

Keywords: consumer financial protection, financial stability, disclosure, transparency, financial education, international principles and standards, financial regulation.

CONSUMER PROTECTION IN THE FINANCIAL SECTOR: *recent regulatory developments*

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After examining the significant international and Australian developments in financial consumer protection, this paper indicates that new international principles and standards in this area lack cohesion and leave a number of important issues unanswered. It finds that there remains much work to be done. An earlier version of this paper was presented to the 2012 Australian Centre for Financial Studies' Melbourne Money and Finance Conference.¹

What is consumer protection?

The current discussion about consumer protection usually revolves around the following concepts:

- > *Transparency:* this concept usually refers to disclosure of key terms and conditions, including applicable interest rates and their method of calculation, fees and charges and applicable returns that might be paid to an investor.
 - > *Product suitability:* this is about ensuring that financial products sold to a customer are suitable for their needs and objectives, with a particular emphasis on the prevention of over-indebtedness.
 - > *Dispute resolution:* the emphasis here is on access to low-cost, independent, accessible internal and external dispute resolution schemes that are binding on the financial institutions concerned.
 - > *Financial education:* The premise here is that consumers should be able to understand the nature of basic financial products and services, and the attendant risks, and have the capability to access and use these products and services.
- > such rules contribute to financial inclusion policies through building trust in the financial system (especially when coupled with financial education programs); and
 - > financial stability – the G20 Leaders' Declaration for the G20 Cannes Summit of 3–4 November 2011 stated: 'We agree that integration of financial consumer protection policies into regulatory and supervisory frameworks contributes to strengthening financial stability'.

Regulatory developments

International

This section contains a brief summary of the more significant global developments in relation to financial consumer protection regulatory issues. Within this context, the key question is whether we are heading for new international financial consumer protection principles with a new international regulator.

G20 Group

The G20 has been active in promoting further regulatory protections for consumers of financial products and services in the international arena.

The November 2009 Official Declaration of the G20 Pittsburg Summit declared that:²

12. Yet our work is not done. Far more needs to be done to protect consumers, depositors, and investors against abusive market practices, promote high quality standards, and help ensure the world does not face a crisis of the scope we have seen. We are committed to take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage.

Why is consumer financial protection important?

Some of the key reasons why consumer financial protection is necessary are:

- > competitive markets are more likely with informed consumers and where suppliers operate on a level playing field;
- > increasingly complex products and services merit more effective disclosure of the risks and benefits and better financial advice regimes;
- > the use of new technologies to deliver financial services (such as smart cards and mobile phones) increases the complexities and risks of the payment system and the associated products;

The G20 Financial Inclusion Experts Group was subsequently formed and, through its Access Through Innovation Sub Group (of which Australia was co-Chair) produced the G20 Principles for Innovative Financial Inclusion. These principles were subsequently endorsed by G20 leaders at their meeting in Toronto in June, 2010.³ Importantly, Principle 4 highlights the need for:

Protection: Encourage a comprehensive approach to consumer protection that recognises the roles of government, providers and consumers.

The need for further international work on enhancing consumer protection was subsequently noted in the G20 Seoul Summit Leaders' Declaration of 11-12 November, 2010: 'Enhancing consumer protection: We asked the FSB to work in collaboration with the OECD and international organizations 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' (paragraph 41).⁴

Subsequently an important request was made at the February 2011 meeting of the G20 Finance Ministers and Central Bank Governors for 'the OECD, the FSB and other relevant international organizations to develop common principles on consumer protection in the field of financial services by our October meeting' (paragraph 6).⁵

In response to this request, the OECD Financial Consumer Protection Task Force developed the Final High-level Principles on Financial Consumer Protection (FCP Principles), which were endorsed by the G20 Finance Ministers and Central Bank Governors at their meeting on 14-15 October 2011.⁶

The FCP Principles are stated to be non-binding, to apply to all financial services sectors and to supplement, and not be a substitute for, relevant international standards or guidelines. They cover the following issues (in summary):

- > *Principle 1: Legal, Regulatory and Supervisory Framework* – the emphasis in this principle is on financial consumer protection being an integral part of the legal, regulatory and supervisory framework, while recognising the need to take into account the context in individual countries;
- > *Principle 2: Role of Oversight Bodies* – the recommendation is that there be an oversight body with specific responsibility for financial consumer protection (dedicated or not) and with appropriate authority, governance and independence;
- > *Principle 3: Equitable and Fair Treatment of Consumers* – this principle is all about treating customers 'equitably, honestly and fairly at all stages of their relationship with financial service providers'.

- > *Principle 4: Disclosure and Transparency* – customers should be given notice of the fundamental benefits, risks and terms of a financial product, advised of conflicts of interest and given objective advice;
- > *Principle 5: Financial Education and Awareness* – the emphasis is on the need for campaigns to ensure that consumers have the knowledge, skills and confidence to understand the risks with financial products and to make informed choices;
- > *Principle 6: Responsible Business Conduct of Financial Services Providers and Authorised Agents* – this principle proposes that financial service providers and their agents should aim to act in the best interests of customers, that the financial capabilities, situation and needs of a customer should be assessed and that remuneration structures should be designed to encourage fair treatment, responsible conduct and to avoid conflicts;
- > *Principle 7: Protection of Consumer Assets Against Fraud and Misuse* – this principle proposes that 'information, control and protection mechanisms should appropriately and with a high degree of certainty protect consumers' deposits, savings, and other similar financial assets';
- > *Principle 8: Protection of Consumer Data and Privacy* – the call here is for 'appropriate control and protection mechanisms' to protect personal information;
- > *Principle 9: Complaints Handling and Redress* – the principle proposes that consumers should have access to redress mechanisms which are 'accessible, affordable, independent, fair, accountable, timely and efficient'; and
- > *Principle 10: Competition* – this principle emphasises encouraging competition and making it easy to switch providers.

Subsequently, the G20/OECD Task Force on Financial Consumer Protection developed a 24-month Work Plan to support the implementation of the FCP Principles, which was endorsed by the G20 Leaders at their 2012 Summit held in Los Cabos, with an update to be provided by the Leaders' Summit in St. Petersburg in 2013.⁷

In its role as the current G20 President, Mexico has also called for the establishment of a global consumer protection body and suggested the International Financial Consumer Protection Network (FinCoNet) might take on the role.⁸ FinCoNet is an international organisation of market conduct and financial consumer protection supervisors. However, the Leaders' Declaration at the Los Cabos G20 2012 meeting simply noted the discussion on the FinCoNet Statutes without making a specific statement of support of the proposal for a new international body.⁹

The World Bank

The World Bank has also developed the 2012 Good Practices on Financial Consumer Protection (Good Practices).¹⁰ The Good Practices do not purport to be a definitive statement of what should be the global rules for financial consumer protection. Nevertheless they are influential as they are used as the basis for the diagnostic reviews conducted by the bank in developing and emerging economies.

The Good Practices cover the following financial sector areas: banking, non-banking financial institutions, securities, insurance, pensions and financial literacy and identify '39 basic Good Practices found in a well-functioning financial consumer protection regime' covering the following topics:

- > Consumer Protection Institutions (Section A);
- > Disclosure and Sales Practices (Section B);
- > Customer Account Handling and Maintenance (Section C);
- > Privacy and Data Protection (Section D);
- > Dispute Resolution Mechanisms (Section E);
- > Guarantee Schemes and Insolvency (Section F); and
- > Consumer Empowerment and Financial Literacy (Section G).¹¹

International Standard Setting Bodies

The International Standard Setting Bodies (SSBs) include the following (among others): Basel Committee on Banking Supervision (BCB); the International Association of Insurance Supervisors (IAIS); the Financial Action Task Force (FATF); the International Association of Deposit Insurers (IADI); and the Committee on Payment and Settlement Systems (CPSS). They too have been encouraged to increase their focus on financial consumer protection issues.

The SSBs have been encouraged to increase their focus on financial consumer protection in a CGAP July 2011 White Paper entitled *Global Standard-Setting Bodies and Financial Inclusion for the Poor: Towards Proportionate Standards and Guidance*. The paper proceeds on the basis that financial consumer protection is central to the core mandates of the SSBs (other than FATF) as well as the goal of financial inclusion (p. 5). In summary, the SSBs were encouraged:

- > to engage with the dialogue around the development of the abovementioned FCP Principles;
- > to support basic consumer protections in each jurisdiction, while having regard to the country context; and
- > to encourage rules which are consistent across product types (p. 43).

Examples of financial consumer protection initiatives undertaken by the SSBs include:

- > IOSCO has released a Consultation Report on consumer protection (suitability) issues relevant to the distribution of complex financial products to retail and non-retail customers (including suitability and disclosure requirements). The public comment period closed on 21 May 2012.¹²
- > The October 2011 Insurance Core Principles, Standards, Guidance and Assessment Methodology released by the IAIS are designed to provide global regulatory standards for the entire insurance industry. They have extensive recommendations relating to the 'fair treatment of customers', which encompass many of the consumer protection principles discussed above (see section 19).¹³

The US Dodd-Frank Act

One would be remiss to finish without mentioning the United States Dodd-Frank Act. The objective of the Act was stated to be:

to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail', to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.

Some of the more notable consumer protection reforms were:

- > *Consumer Financial Protection Bureau*: the bureau is an independent entity in the Federal Reserve.
- > *Responsible lending*: Under the ability to repay test (s. 1411), 'no loan is to be made unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a 'reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance) and assessments'. Similar rules apply to recommendations made by mortgage originators.
- > *Fees*: there are limits on certain fees (such as prepayment fees).
- > *Commissions*: commissions cannot vary based on the terms of the loan (other than the amount of the principal).
- > *Licensing*: mortgage originators must be licensed and registered.
- > *Unfair practices*: there is a prohibition on abusive or unfair lending practices based on race, ethnicity, gender or age.
- > *Disclosures*: additional disclosures are required in relation to repayments on variable rate loans, settlement charges, origination fees and total interest as a per cent of the principal.

- > *Statements*: there are new requirements for residential mortgage statements to include information on interest rates, principal owing, prepayment and late fees, information about counselling agencies etc.
- > *High-cost mortgages*: there are limits on interest rate increases and other limitations on matters such as late fees, acceleration clauses, anti-avoidance conduct etc.
- > *Office of Housing Counselling*: this new office has functions related to homeownership counselling and rental housing counselling.

Australia and recent financial consumer protection regulation

Some highlights of the initiatives taken by Australia in recent years that are directly relevant to financial consumer protection regulation include the following:

- > New responsible lending rules for consumer credit products were introduced in the *National Consumer Credit Protection Act 2009* (NCCPA): there are three essential steps in the assessment process: (a) make 'reasonable enquiries' about a consumer's requirements, objectives, financial situation; (b) take reasonable steps to verify the consumer's financial situation; and (c) make an assessment about whether the credit contract is 'not unsuitable' for the consumer. There are also documentary obligations relating to the provision of credit guides, quotes and a copy of the suitability assessment.
- > *Termination fees*: there has been a ban on certain termination fees designed to make it easier for customers to switch banks.¹⁴
- > *Key Facts Sheets for standard home loans*: the new requirement to provide a standard form Key Facts Sheet is designed to give a consumer essential information about a standard form home loan for comparative purposes.¹⁵
- > *Credit cards*: there are new requirements for Key Facts Sheets for credit cards, restrictions on the offering of credit card limit increases and requirements to give further information on statements.¹⁶
- > *The Future of Financial Advice (FoFA) reforms*: these reforms are designed to improve the quality of advice consumers receive and increase access to more affordable kinds of financial advice.¹⁷
- > *Unfair terms*: an 'unfair' term which is in a standard form contract for financial products or services will be void. In summary, an 'unfair term' exists where there is a significant imbalance between the rights and obligations of the parties, the term is not reasonably necessary to protect the legitimate interests of the parties and it would cause detriment to the weaker party.

- > *e-Payments code*: this new code regulates electronic payments, requires subscribers to give consumers terms and conditions and charges and establishes a regime for mistaken payments.¹⁸

Are we heading towards international consumer protection principles or standards?

The developments indicated above might be considered to go a long way towards providing an international framework for effective consumer protection principles or standards. However, there remain a number of outstanding issues, including the following.

The global standards being developed are not consistent: Individual countries clearly take a different approach to the content of financial consumer protection rules and this is also true of the global initiatives described above (the G20 FCP Principles and the World Bank's Good Practices). Nevertheless, the issues which are covered are generally consistent and it is to be hoped that a coordinated approach might be agreed.

Implementation is difficult: It is one thing to establish the rules, having them implemented is a significantly harder and more long-term task. This is evidenced by the slow steps being taken in relation to implementation of the G20's FCP Principles where the implementation effort seems to be focused on information sharing about experience in implementing particular principles, rather than a coordinated international effort.

Financial consumer protection rules need to be supported by financial capability: As noted by the OECD Secretary-General, Angel Gurría when opening the October 2011 OECD G20 Conference on Financial Consumer Protection:

Let me remind you that consumer protection is part of a broader picture that should include prevention and education, and we believe that the G20 should continue putting an emphasis, not only on implementing the principles, but on forthcoming financial education issues.¹⁹

Are some products too complex for consumers in the retail market? In recent years a number of jurisdictions (including Australia) have introduced rules requiring specialised suitability advice and disclosures for certain products offered to retail customers (for example, the responsible lending rules in Australia). However, advice and disclosure requirements are only one part of the story, especially insofar as complex products are concerned. Such products might include, for example, hybrid debt-equity instruments, collateralised debt obligations and complex derivatives. This issue is at the heart of the product intervention powers being proposed

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for the UK's Financial Conduct Authority and in the review of the European Union's Markets in Financial Instruments Directive.

What do consumers really need? Do we really understand effective disclosure from the consumer perspective? In recent years there has been an emphasis in behavioural economics on how consumers make decisions, and it is arguable that there should be much more focus on this issue.²⁰

Who is a consumer? The issue here is whether financial consumer protection rules should protect a person who acquires a facility for a business purpose, as well as a personal or a domestic purpose, how a 'small business' might be defined and whether there should be a monetary limit on the facilities which are covered.

Conclusion

Significant work has been undertaken to bolster the rules on consumer protection as they apply to financial products and services. However, there is still much more to be done to determine whether we are addressing the right issues and in the most effective way. In particular, the G20's FCP Principles need to be closely examined against other global initiatives in this area. Active debate is also needed on whether we should be looking for the establishment of a new global financial consumer protection and capability standard setter. ■

Notes

1. The views expressed in this paper are personal views of the author and do not represent the views of the University of New South Wales or any member of the CIFR Consortium.
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3. <http://www.g20.utoronto.ca/2010/to-principles.html>
4. <http://www.g20.utoronto.ca/summits/2010seoul.html>
5. <http://www.g20-g8.com/g8-g20/g20/english/for-the-press/news-releases/meeting-of-finance-ministers-and-central-bank.970.html>
6. <http://www.oecd.org/dataoecd/58/26/48892010.pdf>
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8. <http://blogs.worldbank.org/psd/mexico-s-g-20-presidential-agenda-on-financial-inclusion>
9. http://g20.org/images/stories/docs/g20/conclu/G20_Leaders_Declaration_2012_1.pdf
10. <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTERNALFINANCIALSECTOR/0,,contentMDK:22876721-pagePK:148956-piPK:216618-theSitePK:282885,00.html>
11. Page 6 of the Good Practices.
12. *Suitability Requirements With Respect to the Distribution of Complex Financial Products Consultation Report*. IOSCO February 2012 <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD373.pdf>
13. www.iaisweb.org
14. *National Consumer Credit Act Protection Regulations 2010* reg 79A.
15. *National Consumer Credit Protection Act 2009* pt 3-2A.
16. *National Consumer Credit Protection Act 2009* pt 3-2B.
17. *Corporations Act 2001*, pt 7.7A.
18. 2011 Australian e-payments Code: see <http://www.asic.gov.au/asic/asic.nsf/byheadline/Electronic+Funds+Transfer%3A+Code+of+Conduct?opendocument>
19. http://www.oecd.org/document/41/0,3746,en_21571361_44315115_48880873_1_1_1_1,00.html
20. See, for example, E. Shafir 2008, 'A behavioural perspective on consumer protection', *Competition and Consumer Law Journal*, vol. 15, p. 302.