried out the necessary obligations. The UN reported in its 2005 Blue Book that "this minimalist option is often considered anti-consumer"[15].

There is no explicit reference in the summit declaration to competition[16]. This is of particular concern in the light of the recent financial crisis, which resulted in several large-scale mergers and a resultant decrease in competition, with state aid granted to banks financed by taxpayers and consumers. More must be done to ensure that bank shareholders and wholesale creditors accept full responsibility for their actions and are not shielded by the threat of the 'too big to fail' syndrome. The focus must be on ensuring that failure can occur, but without wreaking havoc on everyday consumers and the whole economy.

Finally, we note that more comprehensive consumer protection is in the interests of the industry as well as consumers for it gives consumers greater confidence and willingness to engage with financial services. Potential demand is still far from satisfied as indicated by the estimate of 56% of adults worldwide as 'unbanked'[17]. This is not just a matter of non-availability of services such as in rural areas or poor countries. Willis quotes studies to show how *"faced with choice overload, people 'choose not to engage in decision making'"* and thus remain outside of important sectors such as insurance or pensions. The awareness of the riskiness of the FS sector actually induces non-participation by consumers[18].

The role of consumer education

Consumer education is an important component of consumer protection and many CI members are enthusiastic supporters and participants in programmes on consumer education for financial literacy. Indeed, CI sees the importance of consumer education as a 'given', one of the basic consumer needs recognised by the UN in 1985[19].

Examples of CI members' engagement in this area include the Youth Education Network in Kenya that works with local authorities to disseminate information, and conducts training workshops in the Nairobi slums, and in Zambia, the Zambian Consumer Association that conducts 'training the trainer' courses. Many CI members work with children, introducing them to notions of budgets, savings and the workings of 'high street' commerce. In Asia, CI's Kuala Lumpur Office fosters a consumer education project that focuses on mass media information and education for consumers, while in Latin America, several consumer organisations – in Chile, El Salvador, Peru, Brazil – set up regular programmes to deliver consumer information on financial products and redress mechanisms[20].

Nevertheless, there is a significant danger that excessive reliance is being placed on consumer education as the solution to FCP. The 'conventional wisdom' is well described by Professor Lauren Willis of the University of Pennsylvania who refers to a vision of: *"responsible and empowered market players, motivated and competent to make financial decisions that increase their own welfare. The vision is of educated consumers handling their own credit, insurance, and retirement planning matters by confidently navigating the bountiful unrestricted marketplace".* The professor goes on to warn that: *"the belief is implausible, given the velocity of change in the financial marketplace, the gulf between current consumer skills and those needed to understand today's complex non-standardised financial products, the persistence of biases in financial decision making, and the disparity between educators and financial services firms in resources with which to reach consumers".*

Although the professor refers to the US market, the analysis resonates with the observations of Consumers International members and other studies in this area[21]. The basic point is clearly made by the World Bank in its recent report *"Financial education cannot substitute for adequate financial regulation"*[22].

The fact is that most consumers organise their finances responsibly. The sheer complexity of transactions engaged in by consumers at all income levels counters the view of ordinary consumers as financially incompetent, and somehow to blame for the current crisis. It is true that the level of financial capability amongst consumers has not kept pace with the increasing complexity of transactions. However, the same can be said of regulators and service providers too. Financial education and development of capacity should be seen as a responsibility shared by FSPs and public services (such as education) and not left to consumer organisations alone.

Greater effort should be focused on the behaviour of service providers, whose ‘herd instinct’ led to irresponsible lending, unstable ‘securitisations’, excessive leverage, and business strategies which allowed risks taken in investment and wholesale banking to infect retail banks. All of this resulted in the eventual bail out by taxpayers.

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1. Information design and disclosure

Information is one of the eight *'legitimate consumer needs'* recognised by the UN Guidelines for Consumer Protection[23]. Article 3, c) refers to: "...*Access of consumers to adequate information to enable them to make informed choices according to individual wishes and needs*". Similarly, article 37 e), mentions that consumer education and information programmes should cover "…*Information on weights and measures, prices, quality, credit conditions and availability of basic necessities".*

Yet, in many cases these basic requirements are not being met. In Brazil, CI member IDEC developed a comparative test which showed that only one out of 10 major banks complied with the national Consumer Protection Code, and Brazilian Central Bank regulations on the provision of information on interest rates and other credit charges. The test also showed that 40% of the banks did not give a contract copy to consumers and none of the 10 banks tested gave written information on the package of services contracted. Similarly, a collaborative effort by CI members in Latin America revealed that multinational banks were engaged in practices that would be illegal in the EU, where they were headquartered. A notable example was the lack of advance disclosure of conditions of credit contracts.

In France, a lack of transparency in bank charges was revealed by CI members UFC and CLCV [24]and changes were imposed; the French government has recently responded listing the charges for which comparable information should be provided[25.]

CI's requirements for consumer information are that it be: **clear, sufficient, reliable, comparable and timely,** suitable in these respects for the consumer to compare and contrast and to make an informed decision. This information is required not only during the pre-contractual and purchasing phases, but also throughout the lifetime of long-term products such as pensions or mortgages, where consumers need continually to monitor their fiscal/budget positions (eg how much capital paid off the value of a property), and maybe to modify their undertakings (eg early repayment of a loan).

The peculiar characteristics of financial services, referenced earlier, make it even more essential that information is not only comprehensive and transparent, but is designed to meet consumer needs that may change over time. Simply reproducing information as legally required is not sufficient. There is the danger known as the 'paradox of formalism', whereby service providers comply with disclosure requirements but in a way that leaves consumers bemused by information overload[26]. Financial Service Providers (FSPs) need to move beyond this approach, and focus on information provision to help consumers make informed decisions.

This requirement should be taken as seriously as the substance of a contract, and failure to provide clear, sufficient, reliable, comparable and timely information should cause the contract to be voidable.

What information do consumers need?
Clear: Information about a product, including contract terms and their possible implications, should be easily understood by consumers without expert knowledge. FSPs should be responsible for testing the quality of the information provided, and whether it is capable of being understood by consumers, before introducing a new product or service to market. National regulators should audit or require other substantiation of this process, using tools such as mystery shopping.

In the event of sales across borders, all literature must be in the mother tongue of the country of sale. It bears mentioning that one sixth of the world's adults are illiterate and given the increase in financial services in new markets, methods of communication need to be developed accordingly.

Sufficient: FSPs have shown great ingenuity in promoting the benefits of their products to diverse consumers. They must be required to achieve the same level of effectiveness in developing a full consumer understanding of the costs and pitfalls of their products. Information that is provided should be derived from (but not necessarily reproducing entirely) full disclosure of all pertinent information that may impact consumer choice including the current and future cost of using the product, and the principal terms and conditions of the products offered. Contracts must include clear upfront pricing so that consumers can appreciate the cost of the product before becoming obligated to pay. This should include actual prices paid by the consumer and identifying commission, late payment penalties, fees or other remuneration.

Reliable: Information should be accountable as to its source, and credible, in the sense that it should have a standardised and approved format (obviously varying from product to product). 'Reliable' means more than 'true', for in FS information can be true but irrelevant and thus confusing or misleading.

Comparable: Information should enable consumers to compare similar products, including those offered from outside of their country. It is sometimes argued by service providers (and governments) that comparability of complex products is not possible. However, some governments have legislated/regulated precisely for such comparability, most recently in France, and many CI members regularly make such comparisons in their publications for the benefit of their subscribers[27]. If it is genuinely not possible to compare products, then that may suggest that these products are too complex to be properly understood.

Timely: Information should be offered at the right time during the purchase and post-purchase cycles and throughout the lifetime of a product. There need to be regular personal statements and updates, concerning the performance of the product and containing a reminder of key terms, conditions and prices. Any terms allowing a variation in price must be clear and fair, and consumers should be provided with advance notice of any changes (particularly with regard to applicable interest rates).

Consumer credit information

Credit is obviously an important financial service for many consumers. The following is an example of the information that should be made available to consumers before they are asked to sign a credit agreement:

- Information on interest rates, such as monthly and annualised percentage rates (APRs), preferably with illustrations of typical payments in cash terms over a given period
- How any charges and interest rates could vary over the course of the contract
- All charges that consumers must pay, including as a result of situations in the future, such as failure to comply with a deadline or due date, any increase in charges, costs derived from execution of mortgages in case of repayment default, etc
- Any other stipulation and/or clause and/or special situation that consumers must know before engaging in a long term relationship with the financial institution, for example cooling off periods
- Regular statements of account and notifications of changes in charges should then be provided during the life of the agreement, eg amortisation tables.

Key-fact statements

In highlighting the need for clear and transparent contract terms for financial products, the World Bank also highlights the role that could be played by 'Key-fact statements' (also known as product information sheets), a format that can be used by FSPs to ensure clear presentation of information.

"Key-fact statements should be prepared in order to give consumers a simple summary of the important terms and conditions of the financial contract. For each generic product class, it is best to use a standardised format written in plain language in a page or two. Consumers have almost no ability to amend a financial institution's contract. For high-volume core retail financial products, the use of standard provisions in retail financial contracts (developed by the professional associations) is desirable"[28]. The only reservation CI would have in relation to this statement would be that consumer organisations and other independent participants should also be involved in the public interest.

CI members in Germany, Denmark, Norway, Portugal, Belgium and the UK were active in lobbying for key-fact statements of the kind that are now mandatory under the new EC Investment Funds Directive. This requires that there must be a Key Investor Document consisting of two standardised pages for pre-contract use. This provision is currently taking effect in the different member states, and could be reinforced by the provision of clear model examples.

Similarly in Russia, CI members KonfOP negotiated an agreement in principle with industry and government on the presentation of a 'summary box' of key facts in credit contracts for scrutiny before signature. (As yet the summary box provision remains to be implemented, but certain common terms have been agreed).

Still, although international guidelines, such as those from the OECD and the EU Directives for financial services, include requirements for provision of information,[29] there are no harmonised, global guidelines on how consumer information should be designed and delivered in a 'consumer-friendly way'. Furthermore, reliance on the much admired US 'Truth in Lending' provisions did not prevent the failings of the credit and loans market. This indicates that 'truth' is far from being a failsafe mechanism on its own – it is necessary but not sufficient.

Recommendations to the G20 on information design and disclosure

The G20 should:

Adopt recommendations for minimum standards and guidelines for implementation in G20 countries and regions, and commit to a regular review of their implementation. These standards and guidelines should include the following provisions:

- All information provided to consumers about financial services should be guided by the principle that the information must be clear, sufficient, reliable, comparable and timely.
- Failure to provide information that meets the requirements above should cause the contract to be voidable.
- Standard formats (such as Key-Information Documents) should be used for the presentation of information about financial service products so that consumers can easily compare products.
- FSPs should be responsible for testing the quality and comprehensibility of the information provided, with additional audits conducted by national regulators.
- Contracts must include clear upfront pricing so that consumers can appreciate the cost of the product before becoming obligated to pay.

Identify appropriate international organisations with participation of key stakeholders, including consumer organisations, to:

- Identify and share examples of good practice
- Highlight bad practices that may present risks in more than one country
- Develop standards and guidelines for international use (drawing on the points above). The International Organization for Standardization (ISO) could have a key role to play in relation to the development of standards.

In the absence of appropriate international organisations, the G20 should support the development of a new international organisation to undertake this work. Recommendations for the terms of reference for such an organisation are included in the conclusion to this report.

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2. Contracts, charges and practices

One consequence of over-confident assumptions regarding consumer education and awareness, and a reliance on transparent information is that basic FCP requirements, such as ensuring the fairness of contract terms, charges and practices, often fail to receive sufficient attention. Yet, these aspects should be fundamental to achieving consumer protection in financial services. Consumers must be confident that the products available in the financial services marketplace are sound and do not entail excessive risks, tie-ins, hidden or excessive fees that unfairly take advantage of consumers. A dependence on consumer education and financial literacy presumes that people always act in a rational manner. Behavioural economics sadly demonstrates that people may act irrationally and contrary to their own interests when purchasing.

An argument that is often put forward against product regulation is that it will raise costs and reduce consumer choice. Certainly there are always compliance costs to be considered. But CI fears the argument is abused and rejects the logic that "*we have to accept bad products and bad practices as stamping them out will somehow upset the karmic balance of the banking world - good products do not need to be counterbalanced by bad products*"[30].

Regulation is also sometimes accused of providing incentives for the development of new products whose novelty is simply a way of evading regulations. Whilst this may sometimes be true, it is not an argument against regulation, but rather in favour of making regulation effective.

This is not to say that there aren't legitimate concerns about the limits of regulation. In particular, care should be taken to ensure regulation is not used to entrench existing forms of service and resist innovation.

National approaches to regulation will, of course, vary. Many countries have thorough and precise legislation on unfair contract terms in consumer contracts. Banking contracts for opening and managing bank accounts, consumer credit and mortgages are regulated by horizontal consumer protection laws, **and/or** specific sectoral legislation related to financial services. Different local circumstances will indicate which is the best approach. Moreover, there is now considerable evidence that this sector has not been effectively regulated, and its failure to take proper corrective measures at its own initiative requires statutory intervention. The situation is complicated by the parallel existence of different commercial/legal regimes for different forms of FS within the same national jurisdictions. This goes against the needs of consumers for consistent legal protection and highlights the need for global understanding regarding consumer protection.

Managing the complexity of financial products

In the aftermath of the financial crisis, there is now widespread agreement that many financial service products are far too complex. Not only does this complexity prevent consumers, regulators and even FSPs' own staff understanding products, but in many cases there is little evidence that the complexity is of any benefit to the consumer.

Gillian Tett, award-winning journalist from the *Financial Times,* reported recently in her study of Citibank from the inside: *"'Perhaps there were a dozen people in the bank who really understood all this before (the collapse) – I doubt it was more', one senior Citibank manager recalled bitterly"*[31]. Many financial products were not only not understood by people whose job it was to understand them; they were *scarcely capable of being understood*.

A study conducted on banking services commissioned by the EC found that in two-thirds of cases (an expert panel) were unable to disentangle the structure of bank tariffs in order to ascertain the true cost of a service. As EU Consumer Affairs Commissioner Meglena Kuneva said in a 2009 speech to the Portuguese consumer association (DECO Proteste): "*If experts are unable to understand the fee structure, what chance is there for ordinary consumers?*"[32].

Even the most basic services may not be understood by experts. For example, in evidence to a Committee of the UK parliament, a senior executive at a major UK retail bank was unable to say how much she paid in terms of the overall cost of her own bank account[33].

CI concludes therefore that there is now a strong case for regulation to be used to manage and prevent excessive complexity. Regulatory intervention needs to:

- ***Ensure products and services are comprehensible:*** To restore the trust in the sector, an obligation of *comprehensibility* must be developed, not only to help consumers but also regulators, able to test also the *comprehension* of the agents of service providers by 'flash tests' if necessary. This would shift the burden of understanding from the consumer onto the producer.

- ***Ensure the availability of simple standard products:*** Experience has shown that the financial services industry alone will not develop simple, good value-for-money products which meet consumers' needs. Regulators should pursue the idea that providers and intermediaries should offer simple, straightforward products alongside their additional product offerings. For example, the regulator could require financial companies to benchmark certain products against simple alternatives. In the UK, the financial regulator introduced a rule known as 'RU64', which required firms recommending pensions to consumers to demonstrate why a complex or expensive product is better than the simple, good-value stakeholder pension, which had to meet clearly defined standards. This led to a reduction in mis-selling of more costly and complex pensions and a commensurate reduction in the actual price paid by consumers for their pensions.

- ***Ensure minimum standards for key products:*** There are certain products, such as bank current accounts, and protection products, such as insurance, to which all consumers need access. In these cases, regulators should ensure that any such products meet minimum standards. A parallel can be drawn with motor insurance where, in some countries, all products on sale must meet minimum legal requirements, and consumers may opt to add additional features. Another approach could be to establish default standards for some products in the interests of consumers.

Action to tackle complexity is sometimes opposed on the basis that it will reduce the number of products on the market and therefore reduce 'competition'. However, this relies on a very inadequate concept of competition. As CI's British members 'Which?' have argued in their evidence to the UK Independent Commission on Banking[34]: *"it is important to draw a distinction between 'consumer choice' and 'effective competition'. Whilst within a particular product market, consumers may have the choice of thousands of different products, competition will only be effective at benefiting and protecting consumers if they can properly compare, evaluate and choose between the different products on offer, and better quality and value products and providers gain market share."*

There are for example, in Germany alone, almost 550,000 different certificates betting on the performance of shares, commodities and other assets. No one can conceivably master the details of so many products. The over-elaboration of incomprehensible FS products is a perversion of consumer choice.

Additional issues related to contracts, charges and practices

As well as tackling complexity, regulators should take action in the following areas:

Ensuring consumers give their informed consent

Consumers must clearly indicate adherence to specified charged services such as genuine and unconditional acceptance of the individual elements forming a package of services. Additional services should be notified in addition to contracts under basic terms of accession to the service. In effect this means that 'tied' sales should be banned or, at a minimum, the consumer should have a choice of service providers for the additional products.

Consumers must be able to review contract terms before a signature is required on the contract, and before providing personal or payment information. For example, French banks must publish their tariffs in their branches and on the internet three months before they take effect[35]. From 2011 this must be done in a standard format for ten essential banking services. A recent Consumers International research project in five Latin American countries showed that it is the exception and not the rule to make contracts available for consumers before requiring a signature. Similar practices have been reported by colleagues in the Caribbean region. Enforcement of such protections is also vital to protect consumers. For example, in Peru there is a law that obliges the banks to make available all of their contracts on their websites. However, without significant monitoring by regulatory authorities, this type of legislation is difficult to enforce[36].

Ensuring contracts are fair

It is essential to minimise the high risk aspects of products, and in some cases prohibit a particular type of product or specific product. Product regulation can play a critical role in limiting the harm that certain products can cause.

The fees and costs charged to consumers and included in consumer contracts for financial services products must be fair and reasonable. For example, contract terms should be prohibited where they allow for excessive fees, manipulation of transactions to raise fees (for example by timing them to maximise overdrafts) or charging of advance fees for products unlikely to deliver all of the promised value to a consumer, such as single premium default insurance. This is not to say that CI advocates total and specific price control of all charges. Nevertheless, the everyday structure of charges should be, at least, subject to a test of 'reasonableness', as is customary in many jurisdictions, and ancillary charges should be set in relation to the costs of the transaction or operation. Many charges such as

ATM fees, unauthorised overdraft interest rates and fees and late payment penalties are unrelated to base rates or underlying costs, and are in effect not subject to competitive pressures because they are not part of the core prices offered to consumers.

Consumer protections included in financial service contracts should be non-waivable. FSPs should not be allowed to circumvent consumer protections required by law by including contract clauses that result in consumers waiving essential consumer protections against abusive contract terms, such as tying-in clauses bundling services together. To allow otherwise undermines the value of requiring safe and sound financial services products for consumers. For example, in Uruguay, Santander Bank included a contract clause that read, "...this is not an adhesion contract, as the client had the opportunity to discuss the clauses contained in it"[37]. In this example, once the consumer signs the contract, the consumer waives his or her right to challenge the fairness of the contract on these terms. This is the epitome of an unfair contract practice that should not be allowed. Indeed it would be illegal in the EU where the bank in question is based.

Ensuring advice is free from conflicts of interest

Advice to consumers should be separated from sales-based remuneration of the FS sector. In the introduction it was noted that financial services tend to share a number of characteristics that make them a relatively high risk area for consumers and as such there is a clear need for accessible, accurate and independent advice services. Yet, practices such as commission selling and sales-based remuneration undermine the independence of the advice that many consumers receive.

Consumers may be misled into believing that advisers are acting for them when in fact they are salespeople for particular firms, paid on commission. Alternatively, they may be aware that advisers are not independent and therefore hesitate to seek advice for fear of being subject to inappropriate sales methods. Such hesitancy may be entirely justified. For example, in Germany, more than 40,000 investors lost their savings for old age due to the collapse of Lehman Brothers[38].

Given the complex and long-term nature of these decisions, consumers need to be advised independently, and furthermore professional 'advisers' should be appropriately qualified. This in turn means that consumers need to understand that they may have to pay for advice in the same way that they would for advice regarding other major transactions such as house purchase. This does not have to mean major up-front payments if a way of defraying such fees over a period of time can be developed. The UK Financial Services Authority has prohibited commission-based remuneration for investment advisors from the start of 2013. Instead, the cost of the advice will be agreed with the consumer.

There is an interim position pending such a move. Many FS product commissions are 'front-end loaded', ie the commission is paid immediately following sale. This encourages irresponsible sales with the salesperson facing no consequences, and free to walk away from any ongoing responsibility. At a minimum, commission payments should be defrayed over the life of a product so that termination during the life of a long-term contract will affect the remuneration of the sales force. This gives an incentive for the sale of FS products that are less likely to end in failure. While this may eliminate the most serious conflicts of interest, regulators should aim for a 'clean break' away from payment by commission.

Promoting responsible sales practices

There should be an obligation for sellers of financial products and services to place financial products only with those for whom the product or service is suitable. Consumer contracts for financial service products should contain prohibitions against steering consumers to unsuitable products included to earn higher fees or commission (often undisclosed) and include a reasonable right to rescission and to a reimbursement of all unearned fees if a financial services product is found to be unsuitable. Elements of this requirement already exist in some jurisdictions, and European law contains provisions for testing obligations for appropriate product sales[39].

The South African National Credit Act effectively shifts the burden to financial institutions to avoid reckless lending and over-indebtedness; if a FS has been sold without an appropriate analysis of whether it meets the clients needs, the contract can be annulled[40]. This provision could go as far as banning certain practices outright. A case in point suitable for investigation is the practice in micro-finance services, which amounts in effect to 'obligatory savings', whereby a proportion, up to 25-30%, of the consumer's loan is withheld until the end of the loan period, during which time the consumer pays interest on the loan but receives no interest on the so-called 'savings account' (or much less than is paid by the consumer on the total loan).

Protecting consumers from aggressive marketing
Protection could take the form of mechanisms such as cooling off periods for credit agreements and non-enforcement of agreements that turn out to be unconscionable.

CI members have uncovered and challenged a number of abuses in relation to contract terms and charges.

For example:

- A successful intervention by VZBV in Germany on unfair contract terms in insurance resulted in consumers being able to terminate cover after three years, compared with previous 10-year limits. (In consequence many contracts now run for one year only).
- OCU in Spain persuaded the Supreme Court to declare null and void a wide variety of unfair terms in insurance and banking contracts. These clauses ranged from terms not allowing consumers to know which commissions they were paying, to clauses waiving banks' responsibility for the malfunctioning of ATMs under banking contracts; lack of information on essential aspects of a contract (such as limitations on risks covered) in insurance contracts also became grounds for nullification.
- IDEC reported to the Brazilian Central Bank the problems identified in contract terms practiced by banks and credit cards, and successfully campaigned for better regulation of contract terms and charges of credit cards. Their comparative survey of bank services showed that banks charged for unsolicited services and products.
- *Pro Teste* in Brazil took legal action to suspend the practice of charges to open a bank account.
- Hong Kong – The HKCC was called as an expert witness on credit agreements, resulting in reform of credit charges and the striking down of 'unconscionable contracts' in credit, and successfully campaigned to amend the national banking code in order to reduce bank charges.
- CI's UK members Which? successfully campaigned to prevent sales of loan protection insurance being linked to personal loan agreements.
- Following a complaint by Which?, the UK regulator took action to stop firms unfairly changing premiums on mortgage protection insurance and obtained £40 million of refunds for consumers.
- Following a campaign by CI's French members, penalty charges for aborted transactions in bank accounts have to be related to actual costs; these are very small in electronic transactions.
- In the US, Consumers Union helped to win a rule eliminating expensive overdraft loans sparked by debit-card purchases and withdrawals, unless the consumer affirmatively opted into the programme. The US Credit Card Accountability, Responsibility and Disclosure Act 2009 restricts the amount of credit-card penalty fees to amounts that are ruled as "reasonable and proportional" to the violation. Note: the new US Consumer Financial Protection Bureau is widely expected to promote the use of a short, one-two page credit-card contract, although it is not required to do so by law (www.consumerfinance.gov/).
- Surveys in India uncovered problems including non-payment of insurance claims and arbitrary amendments of bank charge calculations.
- India – Consumers Association of India (CAI) campaigned for interest on savings accounts to be calculated on daily balances.

Recommendations to the G20 on contract terms, charges and practices in financial services

The G20 should:

Adopt recommendations for minimum standards and guidelines for implementation in G20 countries and commit to a regular review of their implementation. These standards and guidelines should include measures to ensure:

- the availability of simple standard financial service products
- minimum standards for key financial service products

- that financial service products and services are comprehensible
- that financial advice to consumers is separated from sales-based remuneration
- protection against inappropriate marketing methods
- removal of remuneration structures for financial service providers that lead to conflicts of interest that impinge on consumers, and
- the following practices should be cause for a contract to be voidable:
    - failure to gain the informed consent of the consumer
    - unfair or unreasonable fees and costs charged to consumers and included in consumer contracts for financial services products
    - clauses in financial service contracts that result in consumers waiving core consumer protections
    - the sale of financial services that are unsuitable for the consumer.

Identify appropriate international organisations with participation of key stakeholders, including consumer organisations, to:

- identify and share examples of good practice
- highlight bad practices that may present risks in more than one country
- develop standards and guidelines for international use (drawing on the recommendations above).

In the absence of appropriate international organisations, support the development of a new international organisation to undertake this work. Recommendations for the terms of reference for such an organisation are included in the conclusion to this report.

3. The structure and functions of national financial consumer protection (FCP) bodies

Under the UN guidelines for consumer protection, all governments have a responsibility to protect and promote consumer rights. CI's interpretation for FS is that governments should establish national autonomous consumer protection bodies, expert in, but not under the influence of, the banking sector, to oversee the financial sector, including products, services and marketing. Such protection needs to be both individual (ie protecting individual consumers and individual products) and general – dealing with prudential and indeed macro-regulatory matters.

Structure of FCP bodies

Many countries have delegated financial consumer protection to the central bank, which is also charged with prudential supervision of the banking sector. Other countries have created a separate agency that is not part of the central bank, but still has responsibility for financial consumer protection, sometimes referred to as the 'twin peaks' model. Other models have developed organically with aspects of financial consumer protection sitting in different government agencies. Any FCP body that lacks the proper budget, legislation, staffing and powers (including sanctions), as well as political support, will have severe difficulties to fulfil its duties. This is equally true during the construction phase of new regulatory institutions[41]. Regulatory institutions should themselves be open to advocacy, including legal action on the part of consumers, to ensure that their functions are being carried out. There should not be a ministerial monopoly of oversight.

Ultimately, the crucial matter is not the detailed architecture of consumer protection bodies but the extent to which they can protect consumers. For example, CI's Brazilian members have advocated that the Central Bank should regulate all financial institutions, despite the fact that it currently does not regulate credit cards. But in the event that the BCB does not take on this mandate, the Federal department of Consumer Protection (CP) should be empowered to do so. IDEC does not advocate a new body as such, but does argue that whatever eventual structure is chosen, that consumer representatives be included in the elaboration of regulations.

The management boards of Financial Service regulators should comprise members who are independent of the industry and include a balance of members with experience of consumer issues and industry expertise. The bodies should have the right to develop appropriate regulations, conduct investigations, and require changes in policies and practice, and appropriate redress. Serious failure to abide by the consumer protection rules should be grounds for withdrawal of an institution's licence to operate. Less serious transgressions should attract proportionate sanctions sufficient to discourage repetition. The same rules should apply to intermediaries.

Alongside these bodies, independent consumer organisations should also play a valuable role in consumer representation in policy making. One model is for an independent consumer panel to be established, made up of independent experts and/or representatives from consumer organisations with competence in financial consumer protection, to monitor, advise and challenge the work of the organisation. This model has been adopted in some countries to ensure consumer voice, eg the consumer panel of the UK Financial Services Authority. Another is for consumer organisations to be represented as stakeholders on multi-party consultative bodies advising industry and government. This is the case in France where CI members *Confederation Consommation, Logement et Cadre de Vie* (CLCV) and Union Federale des Consommateurs - Que Choisir? (UFC) both sit on the Consultative Council for Financial Services (CCSF) convened by the *Banque de France*. If it is to be meaningful, such participation requires funding for logistical costs and the commissioning of expert advice and dedication of in-house time.

Functions and objectives of FCP bodies

Every financial institution, product and provider of financial products should be subject to effective regulatory oversight. The ultimate purpose of regulation should be to ensure that the market for FS works in the interests of consumers. Regulators should strive for the highest standards of consumer protection to be built into the environment in which new products are developed, without eliminating the beneficial effects of responsible innovation on consumer choice and access to credit. A relevant example may be the development of mobile banking in parts of Africa and the Philippines, which has developed very quickly bringing significant benefits for many consumers. This sector's rapid growth now needs to be balanced with emerging and inevitable concerns about consumers' exposure to abuses and risk[42].

Regulators should have a clear and unambiguous mandate to protect consumers of financial services free from any conflict of interest. Potential conflicts arise if regulators also have regard to the international attractiveness of a particular location (usually global centres of finance) when deciding what level of regulation to apply. Giving this objective to a regulator can lead to a 'light touch' approach as regulators become wary of imposing rules that would benefit consumers but reduce the attractiveness of their particular jurisdiction. This potential conflict was explicitly recognised by Lord Turner, the chair of the UK Financial Services Authority, in evidence to the 'Which?' commission on the future of Banking: *"saying that the role of the regulator is to help…the competitiveness of a location or of the nationally registered firms can, in a subtle way, create a conflict of interest".* He went on to say: *"the challenges of good regulation and…industry promotion are completely separate things and should be kept rigorously separate"*[43].

There is also a serious concern that prudential control can trump FCP if it is housed in the same regulatory institution. For example, large scale compensation due to consumers as a result of bad practice by an FSP could be threatening to the stability of the institution itself. This has led some CI members to argue for separation, to avoid a conflict of interest[44].

Whatever the selected model, it is clear that at some level, CP needs to be a supervisory objective of regulatory bodies, in parallel with prudential supervision. Surprisingly perhaps this is not always so, for example in Germany other than for insurance. In other jurisdictions, it has been written into the objectives of regulatory agencies such as the Financial Services Authority in the UK.

Regulators can be required to address a number of issues that are important for consumers of financial products including:

- Information design and disclosure, and overall product complexity including powers of prohibition (chapter 2)
- Fair contract terms and charges, (chapter 3) including suppression of unfair commercial practices such as misleading advertising
- Provision of a financial services ombudsman or complaint resolution window at no charge to consumers (chapter 5)
- Promoting effective competition (chapter 6).

CI believes the following approaches should also be taken by regulators:

- *Regulators must have the authority, obligation, and the will to stop harmful product features and practices.* Financial services providers should be required to review their past business and implement a system of 'product recalls' if significant defects are identified.

The experience of the last few years shows that the concept of 'dangerous products' needs to shift from covering simple physical products and be applied to vital services such as FS. This was underlined by European Commissioner Kuneva, drawing a parallel with the trade in physical goods: *"We do not rely on the good faith of the traders and the alleged vigilance of consumers but require that a regulator guarantees a satisfactory degree of safety. Doesn't the regulator have similar responsibilities in the market of retail financial services? I believe we must limit the risk in retail financial markets and exclude certain 'toxic' credit products from its retail shelves"*[45]*.* For similar reasons, Elizabeth Warren, now the acting Head of the Consumer Finance Protection Bureau of the US, has called for a Financial Product Safety Commission[46].

- Taking strong enforcement action against financial services providers which have breached regulations. This should include levying significant financial penalties and requiring disgorgement of all profits earned from breaching regulations. This will help ensure a proper deterrent against firms mistreating their customers.

The challenge is to strike the right balance between government regulation and market competition forces. Rules need to be proactive to prevent abuses and not simply react to the problems of the past. According to Professor Krugman, about half of the US financial products on the market prior to the financial crisis were unregulated, because the pace of product development exceeded the ability of regulation to adapt[47].

Commenting on this specific aspect, CI has previously pointed out that *"...governments and regulators are not in command of sufficient data to exercise their functions and the same is true even of those bodies such as the US SEC whose business it is to monitor markets and financial sectors. Such a situation amounts to a surrender of governmental responsibility in recent years. This trend must be reversed by better reporting mechanisms."*[48]

Recommendations to the G20 on the structure and functions of financial consumer protection bodies

The G20 should:

Adopt recommendations for minimum standards and guidelines for implementation in G20 countries and regions and commit to a regular review of their implementation. In relation to financial consumer protection bodies these steps should include:

- The existence of a national body that has consumer protection as an explicit regulatory objective; with full authority to investigate, halt and remedy violations of consumer protection law, including where necessary the right to define and prohibit specific practices or products as unfair, deceptive or otherwise illegal.
- The body should be independent of the industry, free from conflicts of interest and include a balance of members with industry and consumer expertise. There should be strong links with other consumer protection bodies (including representatives of consumers) to ensure that the experience and expertise in consumer protection is shared; representatives of the consumer interest should be integrated into the governance of the sector at national level.
- If responsibility for financial consumer protection is shared across a number of agencies, there should be proper co-ordination to ensure that the same principles and standards apply.
- The body should have effective regulatory power over every financial service provider and, in response to a serious failure to abide by consumer protection rules, it should have the power to remove an institution's licence or impose penalties sufficient to discourage repetition.
- The body should have sufficient funding and resources to conduct the tasks assigned to it.

- The body should be transparent in its decision-making and should clearly publicise occasions where it has taken action against specific practices and products or misleading financial promotions.

Identify appropriate international organisations with participation of key stakeholders, including consumer organisations, to:
- identify and share examples of good practice
- highlight bad practices that may present risks in more than one country, and
- develop standards and guidelines for international use (drawing on the recommendations above).

In the absence of appropriate international organisations, support the development of a new international organisation to undertake this work. Recommendations for such an organisation are included in the conclusion to this report.

4. Redress and dispute resolution systems

A significant element of governance is dispute resolution, which is based predominantly on individual cases (as opposed to collective consumer protection enforced by regulatory supervision. The UN Guidelines recognise in their General Principles that "availability of effective consumer redress" is a "legitimate need".

The precise form in which dispute resolution and redress takes shape varies greatly between countries. Under Art 32, the Objectives of the UN guidelines state: "*Governments should establish or maintain legal and/or administrative measures to enable consumers, or as appropriate, relevant organisations, to obtain redress through formal or informal procedures that are expeditious, fair, inexpensive and accessible. Such procedures should take particular account of the needs of low-income consumers".* For Art 33 sets out: "*Governments should encourage all enterprises to resolve consumer disputes in a fair, expeditious and informal manner, and to establish voluntary mechanisms, including advisory services and informal complaints procedures, which can provide assistance to consumers".* Art 34 goes on to say that: *"Information on available redress and other dispute-resolving procedures should be made available to consumers".*

The simultaneous application of the above three articles is essential to guarantee effective consumer redress. It implies communication and close cooperation between institutions such as state administration at central and local level, courts, consumer organisations and other NGOs, ombudsmen, etc and indeed financial service providers themselves, including those that are run by the state. The guidelines are not explicit on independence of redress mechanisms.

Consumer organisations can play an important role in representing consumers, facilitating complaints and taking part in dispute resolution systems. Around the world, CI members play a number of these roles[49], often using their experience to advocate for improvements in the system or improvements in upstream regulation to prevent disputes arising in the first place.

Specifically in relation to financial services, the World Bank has recommended in their recent report that *"Consumers should have access to expedient, inexpensive and efficient mechanisms for dispute resolution with financial institutions"[50].*

In the first instance, complaint and redress systems should seek to provide a means by which consumers and financial service providers themselves can find a solution; only in the event of agreement not being reached, should disputes move on to independent dispute resolution.

Nevertheless, there is a clear risk that the sheer volume of cases may overwhelm procedures for resolving differences:

- In Germany, where CI's member VZBCV provided a hotline for the public after the Lehman breakdown, the service was overwhelmed with 140,000 enquirers in just two months in late 2008.
- In the UK, the financial ombudsman dealt with over 160,000 complaints in 2009/10, a 28% increase in one year[51]. And in the run up to the crisis, according to a survey of 10,000

consumers carried out for the Office of Fair Trading, FS had the unique and dubious distinction of both a high *frequency* of consumer detriment (second only to telecoms) and the highest *volume* in cash terms[52].

- In Brazil, out of *all* consumer complaints going to public consumer defence bodies (PROCONS), according to the National Register of Complaints (SINDEC), 28% regarded financial services. Of these, 70% were solved by direct contact with the service providers and 30% were not. In 2010, banks were consequently asked by the regulatory authorities to make public commitments to improve relationships with consumers, establishing targets for reduction of consumer complaints registered[53].
- In France, FS account for 17% of all legal cases received by UFC-Que Choisir. Nationally, over 160,000 cases received by the local over-indebtedness commissions were outstanding at the end of 2006[54].

Ombudsman schemes

There has also been a proliferation of ombudsman-type mechanisms in recent years. In Italy, an ombudsman panel is available for low-value disputes with banks; in Germany, banking associations have, under their control, conciliation services for consumers. Australia and New Zealand both have banking ombudsmen. The Australian Electronic Funds Transfer Code of Conduct was developed by a working group of government industry and consumer representatives and is now subscribed to by most financial institutions operating electronic funds transfer services.

Some ombudsmen have been established by statute and membership is obligatory; others have been established on a voluntary basis and, as a result, membership is not compulsory, but they have nevertheless achieved fairly comprehensive coverage. In some countries, including the UK, initially voluntary mechanisms have been swept up into statutory ones. Funding may be by a levy imposed on the industry; additionally, individual companies contribute to a ‘pot’ which is held by a third party, be it government, an autonomous regulatory agency or other free-standing body that has the sole function of administering the scheme.

Ombudsmen can be defined by four key criteria:[55] they should be independent of those they have the power to investigate, and the schemes should be effective, fair, and publicly accountable. Despite terminological difficulties, the term ‘ombudsman’ has clearly caught the public’s imagination and their profile is growing all the time. It is now a legitimate aspiration for consumers to have access to Alternative Dispute Resolution (ADR) mechanisms universally, on the understanding that such mechanisms do not detract from the rights of consumers to seek judicial process after the dispute arises. The EU and the OECD have made resolutions to that effect, encouraging governments to ensure such an evolution[56].

A beneficial addition to many schemes would be for the findings of ombudsmen, or other ADR mechanisms, to be synthesised in order to feed into recommendations for the reform of the sector. Otherwise, the whole system becomes a vast treadmill with today’s cases always taking priority over tomorrow’s reform.

In many countries, civil law allows consumers to go to court, but this is unlikely to be taken up in all but the most exceptional cases. It can also be difficult to establish precedent and improved industry practice even when individual cases are solved in the consumer’s favour; this has been the experience of CI’s Russian member. The long debate on group actions in the EU has been frustrated, and yet the need is there and such mechanisms should be developed to allow consumers to join together to take action against a firm which has treated them unfairly. Perhaps, as a result of these frustrations, the energies of consumer associations have tended to be concentrated on non-court procedures such as those set out above. One way forward is for consumer associations to be awarded *‘locus standi’* (legal recognition) to be able to take action on behalf of large numbers of consumers with similar complaints.

In conclusion, while ADR mechanisms have clearly met a need, they are not a solution to more fundamental problems with consumer protection in financial services. The sheer numbers involved suggest that more needs to be done to prevent conflicts from arising in the first place and reduce the need to use the redress mechanisms.

Recommendations to the G20 on systems for dispute resolution and redress in financial services

The G20 should:

Adopt recommendations for minimum standards and guidelines for implementation in G20 countries and regions and commit to a regular review of their implementation. These steps should include:

- Access to adequate redress mechanisms for individuals to use, whether they be governmental or sectoral ombudsmen, or properly funded redress complaint systems with scope for NGO participation. Ideally, there should be one clearly identifiable scheme for redress per sector, but in any case all systems should be expeditious, fair, inexpensive and accessible. Consumers should be proactively informed about the availability of such a system.
- Synthesis of findings from these redress mechanisms to be reported to regulators in order to inform future regulation.
- Provision of collective redress mechanisms, in order to reduce the demand for individual proceedings.

Identify appropriate international organisations with participation of key stakeholders, including consumer organisations, to:

- identify and share examples of good practice
- highlight bad practices that may present risks in more than one country
- develop standards and guidelines for international use (drawing on the recommendations above).

In the absence of appropriate international organisations, support the development of a new international organisation to undertake this work. Recommendations for such an organisation are included in the conclusion to this report.

5. Promoting competition in financial services

Promoting competition in consumer financial services is a key element in ensuring good consumer protection. Effective competition delivers downward pressure on prices and upward pressure on quality and innovation. Firms respond to the needs of their customers and compete on the positive benefits or features or their products, without obscuring prices or confusing consumers with contract terms.

CI members are playing an active role in many regional and national competition authorities, as well as undertaking advocacy on the issue[57].

As the OECD has said: *"As in most sectors of the economy, the benefits of full, effective competition in the financial sector are enhanced efficiency, the provision of better products to final consumers, greater innovation, lower prices and improved international competitiveness."*[58]

In particular a market where competition works to reward firms which deliver good-value products and customer service, and punish firms which do not, would expect to have the following features:

- Competition on the merits – firms genuinely competing on the basis of the quality and value of their products or services rather than exploiting consumers' behavioural biases;
- Consumers engaged and able to compare the quality or performance of different financial products and firms;
- Consumers' access to the products they need;
- Prices, quality and characteristics of products that are transparent and easily comparable;
- Products that do not include hidden charges or unfair contract terms;
- Low barriers to market entry and exit (while preserving essential services for consumers);
- Low barriers to switching (both real and perceived);
- Consumers able to pursue effective and speedy redress where necessary.

The financial crisis has pushed competition in financial services to the fore. Yet, it should be noted that anti-competitive trends were already at work before the crisis. In Brazil, currently 75% of all deposits of the financial system are held by the five largest banks. Ten years ago, that share was 52.5%[59]. The Brazilian FS sector has been relatively unaffected by the global crisis, yet concentration by mergers has continued. The ten largest banks in 2009 became seven in July 2010 after three big mergers (Itaú-Unibanco, Santander-RealABN, Banco do Brasil-Nossa Caixa).

Issues relating to the financial crisis are addressed first before considering other means by which governments can encourage competition in the sector.

The financial crisis and competition issues

CI has already expressed concern about how the banking crisis has increased monopoly concentration in some countries[60]. During the crisis, some markets became less competitive as some banks collapsed and others were taken over or merged in order to prevent their collapse. For example, by 2010, the UK's top six banks, already highly concentrated before the financial crisis, had become even more so, accounting for 88% of retail deposits while in Germany the figure reported by the FT was 68%[61].

A key feature of the financial crisis was that there were a number of banks that, despite suffering enormous losses, were deemed 'too big to fail' and were rescued by governments, takeovers or mergers. Although this was not an issue in every country, it has been included here as it has had impacts beyond the countries where it is a problem. There are two main concerns with this process, namely the diminution of competition at tax payers' expense and the lack of transparency with which decisions were made.

As a result of the crisis, many banks received public money to save them from failing. Yet, these banks are now using that state aid to acquire other banks in merger processes (often encouraged or negotiated by national governments). Examples include the BNP takeover of FORTIS, the mergers of Spanish saving banks, the purchase of Merrill Lynch by Bank of America. The consequence is that competition, in terms of choice, is being reduced - a process which is encouraged and financed by public authorities, in markets where the concentration of supply was already high.

In terms of competition law, the rescue plans constitute state aid. The European Commission has examined and approved a considerable volume of such schemes in record time, meaning that perforce, consumers/taxpayers have not been involved in the process. So, in many countries, people do not know which banks are receiving funds and why. Taxpayers and consumers should be able to know what their money is being used for and that conditions are being imposed on their behalf in return for state aid.

Furthermore, there is a danger that they could hold consumers and taxpayers to ransom. Lest this appear paranoid, the following quote from the Financial Times takes a similar view: "*The increasingly cross-border nature of banking poses a threat to stability. It would be intolerable were UK taxpayers to be forced to bail out Barclays Capital because of losses it had taken on its investment banking activities in the US".*[62]

At the height of the crisis, such decisions may have been necessary in order to defend the wider economy and consumer interests. However, as countries emerge from the crisis, competition rules should not be seen as a luxury that countries can no longer afford.

Breaking up the banks?

In some countries concentration in financial service markets has led to a heated discussion about the desirability of 'breaking up' large banks in order to encourage competition and to deal with the implicit state subsidy that some large banks receive as a result of being 'too big to fail'.

In the meantime, the rescue plans are having ever more perverse consequences. Taxpayers have provided guarantees against losses on loans, not only to small businesses and consumers, but to hedge funds based in offshore havens, and losses on portfolios of complex securities which the bank thought it would be able to trade for a profit.[63] Markets are offering very large banks lower rates in the knowledge that, no matter how risky their activities, the state will bail them out if necessary[64]. This subsidy distorts the market and makes it harder for new banks to enter the market. It also encourages banks to intertwine highly leveraged investment and wholesale banking activities with essential retail banking activities and the payments system. As discussed in chapter 6, CI would favour more demarcation to limit the extent of the subsidy, and to protect retail banking from infection by risks taken by wholesale and investment banks.

There is also concern that in the current climate there is a danger of over-large state-supported institutions increasing margins, and suppressing genuinely useful innovation. Indeed, perversely, the state as shareholder in the rescued banks may have a stake in that suppression in order to protect its share values.

In CI's submission to the NGO consultation by Commission of experts of President of UN General Assembly on Reforms of International Monetary and Financial system (Stiglitz Committee), May 2009[65], CI stated;

> *"There may be scope for demerger powers being applied, powers that already exist in the US, and which were used in the context of the telecom 'Baby Bells' in years past. 'Too big to fail' cannot confer a long-term monopolistic status nor a recipe for public support without obligations to the public."* We expressed the view that "*If 'too big to fail' does not attract stringent obligations in return for state aid, it is the equivalent of a blackmail note".*

In many countries, the state has announced its intention to reduce the explicit guarantees it has provided to banks and to dispose of its stakes in wholly-nationalised or part-nationalised banks. In Europe, the European Commission has required banks which received state aid to make divestments, including requiring them to sell off assets, in some cases including branches serving retail consumers. However, there is a danger that unless these disposals properly consider the need to increase competition, then these divestments and wholly-owned institutions could be sold to other large banking groups – further entrenching the lack of competition for consumers.

If governments take a short-term view of trying to maximise the revenue from these sales, then all consumers will be paying a heavy price through increased cost of financial services for many years to come. Decisions on divestments in some countries show a worrying precedent. In the UK, as part of divestments required by the European Commission, Royal Bank of Scotland sold 318 retail branches to Santander. CI UK member Which? viewed this sale from one large bank to another as a huge missed opportunity to inject some much-needed competition into the UK market.

Switching products

Alongside these structural changes there are a number of steps that governments could take to support consumers switching products and thereby encouraging competition. For proper competition to exist, consumers should not experience barriers to switching financial products and services thus reducing the duration of commitments to a sole FSP[66]. This allows them to drive improvements in products and practices by exercising their consumer power and switching to providers which offer better value for money, better products and better service. It is useful to analyse switching by considering the 'switching journey' which consumers need to go through when they switch products.

This has a number of stages:

1. **Awareness**: Consumers are prompted to switch by becoming aware that they may not be getting the best deal.
2. **Information gathering/obtaining advice**: Consumers gather information about alternative products and/or obtain advice from a third party.
3. **Choose/buy**: Consumers weigh up the different options and make a decision as to which to buy.
4. **Execute**: Consumers execute the switch and/or contact their provider/providers who executes the switch for them.
5. **Post-mortem**: Consumers reflect on the costs and benefits of their decision and decide whether to switch products again.

The switching journey can breakdown at any stage. The complexity and lack of transparency in the market, in terms of product and fee structure, has rendered many consumers 'inert' – unwilling or unable to make effective choices, as already discussed. Furthermore, a loss of trust in banks, and concerns over securing access to credit, are likely to make consumers more wary of switching provider. They may perceive that any new entrants are more risky than the established incumbents (who they believe would benefit from government support if they were at risk of failing). Anxiety they may feel around the switching process including costs, concerns about the switching process going wrong or the hassle it involves, may all discourage consumers from switching.

There is no single measure which can improve switching rates, and it is important to note that measures to promote switching alone should not be seen as the sole remedy to the lack of effective competition in the banking sector. For example:

- Switching may not provide a strong enough incentive for firms to improve their price and service offering for existing customers.
- Providers may respond to the threat of switching by developing even more complex products and even product information, thus intensifying consumer inertia.
- Even with these measures, consumers still face a considerable imbalance in their relationship with banks, with a lack of choice and products that may cease to become available or change in nature.

Alongside the measures below, it will be important to commission research concerning the quality of switching decisions by consumers. As a warning, CI notes that in the UK energy market, research in 2005 found that one-third of consumers who chose to switch, transferred to a more expensive supplier.[67]

A number of measures should, however, be considered:

- Annual statements: Annual statements could be provided, clearly explaining the total cost of the product/account. Regulators could require that interest rates be provided in all communication, or for more detailed information about a customer's use of a product and holdings to be available electronically so that consumers can more efficiently compare their current product and other products that are available.
- Measures to enhance the comparability of different firm's products: The regulator could take steps to improve the comparability of products and services by ensuring that all providers offer information about charges on a standard basis. Such a step has just been enacted by the French government, in the face of resistance from the banking sector, and the EU is moving towards a code of conduct to this effect[68].
- Automated switching services: In the Netherlands a service known as the Interbank Switch Support Service (the *'Overstapservice'*) was introduced, which automatically reroutes any payments including direct debits, from the old account to the new account for up to 12 months. The regulator can take steps to ensure that, when switching savings accounts, banks use electronic transfer systems rather than sending paper-based cheques to each other.
- Portable bank account numbers: At present the consumer and the organisations to which the consumer makes regular payments bear the risk of the failure of these payments. Some form of portable bank account numbers offer a potential solution. It would eliminate the actual and perceived risk for consumers and require only the banks to make administrative changes, instead of the many organisations and people who may make payments into or receive payments from the consumer's account. There are various models for how this could work in practice, and the Swedish Bankgiro number is an example of a portable customer account number used for crediting purposes.
- Measures to diminish the duration of contracts, reducing lock-in effects on consumers.

Recommendations to the G20 on the promotion of competition in financial services

The G20 should:

Recognise:

- That allowing competition law to be overridden in the interests of financial stability is counterproductive as it results in the creation of even larger institutions and increases the probability of taxpayers needing to provide support in the future
- That the steps taken to support financial institutions which are 'too big to fail' have resulted in significant distortions of competition
- The role that additional competition in FS can play in encouraging economic recovery.

Encourage:

- Member countries to instigate independent competition inquiries into the increases in concentration and reduction of competition caused by the financial crisis.

Recommend:

- That national governments apply 'public interest tests' to the disposal of their stakes in the banking sector. This should include specific objectives to make competition stronger post- disposal of the stakes so that some of the increases in concentration are reversed.
- Steps, such as those outlined above, to ease switching of accounts for consumers.

Identify appropriate international organisations with participation of key stakeholders, including consumer organisations, to:

- Identify and share examples of good practice in the promotion of competition in financial services
- Highlight bad practices that may present risks in more than one country
- In the absence of appropriate international organisations, support the development of a new international organisation to undertake this work. Recommendations for such an organisation are included in the conclusion to this report.

6. Measures to promote stability and safety of consumers' deposits and investments

As Sir John Vickers, the Chair of the UK Independent Commission on Banking, has said: "*One of the roles of financial institutions and markets is efficiently to manage risks. Their failure to do so and indeed to amplify rather than absorb shocks from the economy at large has been spectacular. The shock from the fall in property prices, even from their inflated levels of a few years ago, should not have caused havoc on anything like the scale experienced. Rather than suffering a 'perfect storm', we had severe weather that exposed a damagingly rickety structure*"[69].

The current crisis was sparked by a failure to protect consumers. But, as indicated by the quote from Sir John Vickers, the underlying conditions leading to the crisis were due to the imbalances that had developed during recent years, magnified by highly-leveraged, largely-unregulated financial instruments and inadequate private-risk predictions.

There is a need to strengthen the role of regulatory bodies in the FS sector covering classical issues of consumer protection such as retail behaviour, but also contributing to macro-economic stability through such mechanisms of prudential supervision as:

- Reducing leverage to sustainable levels
- Reforms to make the provision of credit less volatile
- Incorporating risk assessment and risk coverage
- Clear demarcation between investment banking and retail banking
- Protecting smaller depositors from lack of funds in the event of a financial institution's instability or insolvency.

Reducing leverage to sustainable levels[70]

Expert opinion is still far from reassured that the FS industry is on the road to stability. Blundell-Wignall, Wehinger & Slovik, present the following analysis for OECD[71]:

"There are likely always to be some players eager to push complex products and trading beyond the sensible needs of industry and long-term investors in order to drive profits. Indeed, right now such activity is driving the rapid profit growth of some banks with little having been learnt from the past. "…the system will always be hostage to the 'gung ho', the question is whether there is a better way via leverage rules or rules on the structures of large conglomerates, to ensure volatile investment banking functions do not dominate the future stability of the commercial banks and financial intermediation environment…". They quote a fund manager, pessimistic about current efforts to reform: "*by working to mitigate the pain of the next catastrophe, we allow ourselves to downplay the real causes of the disaster and thereby invite another one".*

Blundell-Wignall *et al* point out that similar banking rules have produced very different results, and some countries came through recent years without a banking crisis, eg Australia, Canada, Chile, Brazil. They conclude that the 'too big to fail' banks figured prominently in the crisis. They also noted that the banks most heavily implicated in the crisis had very large investment banking components. Conversely, deposit funding was more prominent in Australian, Canadian and the more secure of the Spanish banks (eg Santander), which have not needed bail-outs. Their analysis is that direct loans generate reliable cash flows. Investment banking was found to be much more problematic in terms of contagion and counterparty risk than plain commercial banking. They conclude that larger UK/EU banks "*look like large highly leveraged hedge funds"* although with much more risky leverage ratios than regular hedge funds. In other words, the intermingling of consumers' banking activities with investment banking is a mixture of the stable and the risky to the detriment of the consumer.

This analysis suggests that the problem in the case of the US and EU markets was the instability wrought by the property bubbles and the resultant overvaluation of collateral. Credit Default Swaps (CDS) played a huge role in the crisis, following US Securities and Exchange Commission rule changes in 2004 which allowed investment banks to be supervised on a consolidated entities basis (thus raising the issue of bank legal structure). In practice this allowed *'a leap in leverage'* and a *'truly explosive growth in CDS'* from 2004 to 2007. "*In practice there is no safe amount of capital that banks can reasonably hold to protect themselves from such events … The 'too big to fail' problems peculiar to this crisis arose from the losses associated with excessive growth through derivatives and structured products".*

The OECD analysis concludes that 'plain' commercial banks can be wiped out by contagion from risky subsidiaries. This accords strongly with the conclusion of our UK member Which? Commission on Banking that: *"Structural reform should … impede cultural contamination of retail banking by investment banking"*[72].

Questions of leverage are different from matters of structure which are dealt with below, although the two are related. There is a judgement to make in that excessive leverage leads to instability and thus in the longer term to additional risks for consumers. On the other hand, reining in leverage will lead to restrictions on lending so that banks arrive at more sustainable capital ratios. The result could be that banks further limit lending to already underserved consumers and SMEs, while leaving risky behaviour unmodified and indeed supported by the morally hazardous state subsidies.

Reduction of leverage does not have to starve consumers of access to finance. Indeed it is worth noting the much lower levels of leverage for micro-finance institutions (MFIs) in developing countries, and that some states exert a central control of leverage levels, such as China. Leverage control should rather be aimed at reducing the propensity of the sector to undertake risky ventures. In this way it should counterbalance the transfer of risk over the last decade from investors to depositors, a risk which has had to be reconciled at the cost of the taxpayer and those dependent on public services (which also include state-provided financial services such as pensions and unemployment benefits). Risks should be redirected towards bondholders not depositors, and managements should bear the risks of failure.

Reforms to make the provision of credit less volatile

Clearly such reforms need to be applied at the micro-level, ie at the level of ordinary consumers as well as the macro-level. In this regard, consumer organisations have been eager to see the establishment of mechanisms to assess consumers' ability to meet their commitments, to help them manage their commitments post-contract, and to see regulatory reinforcement of responsible behaviour.

Despite the problems brought on by irresponsible lending, it is important not to return to the days when in some markets consumers could be barred from access to credit as a result of crude policies such as 'red-lining' where entire neighbourhoods were denied access on the basis of address only. Indeed, such discrimination still happens in terms of belonging to some social groups. Instead, the aim should be 'responsible credit' that is neither indiscriminate nor too restrictive, with responsibility shared between lender and borrower.

For example, one of the features thrown up by the crisis is the increasing length of the financial chain and the associated failure to allow consumers to have remedies against assignees to whom loans have been sold. Consumer credit laws need to ensure that assignees are liable for any unfair practices of the original credit seller. This would make assignees far more cautious in accepting the new portfolios, and thus eliminate the risk-insulation effect of a longer chain by providing a new economic incentive for every party at each step in the chain to evaluate independently the riskiness of the securitised assets in order to control its own risks. This could affect incentives in the remuneration system helping to move away from reckless lending. The impact of regulation in this respect is signified by the finding that those states in the US which did not have assignee liability were clearly worse in terms of FS stability[73].

Credit reference agencies

Assessment of consumers' ability to repay loans is increasingly common, often through credit reference agencies or bureaux, both public and private. In some jurisdictions, such as France and South Africa, such credit checks are mandatory. There is debate among CI members regarding the extent of data held about consumers by credit reference agencies, whether it should include positive data (such as completed agreements) as well as negative information (regarding payment defaults for example). Practice varies even among neighbouring countries: negative lists operate in France under the auspices of the *Banque de France (fiches des incidents de paiements),* while in Germany, negative as well as positive lists operate on a voluntary basis. In Belgium, under the National Bank, all credit contracts are registered and any default recorded. The national bank gives prior approval for all credit contracts (following a formula), and consultation with the Central Individual Credit Registry by lenders is mandatory. The World Bank International Finance Corporation's global credit registry project recommends inclusion of both positive and negative data.

One of the more comprehensive databases is that established by the People's Bank of China in the 90s. It features a personal credit information system connecting all commercial banks and some rural credit co-ops, and helps lenders with risk assessment (and thus indirectly consumers, whose consent is required before data is disclosed). Within a short time of being created, the database included data on 340 million customers and 97.5% of all loans granted by Chinese banks, including credit cards. It includes such basic information as previous defaults or whether a property loan was granted to first- or second-time buyers. The introduction of this database resulted in a 10% refusal rate in applications for credit[74]. While this will have left some consumers unable to borrow, it is argued that reasonable constraints on credit granting are advisable in order to avoid the recent fate of less risk-averse markets, such as the US.

China is at one end of the spectrum with positive and negative information together and centralised. Whatever the precise model, the principle is widely accepted that irresponsibly granted credit (ie without a proper assessment) should not be enforceable. As a further safeguard, consumers should have the right to check and challenge the data which is held about them. In Belgium, such access is free of charge, in the UK for a nominal charge. In the US, one credit report per year is free. These rights of consumers and obligations of credit bureaux must be subject to strict oversight and enforcement. Consumer advocates in the US have documented serious problems in getting credit report errors fixed despite clear statutory mandate. Where there are multiple credit bureaux, it is difficult for consumers to challenge them all at once[75].

Of course, the accumulation of so much data raises issues of privacy and discrimination. Relevant here is the recent reform in Brazil, where the database system was recently regulated. Under the terms of the reform, the main rights of consumers are:

- free access to information
- immediate correction to any erroneous information
- disclosure of criteria used for risk analysis
- prior information about the identity of the database manager, and
- disclosure of purpose for storing and processing of data and of recipients in case of information sharing.

The data stored has to be restricted to the analysis of risk in case of access to credit, instalment sale or commercial or financial transactions involving risk. Excessive information is prohibited (disproportionate or unrelated to the analysis), and also sensitive personal information (social and ethnic origin, health, sexual orientation, political beliefs, religious, philosophical). The quality of information must be guaranteed as objective, true, clear and easy to understand.

In developing countries, credit bureaux rarely include micro-finance (MF) client debt. It should not be assumed that this is because there is not the capacity for there have been some successful instances. For example, Jordanian and Ecuadorian micro-finance institutions (MFIs) have created industry-wide data information sharing systems based on agreement amongst MFIs. The project in Ecuador was aided by the World Bank IFC's global credit registry project, and in Jordan it was spearheaded by a FS software provider and several leading MFIs at very low cost. These examples may hold lessons for emulation, especially as commercial banks have been reluctant to share data with MFIs, and it is often too costly for MFIs to participate in the big commercial credit registries.

Dealing with the 'data shadow' of a consumer will always be an inexact science, and the problem with positive data is that it may discriminate against consumers who rarely resort to credit at all, and thus have no 'positive' history. The collection of positive data also results in such volume of data as to render the logistics of schemes problematic. For example, if a consumer tests the market by making multiple enquiries, (exactly the kind of behaviour that current theory recommends), this may be treated by the data record as multiple applications, and thus signal potential over-commitment or even fraud, with undue influence being attached to the 'verdict' of the first lender to be approached. And it is reported in the US that use of credit was encouraged, and the termination of credit cards by consumers discouraged, in order for them to develop a positive personal profile[76]. Furthermore, the more data that is collected the greater are the risks of violation of data protection rules. Ever-expanding data stacks do not resolve the dilemmas of this sector. And in any case, even the most comprehensive of registers will leave out regular expenditures such as rent or public utility bills that will also have a serious impact on a household's credit worthiness. CI members have a range of views as to whether lists should be positive or negative, or both, for mixed reasons of fairness and feasibility. But all agree that where positive data is collected, then bureaux should go to greater effort to ensure that it can be shared in a way which does not discriminate against consumers. Many members also support the double legal obligation on the lender that exists in Belgium for example, first to verify the creditworthiness of the potential borrower, and then to refuse a loan if the lender cannot reasonably envisage the likelihood of successful repayment.

There is a significant gap in the dispute settlement system in that consumers are not the clients of the credit reference agencies, and so have no recourse to the FS ombudsman in the event of a dispute over data held and acted upon. There needs therefore to be stringent application of legal rights of access to data by data subjects such as individual consumers. There need to be clear and timely processes enabling consumers to correct information with clear rights to compensation for incorrect information. Individual banks also need to be more transparent about the reasons why they have turned down applications, rather than simply referring to the data they received from the bureaux.

Risk assessment and risk coverage

Much of the above discussion is one-way traffic, that is, it concentrates on information about consumers to service providers. What about information in the opposite direction? Information to individual consumers and regulators has been dealt with already in section 2. And of course, to ensure stability in the markets, financial service providers should also provide full disclosure to relevant governments and regulators to ensure accountability and credibility and enable them to monitor markets and exercise their proper functions. CI's view is that some of this information needs to be shared with consumers to alert them to risk levels for particular products or firms, and indeed to help in choosing service providers. For example, CI's colleagues in the *Bureau Européen des Unions de Consommateurs* (BEUC), have argued that new financial products need labeling to indicate levels of risk. They argue that supervisory bodies should develop early warning systems to warn consumers of problems regarding sustainability of particular financial products, covering such issues as: guarantees of investment capital, investment volatility, retention period for expected return[77]. This service was, until recently, provided by the *Caisses d'Epargne* in France using a 'traffic light' system of indicators. (It is currently under reconsideration). A similar scheme operates in the Netherlands. In such ways, the prudential supervision of the sector can be used to the direct benefit of consumers.

Ratings agencies

Rating agencies were severely criticised for their role in the run up to the financial crisis, largely for two reasons: their technical competence in failing to sound the required alerts, and their conflicts of interest. Financial intermediaries use the published ratings to justify their advice, and so their analyses have an impact on consumers[78]. Given the importance and the significant role of rating agencies, they should bear responsibility for the reliability of the ratings published. Agencies should therefore be liable in case of gross negligence and should in any case, be answerable to the prudential supervisors for the integrity of their methodologies and operation. There have been moves in that direction in the European Union, where the European Financial Market Authority has been given supervisory responsibility notably regarding conflicts of interest, as has the Securities and Exchanges Commission in the US, under the 2010 Dodd-Frank Act.[79] It remains to be seen how effective these measures will be and what impact they will have on the global operations of the agencies[80]. In particular, CI propose a purge of conflicts of interest between the carrying out of analyses by these agencies and the subsequent public reports on the one hand, and, on the other, payment by FSPs for an evaluation which will have an impact on the value of those same businesses. The agencies need to move more to a role of independent auditing as is customary for businesses in many jurisdictions, so that the auditors themselves have a public responsibility for the validity of their reports.

Clear demarcation between investment banking and retail banking
Much of the above raises this difficult 'structural issue' on which debate has raged. The Which? Commission on Banking, which called independent witnesses concluded:

"There are strong arguments for making a unique separation of retail banking; The Commission believes that …Glass and ...Steagall [81] were correct to identify the commingling of securities trading and banking as the fault line in 20th century (US) *banking. That fault has been widened by financial innovation and deregulation (including the repeal of their 1933 Act in 1999). ...If it were deemed necessary, isolating retail banking from other banking activities could provide a measure of protection to consumers but it does not address the wider issues of scope and scale in global banking. …we must also address conflicts of interest within investment banks".* In other words a degree of separation is a step but not the entire story. Furthermore, *'demarcation'* of activities is not the same as total separation of ownership. This approach is endorsed by the OECD report cited above, which argues that capital pools need to be legally separated, rather than subsidiaries divested (as under Glass-Steagall). The recommended structure is that of non-operating holding companies. "*If the parent of the group was non-operating and could only raise equity on the market, and invest in its subsidiaries, which were legally separated – separate reporting and balance sheets with their own boards and governance – then an entirely new dynamic is introduced. ...* (with) *capital in separate silos"[82].* A non-operating parent would have no authority to shift capital between subsidiaries in a crisis, by special dividends for example.

Ring-fencing of this nature would mean that any shut-down would be much less damaging and would make the execution of 'living wills' less complex. CI supports the preparation of living wills, and believes that they should offer a form of published guarantee to consumers that their interests will be considered alongside other stakeholders in an equitable manner in the event of a collapse. Indeed the preparation of living wills is a crucial first step, as by introducing a credible threat of failure they should help competition work more effectively by ensuring that financial institutions which are badly run or take excessive risks are allowed to fail. They would help support a change of regulatory approach away from trying to pretend that failure can be prevented in all circumstances, and towards ensuring that failure can occur, but in a way which does not have catastrophic consequences for consumers or the economy as a whole. By introducing a firebreak into the system, clear demarcation will also help reduce the probability of excessive risk-taking in the investment, and wholesale bank infecting the retail bank.

Furthermore, the OECD report suggests that: "*To protect consumers, deposit insurance and other guarantees could apply to the bank without being extended to the legally separate securities firm."* This approach embraces the separation of function and the risk of cross-contamination and also allows regulated 'utility' activities to be separately identified in the way that other essential networks, such as water and electricity, are regulated within enterprises that have a wider range of activities. CI agrees with this distinction between function and ownership.

This does not mean that divestment should be ruled out however, and full divestment remains as a weapon of the regulatory authorities in the longer term. But divestment is always a more dramatic step and bound to involve extensive procedures and extensive challenge by the industry. In contrast, the demarcation of function is something which we would expect on an every day basis including in well-functioning financial institutions. Indeed, as the OECD report indicates, the non-operating holding company (NOHC) structure simply reflects many existing profit-centre structures, but goes one step further by applying legal separation to capital silos.

Needless to say, many banks will resist moves to establish the NOHC structure because it affects short-term returns in that it reduces the scope for consumers' resources to be used by investment banks as they have been hitherto. That is indeed the case and is indeed CI's objective if greater stability is to be achieved. This means that voluntary restraint is unlikely to be successful.

Protecting smaller depositors

Consumers use deposit products to deal with their basic financial needs (such as transactional banking) and to hold money as a store of value. This means that they could be particularly vulnerable to any banking crisis which results in the insolvency of an individual bank. To cover deposits in the event of bank failure, many governments have introduced or expanded the coverage of explicit deposit protection schemes. For consumers, even several hours without access to their deposits could impose substantial consumer detriment as was shown during the recent state-mandated bank closures in Egypt. Without adequate protection for their deposits consumers will be less likely to engage with the financial services industry.

In some countries, a banking institution can operate under several different brand names but it needs to be so licensed by the regulator. If the coverage under the deposit protection scheme is only available for each institution, then a consumer who has several accounts with different brands under the same licence will only be compensated up to the limit in the scheme. There are concerns that consumers will not be able to understand the complexities that this approach introduces. Given the plethora of different brands, it is extremely difficult for consumers to understand the corporate structure of a bank and determine whether their money is protected.

This was confirmed in research carried out by the UK regulator, the Financial Services Authority, which showed consumers "*identified the brands as being different entities, leading to an assumption that all separate brands would be treated separately for the purposes of compensation*". The FSA research found that "*The discovery that this separation might apply, but could not be taken for granted, was a shock that prompted considerable criticism of both the system and the banks which had a single authorisation across brands. This was seen as unfair at best and underhand at worst, a practice intended to benefit the banks at the expense of their customers*"[83].

Many consumers will face situations during their lifetime where they hold temporary high balances in their bank accounts – for example if they sell a house, receive a redundancy pay-out or benefit from an inheritance. For such ordinary consumers, issues of speed of payment of deposit guarantee schemes may be vital. For example, the 30,000 German depositors who lost out after the failure of the Icelandic bank Kauthing had to wait an unconscionable length of time for what compensation came their way[84]. In the light of such events, consideration needs to be given to whether consumers should have access to a class of deposits which carries a 100% guarantee, but is only invested in safe assets.

Enhancing deposit protection could also include reform to bankruptcy procedures so that the ranking of creditors is changed to put depositors at the top. As the Future of Banking Commission concluded: "*This would have the added advantage of removing the additional protection which is currently afforded to bondholders by the belief that, since they rank in the same order as depositors, their investment will be protected. It must be made clear that bondholders can lose money and will not be supported by the government*"[85].

To what extent are the above measures practicable in technical and political terms? CI believes that some progress has been made by the new US Dodd-Frank Wall St Reform and Consumer Protection Act. The new Act:

- Establishes the Financial Stability Oversight Council, a council of regulators to monitor growing risks in the financial system, with the goal of preventing companies from becoming 'too big to fail' and stopping asset bubbles from forming, such as the one that led to the housing crisis.
- Creates an independent Consumer Financial Protection Bureau funded through the Federal Reserve System. The CFPB is charged with writing rules against unfair, deceptive, or abusive practices in most financial products and is given significant powers in the supervision and enforcement of large banks and certain non-bank providers of financial services products.

- Empowers the Federal Reserve to supervise the largest, most complex financial companies to ensure that the government understands the risks and complexities of firms that could pose a risk to the broader economy.
- Expands the government's power to seize and liquidate a failing financial company in a way that protects taxpayers from future bailouts.
- Gives regulators new powers to oversee the giant derivatives market, increasing transparency by forcing most contracts to be traded through third-parties instead of only between banks and their customers. Derivatives are complex financial instruments. Speculative trading in the contracts led to losses at many banks in the 2008 crisis.

Recommendations to the G20 on promoting stability in financial services

The G20 should:

Agree:

- To use leverage control to reduce risky activity rather than starve consumers and businesses of access to credit
- To use NOHC company structures to complement leverage ratios to address contagion and counterparty risk directly
- To make ratings agencies liable for the validity of their analyses, and answerable to prudential supervisors.

Recommend:

- that systems are developed to assess consumers' capacity to take on financial commitments
- that regulatory agencies share risk data with consumers regarding individual service providers
- that loan assignees should be liable for the practice of the original credit granter
- that demarcation needs to be maintained between investment banking and retail banking reducing risk of cross-contamination through legal separation of operations
- insolvency procedures are reformed so that the rank of creditors is changed to put depositors at the top
- that deposit protection schemes should provide cover for each separate brand and create a seamless transition of essential banking services with consumers maintaining access to deposits used for transactional banking
- that any payment from the protection scheme regarding deposits held in savings accounts should be made within a fixed and reasonable time limit. Measures should also be introduced to provide flexible cover for temporary high balances.

Identify appropriate international organisations with participation of key stakeholders, including consumer organisations, to:

- identify and share examples of good practice
- highlight bad practices that may present risks in more than one country
- develop standards and guidelines for international use (drawing on the recommendations above).

In the absence of appropriate international organisations, support the development of a new international organisation to undertake this work. Recommendations for such an organisation are included in the conclusion to this report.

7. Access to basic financial services and the role of new forms of service

Some of the most innovative work in terms of extending access to FS has been done in developing countries in recent years. The best known are the development of micro-finance (encompassing credit, deposits, insurance, remittances) now well established, and the more recent development of mobile banking. Both of these services are in fact spreading from developing countries to the richer countries, sometimes targeting immigrant populations (such as ADIE in France and Grameen America), but arising also from the realisation that they have new elements to offer. New and technologically innovative FS could have a major role to play in promoting universal access and improved competition. Nevertheless there are CP issues that need to be addressed to allow such new forms to achieve financial inclusion while protecting the poor, maybe semi-literate, consumer.

Universal service

The questions about the newly evolving services need to be framed in terms of their contribution to the goal of universal service, an aim which is supported by the G20 programme on financial inclusion. Some studies have expressed concern that regulation should not stifle innovation[86]. However abuses, scandals and monopolies are just as significant a risk to the sector. Regulation can also be used to create incentives for the industry to support the development of universal service.

Retail banking is already fairly universal in scope in the OECD countries, at least in its basic forms. In that sense, it is sometimes described as a 'utility'[87] or as a 'service of general interest' in EU parlance[88]. Banking services have also entered the debate on universal service at a more global level too, notably in India and South Africa. The UK, France, Sweden and Ireland among others have tried by legal means to broaden access[89]. In France, anyone seeking to open an account, but rejected by a bank, can contact the *Banque de France*, which will provide a named bank, often the post bank, which will be obliged to open a bank account for that person. In Belgium, all high street banks have to offer basic current accounts to all citizens on the basis of defined fair conditions. In other countries postal banks are given the task of providing basic banking services.

Progress in the direction of universal service has been sponsored by legislation in several countries. The Reserve Bank of India (RBI) has initiated the National Rural Financial Inclusion Plan (NRFIP) with a clear target to provide access to comprehensive financial services, including credit, to at least 50% of the financially excluded rural cultivator/non-cultivator households, by 2012 through rural/semi-urban branches of Commercial Banks and Regional Rural Banks. The remaining households have to be covered by 2015[90]. Failure to meet coverage targets results in an obligation to buy government bonds, and there have been obligations, no longer in effect, to open rural branches as a prerequisite for opening urban branches. Some Latin American countries have similar obligations covering priority sectors, usually expressed as a percentage of lending portfolios.

The US Treasury Department provides incentives to investors in rural and under-invested areas through Community Development Financial Institutions (CDFI) grants. Recently, Accion, a noted micro-finance lender and investor, has received CDFI status in several states where it offers MF services, (Florida, New York, California, Georgia)[91].

The European Commission has made universal access to basic banking services an explicit objective and a draft Directive is expected in April 2011. CI colleagues in the *Bureau Européen des Unions de Consommateurs* (BEUC), have strongly supported this objective, declaring simply that: "*Every EU citizen and resident should have access to a basic bank account"* going on to say that "*Access to a saving scheme for low income consumers should also be taken into account"*[92].

Basic bank accounts (BBAs) are already up and running in Belgium, Italy, France, Netherlands and UK, although there are practical problems in making universal access to BBAs a reality. Although there is not a single model for BBAs, they involve such features as[93]:

- inward direct payments (eg wages)
- inward payment of cheques without charge
- ATM cash cards
- Post office withdrawal facilities, and
- direct debit facilities.

(Features which BBAs frequently lack are debit cards, cheque books, and overdrafts).

Moreover, despite progress towards BBAs in Europe, BEUC report that there remain problems in getting them to become a reality. They traced problems in Italy, Germany, Denmark and the UK where there were two million adults living in 1.3 million households without access to a bank account in 2005[94]. Some 23% of Italian adults are unbanked and 14% of families do not even have a Post Bank account, according to the Bank of Italy[95]. CI's French colleagues have noted that the right to a bank account is not working in practice, with the result that there are several million 'unbanked' adults in France, and that it is possible for banks to impose conditions which do not amount to an outright refusal but are likely to be refused by the consumer, who can thus be deemed to have refused the offer of service. A recent interesting development, which also illustrates lack of access among the very poorest in rich countries, has been the development of micro-credit services, public and private, aimed at the excluded populations in major agglomerations, such as Paris, London, Brussels and New York as indicated earlier.

Can progress towards full inclusion be made without regulation to that effect? BEUC has expressed scepticism regarding self-regulatory codes. They report disappointing results in Slovenia, Germany and Belgium. The EC's own report concludes that the record of self-regulation is mixed. "*Effectiveness and compliance problems of voluntary charters are currently questioned (Italy and Germany* (by government)*); or have paved the way to the introduction of a regulatory system (France and Belgium) while other experiences are rather positive and ensure high levels of transaction banking inclusion (UK and Netherlands)"*[96]*.* For reasons of this unevenness within the EU market, BEUC do not support the 'soft law' approach and instead argue for EU legislation creating an obligation on all providers to offer BBAs setting minimum common standards.

Diversification of access to financial Services
Innovation may have much to offer in developing countries where access is still relatively low. So far some countries, notably Kenya, Brazil and the Philippines, have adopted a relatively liberal approach to the development of branchless banking, for example[97], and the use of banking agents, and this has increased access to money transfer services for poor consumers. There are dangers that too demanding a regulatory regime may stifle such developments while at the same time there is a need to regulate risks to consumers. Access to banking services certainly varies according to technological innovation. For example, numbers of bank branches are 30.6 per 100,000 people in developed countries. This is about three times more than such developed Latin American countries as Brazil, (9.5) and Chile (11.3) and five times more than Peru (5.9). However, regarding ATM machines, the gap is narrower; there are 64.3 per 100,000 in developed countries, compared with 40.5 for Brazil, 36.9 for Chile and only 9.1 for Peru[98]. This narrower gap indicates the greater dispersal of ATMs and associated electronic tools such as debit cards compared with the slow roll out associated with 'bricks and mortar'. (Note: this is not to assume interoperability of bank cards at ATMs).

An interesting example is Brazil, which saw a decline in the number of banks during 1990s, followed by an increase in bank branches since 2000. According to Kumar, in 2005, only 60 million of its 176 million population were covered by bank accounts - one-third of the population - even though some 80 million were considered 'bankable'[99]. More recent estimates by government researchers suggest that 40% of the population do not have bank accounts[100]. This restriction in access has knock-on effects. The cost of credit remains high, and bank spreads (ie differentials between rates of interest paid to depositors and rates of charge levied on borrowers) are among the highest in the world[101].

Legislation imposes a duty on the banks to provide a basic set of services free of charge such as debit cards, cheque accounts, statements and savings account services[102], but as CI's Brazilian colleagues IDEC discovered in a survey, only 50% of banks comply with it. So, it is understandable that other outlets are sought both by policy makers attempting to raise coverage and by individual consumers seeking service. Such outlets are known as 'bank correspondents' or agents. They are usually commercial institutions such as car dealers, supermarkets or pharmacies, even lottery payment centres, all of which outnumber more conventional service agency points such as post offices. Other financial institutions, such as credit cooperatives and microcredit institutions, can be agents.

There are around 118,000 bank agents in Brazil, and they have increased in number by over 85% between 2000 and 2008 compared with a 17% increase in the number of bank branches. Bank account payments and deposits are dealt with by only 30% of agents, a wider set of agents handle other functions which banks traditionally carry out. For example, bill payments account for 75% of all agent transactions, and half of them are accounted for by utility bills, thus carrying major implications for the whole range of basic services. Government transfers (such as social security payments) are dealt with by agents accounting for 7.3% of agent transfers. The poorest regions of Brazil, such as the North-East, have the highest proportion of bill payments and welfare payments, and indeed the highest prevalence of agents (as opposed to bank branches). IDEC have expressed concern about the proliferation of agents, and this illustrates the dilemma of failure of a service to meet all potential customers on the one hand, and fear of risks to consumers from new developments on the other.

It is also important to recognise long established institutions, such as the credit unions, which are sometimes hampered by legislation compared with the commercial sector[103]. Such institutions can make a difference to overall access to FS; for example Jamaica had a rate of bank service coverage of almost 60% as long ago as 1997[104]. This is far higher than other countries of similar income level, and is doubtless due to the successful development of credit unions in the Caribbean.

FS functions are increasingly being handled by bodies other than banks. Clearly these developments raise issues regarding consumer protection even though the evidence shows that they are rapidly increasing access to FS for the poor, especially when combined with new technology such as mobile telephony where access by the poor has also massively increased in recent years. This can only bring huge improvements such as reduction in travel time and personal risk involved in transporting money to family members in rural areas for example. Another virtuous circle is the greater ease of payment of utility bills (for which many consumers in poor countries have to queue for hours), which brings about a reduction in wasted time, and an increase in payment levels to the utility, thus improving revenue and services.

Remittances

There is a monopolistic situation in the remittance sector, which can reach 30% of GDP in some countries[105]. CI has received reports of market share between 65% and 100% in some Francophone African countries for Western Union, for example[106]. In many developing countries, the development of new money transfer systems for cash remittances is helping to erode such *de facto* monopolies, which lead to high money transfer charges. The current developments in ‘branchless banking’ therefore hold considerable promise for ‘unbanked’ consumers in poor countries who may well have mobile phones. There are over one billion consumers with mobile phones in the world but no bank accounts, a situation that cries out for innovation[107].

The global market for international remittances is sometimes estimated to exceed international aid. The flows are very variable with echoes of past colonial patterns of migration such as France-Africa, UK-India, while others are simply a replication of migration patterns: US-Latin America, Gulf States–Pakistan; Italy-Philippines; but also intra-regional, eg Russia-Former Soviet Republics, South Africa-Sub-Saharan Africa, Australia-Pacific islands; or internal from metropolis to rural areas, eg Nairobi – rural Kenya, Bangkok-NE Thailand, urban China-rural China. Thus G20 countries are heavily involved in the remittance business, even though this involvement may not be fully apparent to the general public.

African remittances account for about US$10 billion annually and in Sub-Saharan Africa they rose by 55% between 2000 and 2005. They are now thought to be in decline because of the recession in the ‘exporting’ countries, with the likelihood of greater unemployment among migrant workers. The *Agence Française de Développement* estimates that in Francophone Africa there is a 65-100% market share belonging to Western Union. Commission often runs to 10-15% with the result that many use informal ‘money porters’, with all the risks that that implies[108]. Remittances are however a very efficient source of revenue in that a high proportion is saved, 40% in one IMF study[109].

In brief, the consumer issues in the remittance sector are:

- security for money transfer
- protection against excessive and multiple charges (for example fees and adverse conversion rates)
- competition and risk of abuse of dominant position by major service providers
- development of alternative provisions such as the International Remittance Network, and
- the implications of new technology such as mobile telephone transmission.

General Principles on Remittances were issued by the Bank for International Settlements and the Committee on Payment and Settlement Systems in 2007 to set out public policy objectives to guide policy makers and regulators to achieve “*safe and efficient international remittance services. To this end the markets for the services should be contestable, transparent, accessible and sound*”[110]. While they are a useful set of principles, consumer protection only figures as a part of one of the stated principles, and then jointly with transparency. A second principle covering efficiency is equally appropriate to consumers and providers but a third principle, dealing with *sound, predictable, non-discriminatory and proportionate legal and regulatory framework in relevant jurisdictions,* uses the language normally used in the context of preventing discrimination against particular service providers rather than against particular consumers. The principles also cover *Roles of remittance service providers and public authorities,* but the recommendation for industry participation in governance is not accompanied by any parallel recommendation for consumer participation. So the BIS/CPSS principles clearly have some way to go before they could be described as consumer-orientated. But they are a start.

Regulation of mobile financial services

The mobile telephony/money transfer sub-sector is witnessing a major debate between advocates of regulation through banks and other forms of regulation. There are issues surrounding whether such services should be bank-led (as in India, where registered micro-finance institutions (MFIs) and post offices can be agents, but otherwise restrictions are tight) or more diverse as in the Philippines, where mobile operators and banks have taken the lead and small retail outlets can be agents too[111]. The Telecom Regulatory Authority of India has taken the initiative to fix tariffs for banking and other FS on mobile phones to ensure affordability of m-banking for poor rural households.

In Africa, there are similar variations in approach. Kenya has adopted the more open approach as in the Philippines, while South Africa has approached telephone money transfers through bank regulation. Both approaches have their advocates. M-Pesa was introduced by Safaricom in Kenya in March 2007 with initial support from the Financial Deepening Challenge Fund of the UK Department for International Development. The service provides an SMS-based, low cost, person-to-person, money transfer facility, which also allows the user to purchase prepaid goods and services (eg mobile top-up time and utility payments). It has seen subscribers increase from around 100,000 around its launch to more than seven million by August 2009. During that time M-Pesa moved some 130 billion Kenyan shillings (US$1.7billion) around the country. The average transaction is less than $40, but, by 2009, the volume had risen to US$8.5 million per day[112]. M-Pesa also took the strategic decision to develop its own regulations and to behave as if it were a regulated entity, and now offers savings accounts through a partnership with Equity Bank in Kenya.

It is still early days in the development of telephone money transfers, and therefore of its regulation. The development of standards is likely to be tied up with the development of regulation and whether it should be 'light touch'. The lighter the touch the greater the likely reliance on self-regulation and on voluntary standards. CI has been asked by ISO COPOLCO to assist them in assessing the need, if any, for international standards in these emergent areas[113].

Microfinance

A rather more mature sector is Microfinance although in terms of recognition as a financial service it still has some way to go. Principles for client protection in Microfinance (MF) were drawn up by CGAP (Consultative Group to Advise the Poor – a trust fund of the World Bank)[114]. These have been influenced increasing concern among MF providers that they were facing criticisms. MFTransparency (sometimes described as the 'industry policeman'),[115] describes itself as "*a global initiative for fair and transparent pricing in the microfinance industry".* It aims to become the "*venue for the MF industry to publicly demonstrate its commitment to pricing transparency integrity and poverty alleviation".* In Indonesia, in 2008, Muhhamad Yunus, the founder of Grameen and Nobel Prize winner, having singled out for criticism the recently commercialised Compartamos of Mexico in 2007, warned against "*new loan sharks created in the name of microcredit"*[116]. Such concerns, which augment as micro-credit gathers pace, seem to be generating greater pressure for industry standards to develop, as governments are nervous about over-regulating a sub-sector which they had previously claimed was something of a success.

However, having been widely praised, microfinance is now undergoing something of a moral crisis. Both poles of the debate may be exaggerated. There is no doubt that repayment rates in MF have been very high and that in itself is a considerable achievement and lays to rest the stereotype of the feckless poor. Moreover, as the sector has grown, in states such as Bolivia, India, Nicaragua and the Balkan states, the industry has started to saturate the urban market leading to repayment problems. A period of 'client overlap' has set in whereby people are juggling micro-credits from multiple MFIs – quite possibly using one loan to pay another, sometimes because the microcredit issued by one MFI is rarely enough to cover the intended use, as the MFI values repayment ability and minimises risk to itself. Currently in Bangladesh, for example, 40% of Grameen bank clients get loans from other institutions at the same time. In Bosnia, recently one MFIs Portfolio at Risk (PAR) went from well below 3% (ie very good) to four and then five in short time, followed by further serious deterioration.

These are indications that the sector is showing stress and some undesirable practices are emerging. One worrying practice, in effect a kind of product bundling or tying-in, is to take forced savings. For example, an MFI grants a loan of US$100, but retains US$25 in a 'savings account' on which it does not pay interest to the consumer; on the contrary, the borrower continues to pay interest on the full amount borrowed. This renders calculations such as APR even more complex than usual. Already interest rates are difficult to estimate as they may not always be clear as to whether or not the loan is a flat rate or a declining rate as the loan is reduced. Such calculations are only just being standardised in the rich countries, and so it is perhaps not surprising that these problems exist. Microfinance Transparency has created a microloan calculator and has gathered pricing data on a variety of developing country MF products.

Other worrying practices include: not giving the client a copy of the loan agreement (corrupt loan officers can then change the terms of the agreement, demanding more fees for late payments etc); inappropriate practices with regard to collateralisation such as asking for collateral valued at 300-400% of the loan amount; not utilising legal registration procedures, and selling collaterals without the consent of the borrower and without due process.

In the absence of imposed standards, some MF providers are developing their own standards. Client protection principles were developed as a code of ethics by Accion and other industry investors who established the Smart Campaign, following criticism of the US$150 million profit by Compartamos of Mexico[117]. Microfinance Transparency guidelines have been developed and endorsed by various NGOs, development agencies and service providers working to raise standards in the absence of standards developed by governments. In Uganda, for example, the Association of Microfinance Institutions has developed a code of practice for consumer protection with a focus on disclosure and financial education. It has been adopted by 42 MFIs and is a condition of entry to the association thus providing a 'badge' of conduct to reassure consumers[118].

It should not be forgotten that the MF sector serves some of the poorest consumers, many of whom are illiterate, and therefore extremely vulnerable to being misled even though they may have considerable competence in terms of family finance. A moral and legal case could be made for standards of CP being higher in this sector than for services that deal with richer clients. Currently, despite its achievements, the MF sector appears to be in need of basic CP practices.

Recommendations to the G20 on basic financial services and the role of new forms of service

The G20 should:

Recognise:

- access to a free or affordable basic payment account as a universal service and a right
- the need to balance the encouragement of innovation with the need for consumer protection in emerging financial services, for example by supporting the development of consumer protection standards in money transfer by mobile phone.

Encourage:

- the development of safe, effective, low-cost methods for banking inclusion
- the development of consumer protection standards in micro-finance.

Recommend:

- the development of the General Principles on Remittances (2007) with a view to introducing a stronger consumer orientation, with CP as a primary objective.

In support of the above actions, identify appropriate international organisations, with participation of key stakeholders, including consumer organisations, to:

- identify and share examples of good practice
- highlight bad practices that may present risks in more than one country
- develop standards and guidelines for international use.

In the absence of appropriate international organisations, support the development of a new international organisation to undertake this work. Recommendations for such an organisation are included in the conclusion to this report.

8. Conclusion: ongoing international cooperation on FCP including reviews of implementation

This paper has clearly highlighted the need for improved regulation in financial services. This is an urgent task. Failure to take action exposes individual consumers to considerable risk, but also threatens financial and economic stability and progress.

International action has an important role to play in supporting national implementation of improved FCP for a number of reasons:

- The Financial crisis showed that weak consumer protection in one country can now pose a risk to other countries. In the context of interconnected global financial service markets, financial consumer protection has become an international issue.
- With the global dimension of financial services and the increasing interdependence of financial markets, all FS market conduct regulators around the world now face similar issues and challenges. It is common sense for regulators to have a common platform where they can compare notes on consumer protection and information, and share best practice.
- Following the recent financial crisis, consumers have lost confidence in the financial services sector. A visible international organisation whose role is to protect consumers and ensure transparency, accountability and good practice could serve to build consumer confidence.

Whilst G20 adoption of the recommendations made in this paper will be a significant step forward, in order for the recommendations to become internationally relevant and establish a mechanism to review their implementation, a permanent international organisation should be established. The new organisation should have a remit including:

- Enabling cooperation and the exchange of information between national financial consumer protection organisations (state and private) so that they are better able to promote fair, safe and competitive markets in financial services
- The development of minimum international standards and guidelines to support and improve financial consumer protection
- Active cooperation with other international financial organisations (such as the World Bank and FSB) and international consumer organisations (such as the International Consumer Protection and Enforcement Network-ICPEN) in order to assist with consumer protection issues relating to international research, guidelines and agreements. This would include fraud monitoring and scrutiny of industry practices and high risk practices, communicating the information to FS regulators with suggestions for action.

The new organisation would ensure that the consumer perspective was represented in the international debates regarding 'recovery and resolution plans', deposit insurance schemes and micro- and macro-prudential regulation, as well as debates around financial inclusion.

The aim should be a virtuous circle in which good practices are notified to a body mandated by G20, endorsed by that body and then disseminated back to all G20 countries with recommendations for implementation.

However, international cooperation on financial consumer protection is currently limited to a loose international network of national financial consumer protection bodies called FinCoNet. FinCoNet has between 20 and 40 national members, operates an email system for sharing information and holds occasional meetings. The existence of FinCoNet is recognition of the need to share experience and expertise amongst national government financial consumer protection agencies. Still, FinCoNet does not have the resources or mandate to do this to the extent needed. It does not have a permanent secretariat and representation is not at a high level. There have already been some specific discussions within the network about the need to establish a secretariat.

Organisations such as the one CI is calling for have been established to facilitate exchange and develop principles in other areas of the financial services market, indeed the G20 expressed its support for the International Organization of Securities Commission (IOSCO) in the statement from the Toronto summit[119]: *"[*The G20] *acknowledged the significant work of the IOSCO to facilitate the exchange of information amongst regulators and supervisors, as well as IOSCO's principles regarding the oversight of hedge funds aimed at addressing related regulatory and systemic risks."*

There is also an International Organisation of Pension Supervisors (formed in 2004, previously a network) and an International Association of Insurance Supervisors.

The structure and governance of the new organisation

- The new organisation should maintain a network structure, as the linkage into national financial consumer protection agencies would give it geographical spread and reduce costs. Moreover, it should have the resources to establish a secretariat – possibly based at the Bank for International Settlements in Basel, Switzerland where the secretariat for the Financial Stability Board is also located.
- An independent consumer panel should be established, made up of representatives from independent consumer organisations with competence in financial consumer protection, to monitor, advise and challenge the work of the organisation. The panel should be free to conduct its own research and publish its views and findings[120]. Representation from national bodies may be complicated by the fact that the structures for financial consumer protection differ considerably from one country to another. Different aspects of financial consumer protection can also be divided between different bodies within countries making it hard to identify one organisation or individual that has overall responsibility or even an overview. Although this may create a challenge for some countries it underlines the importance of establishing a system for ensuring consistency within countries, either through the establishment of one body or through effective coordination.
- The new organisation should be given consultative status with other international financial regulatory bodies in order to assist with consumer protection issues relating to international research, papers, guidelines and agreements. These should include the Financial Stability Board, the Basel Committee on Banking Supervision, the IMF, the World Bank and the International Association of Deposit Insurers.

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