



## Consumers International

### Consumers International's position on the financial crisis

#### Summary

Consumers International (CI) has over 200 member organisations in over 100 countries worldwide. Large numbers of their individual members are being affected in different ways by the financial crisis. So far the greatest attention has been paid to consumers as borrowers and savers, and of course we share that concern, but we also point to the position of users or potential users of public services, including state provided financial services (FS), who could be penalised by the diversion of funds necessary to prop up banks and other industries.

Most consumers organise their finances responsibly. Yet, they currently face the paradox of being blamed for the present crisis due to **insufficient** prudence (irresponsible borrowing) while hampering recovery because of an **excess** of prudence (insufficient consumption). Consumers have their part to play, but the FS sector, its regulators and governments need to set their own houses in order so that recovery can get under way. This should not be seen as 'going back to normal' for it is quite clear that the pre-crisis situation was far from normal. Reform is essential.

The following overview leads us to some clear conclusions and recommendations. We also comment on the recent G20 proposals which are analysed at the end of the document.

#### 1. Regulation

The crisis started with a failure to protect consumers. It was magnified by highly leveraged, largely unregulated financial instruments and inadequate private risk predictions. Effective, affirmative, preventative consumer protection must be a top tier regulatory goal from now on.

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 mechanisms of prudential supervision such as:

- Reducing leverage to sustainable levels
- Incorporating risk assessment and risk coverage
- Clear demarcation between investment banking and retail banking
- Reforms to the regulation of capital and liquidity to make the provision of credit less volatile.

Conflicts of interest need to be purged from the FS sector. It is clear that key parts of the financial system cannot be expected to perform for the long-term health of the system if they are overseen only by managers with short-term goals or by self-regulatory entities.

## *2. Consumer protection*

Despite some steps to improve credit information to consumers, we believe that the industry is still lagging behind the necessary level of transparency and consumer protection - we have encountered continuing examples of poor practice from different regions.

Stronger measures than improved disclosure of information will be necessary to protect consumers. Financial products must be designed with features, pricing and risks understandable to the intended consumers. Regulators must have the authority, obligation and the will to stop harmful product features and practices.

## *3. Universal service*

In the context of massive taxpayer support for the banking sector on the grounds that it is 'too big to fail', there is a strong case for the obligatory support across the sector for socially desirable objectives such as universal service and sustainable development. Legislative and financial support should be developed for the promotion of new institutions such as credit unions and other financial cooperatives. In the meantime, the necessary social obligations must accompany any subsidies and guarantees which consumers and taxpayers have been or are being called upon to provide. The role of the multilateral financial (public) institutions must be maintained to shield developing countries, who were not to blame for the crisis, from adverse effects on the development of vital services.

## *4. Competition*

In the event of mergers and acquisitions, many of which have already taken place, the resultant dilution of competition rules is fraught with long-term dangers for consumers. There is a clear need for strong, transparent and independent regulation, with strict reporting requirements to allow macro-economic policy to proceed on an informed basis, and within a legislative framework that sets out the counter-balances to the new monopolies.

## *Conclusions on G20*

- We welcome the G20 proposals for Flexible Credit Lines and expanded Special Drawing Rights. These need to be accompanied by a return to the original IMF mandate to increase financial stability rather than govern the minutiae of national fiscal policy. The control of public deficits and the use of public funds to guarantee the financial system must not be at the expense of vital public services.
- IMF structures of governance need to be reformed so that no one country can apply a national veto.

- Rescue funds should be granted only subject to strict conditions and should be designed to be of lasting benefit in terms of forming a long-term investment in human and physical capital.

We go on to discuss the origin of the crisis in the richer economies and its global impact. From there we move on to policy recommendations, including those emanating from the recent G20 summit.

### **Consumers and the origin of the crisis**

At the root of this crisis lies the evolution of the banking system, characterised by the blurring of the lines between retail and investment banking, and ever lengthening chains of derivative financial products in which loans are sold on to third parties by the original lenders who retain little or no interest in the soundness of those underlying loans. Traditional safeguards such as the requirement for banks to maintain a percentage of their deposits in cash and other realisable assets have been eroded as banking activities have diversified. The effect has been that, in the words of John Kay, (first Director of the Said Business School at Oxford University), “*Once conservative universal banks took the opportunity to use the cheap funds provided by their retail depositors to speculate in global capital markets*<sup>1</sup>.” In other words, ever larger liabilities became reliant on the cash reserves provided by the bank’s customers. So a much needed safeguard is to regulate the extent to which the banks can exercise such leverage, which clearly reached unsustainable multiples. Consumer deposits and any taxpayer expense both need to be ‘ring fenced’ from speculative investment, and this may require regulatory approaches towards ‘universal’ services such as retail banking which are different from those towards the services provided by investment banks. Precise regulatory arrangements will vary by country.

In the words of our US colleagues, Consumers Union (CU), the complex financial instruments that sparked the financial crisis were based on home loans that were poorly underwritten; unsuitable to the borrower; arranged by persons not bound to act in the best interest of the borrower; and with terms so complex that many individual homeowners had little opportunity to understand fully the nature or magnitude of the risks of these loans<sup>2</sup>. A consequence of the process of longer chains of financial commitments has been that lenders have paid less attention to the credit worthiness of their borrowers, for selling-on insulates them from the future consequences of bad debt, while commissions on sale of loans is immediate.

The way to increase ‘shareholder value’ (the commonly used benchmark for business performance) was seen to be to take on more risk through ratcheting up lending. This risk was under-priced and packages of loans were frequently sold to other banks thus keeping risk inside the banking system, where it became ever more difficult to measure. Under the resultant pattern of perverse incentives, lenders were able to profit from poorly underwritten loans. According to *The Economist* 24 January

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<sup>1</sup> John Kay, *Making banks boring again*. In *Prospect*, January 2009

<sup>2</sup> (See *The Faces of Foreclosure*, a video presentation of stories of individuals caught up in the mortgage crisis at <http://www.defendyourdollars.org/video.html>)

2009, in the US, financial services accounted for 14% of GDP at the peak level in 2007, accounting for 5% of private sector jobs, but no less than 40% of total corporate profits and 23% of stock market value. According to UNCTAD, FS profits as a percentage of total corporate profits reached that 40% level from a base of only 6% in the 1980s<sup>3</sup>.

This shift in the balance of incentives has rebounded against consumers by encouraging credit growth, the under-pricing of risk and stoking up house prices. It has meant that consumers have found themselves caught up in financial practices of which they have no knowledge. The overall shift in the rich country economies has been towards ever more serious under-capitalisation of banks and ever more serious over-valuation of consumers' biggest collateral assets, their houses, or in some cases, their pensions. The system proved to be pro-cyclical, magnifying the boom but also making the eventual bust and the contraction of lending more dramatic. Banking needs to return to first principles. Indeed it needs to be forced to do so as the condition of the huge financial support it has received.

### **The macro- economic impact of the crisis on consumers**

Despite the widely confessed ignorance of the dimensions of the problem, the general consensus is that it is several degrees worse than first thought. And its ramifications have spread far beyond the rich economies where it started. For example, according to the PPIAF (Public Private Infrastructure Advisory Facility) newsletter of January 2009, from August to November 2008 public-private infrastructure agreements in developing countries were 40% down over the same period in 2007 on some very conservative assumptions. And this is during a period when many projects were already in the pipeline with agreed finance. Worryingly, their note in the PPIAF bulletin *Gridlines* refers to the 'flight to quality' by banks and other financial institutions, ie to 'more stringent financial conditions, lower debt/equity ratios, more conservative structures' as well as likely reduction in demand, project revenue and reduced financial viability. In other words, the 'flight to quality' translates into the search for lower risk.

The PPIAF note emphasizes the growing role of public sector banks in the light of what it describes as the collapse of the syndication market and the inactivity of bond markets leading to the costs of financing becoming 'unprecedentedly high'.<sup>4</sup> The latest data from PPIAF indicates that the slowdown is continuing in terms of private investment with cancellations mounting.<sup>5</sup> In the meantime, multilateral and bilateral agencies remain a key lifeline, as do public banks.

The Public Services International Research Unit (PSIRU) point out that the banking problem is largely confined to the EU and US, and also that government spending has not been a primary contributor to the crisis. (Of course the effect of the recession will be to depress public budgets due for example to commodity prices and trade both falling, but that is a consequence and not a cause). David Hall for PSIRU made the following calculation in December 2008: '*The total cost of constructing sewers and*

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<sup>3</sup> UN conference, *World Financial and Economic Crisis and its impact on development*, draft outcome document, presented by M. D'Escoto Brockmann, 2009

<sup>4</sup> PPIAF *Newsletter*, January 2009

<sup>5</sup> PPIAF *Gridlines*, March 2009

*water systems throughout the world's cities, to provide household connections for water and sewerage for over three quarters of the urban population in developing countries, would require €280 billion – about 5% of the guarantees already given to the banks.'*<sup>6</sup> (The guarantees are reported as €6 trillion with €645 billion being spent in the EU and US buying bank and insurance company shares, as of December 2008).

After years of campaigning for infrastructure development on behalf of the poorest consumers, and being told that resources are scarce and risks are too high to guarantee, it is profoundly shocking that such resources appear in a matter of weeks to bail out an industry which has failed to meet its prudential obligations. As a result of cancellations of public and private programmes for the development of vital networks, a high price for the crisis will be paid by the 800 million people in developing countries without ready access to drinking water, the 2 billion without access to sanitation, and the 2 billion without access to electricity.

In developed countries, it is present and future taxpayers that will have to pay the bill currently being incurred and this raises an issue which is perhaps so obvious as to have been little remarked upon. Discussion of financial service rescue plans has concentrated on banking services provided by 'high street' and investment banks. However, this overlooks the huge role of the state in providing financial services in the form of pensions, unemployment and sickness benefits, in fact the whole range of social security services. *These are financial services every bit as much as private sector financial products.* The lack of attention to them perhaps derives from an assumption that they are 'safe' because they are provided by the state. We fear that this is an illusion. If governments continue to try to hold down public sector borrowing (as some are clearly trying to do) and yet commit vast sums to bank support, then downward pressure on social security spending (often the largest single budget line) is most probable. The speed with which bank rescues were undertaken illustrates how private financial services have been pushed to the top of the public expenditure list and taken precedence. In distributional terms, this is almost bound to be socially regressive given the reliance of the poor on social security as a financial service of last resort.

### **Is the crisis in banking the fault of consumers?**

Households have the responsibility to manage their own affairs and not to take on excessive commitments. The generality of consumers do take care, which is one reason why we would caution against excessive reining in of credit, for its denial can cause (and is causing) hardship as can its excessive use. Even in the EU member state with the highest reliance on personal credit, the UK, a 2005 survey found that the majority of households had access to financial services (FS) and generally proceeded without undue difficulty. Most people surveyed managed well with credit: *'keeping up with bills and commitments, not constantly in overdraft, nor were they using a credit card they did not repay in full to buy food, pay bills or get cash.* Six in ten households were *'financially sound'* and a

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<sup>6</sup> D Hall, *Economic crisis and public services*. Public Services International Research Unit (PSIRU), December 2008, [www.psiru.org](http://www.psiru.org)

further one quarter were '*managing reasonably well*'.<sup>7</sup> So where is the problem? We believe it lies in the explanations we have provided above. Clearly, returns to FS professionals have been excessive and incentives perverse, and these tendencies have accelerated over the last two decades.

### ***The role of consumer financial literacy***

It is tempting to view sub-prime lending and the resultant problems through the prism of the need for consumer education to promote financial 'literacy'. CI has long been an enthusiastic advocate of consumer education which we see as a 'given', one of the basic consumer rights adopted by the UN in 1985. In the current context, one can point to the need for financial literacy to avoid the kind of excessive credit commitments that were experienced in the US sub-prime market, with destabilising consequences. CI investigations in Latin America, for instance, identify the same needs in the the region's evolving consumer credit sector.

However, we would caution against the argument that the crisis is due to a lack of consumer education. The problem is more fundamental. In some markets, the complexity that defeated careful market conduct was present at more than one level, both at the level of products offered directly to individual consumers and further upstream at the 'wholesale' level. Complex pricing and design created an illusion of affordability not just for consumers but for financial institutions and for regulators. This illusion proved to be tragically temporary.

Furthermore, the syndrome spread beyond 'ordinary' consumers. Clearly the clients of Bernard Madoff in the US and *Societe Generale* in France could not be described as lacking access to financial advice. But they were swindled because they could not keep track of the financial transactions that were under way, and furthermore, **neither could the regulators**. Highly paid board members, senior managers and regulators failed to spot that business models of many financial institutions were subject to significant risk and were ultimately unsustainable. Indeed our contention is that some of the financial products and business structure that have evolved in recent years are incomprehensible, even to the most expert observers, including quite possibly many of the agents that have been selling or operating them. In arguing this, we find ourselves in good company, namely the UN Commission of Experts of the President of the General Assembly on reforms of the international monetary and financial system, chaired by Joseph Stiglitz. In its report of 29 March 2009, the Stiglitz Committee discussed the need for transparency in the development of financial regulation, on which there is a wide consensus. However, the report goes on to make the further point that: "*Even if there had been full disclosure of derivative positions, their complexity was so great as to make an evaluation of the balance sheet of the financial institutions extraordinarily difficult*".<sup>8</sup>

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<sup>7</sup> E Kempson and A Atkinson, *Overstretched: people at risk of financial difficulties*. University of Bristol Personal Finance Research Centre, 2006

<sup>8</sup> UN Commission of Experts of the President of the General Assembly on reforms of the international monetary and financial system; *Recommendations 63<sup>rd</sup> session agenda item 48* UN 2009, para 40

As if in confirmation of the Stiglitz Committee, in her recent speech to DECO, the Portuguese consumer association, EC Consumer Affairs Commissioner, Meglena Kuneva reported on a study on banking services which her Director General had commissioned and which found that: *“in two thirds of cases (the expert consultants) were unable to disentangle the structure of bank tariffs in order to ascertain the true cost of a service. If experts are unable to understand the fee structure, what chance is there for ordinary consumers?”*<sup>9</sup> In other words the problems of the sector go beyond consumer education, indeed we would argue that they go beyond even transparency. Commissioner Kuneva alluded to this when she said that regulators should take action to: *“exclude certain ‘toxic’ credit products from retail shelves”*.

While many ‘sophisticated’ consumers have been ‘burnt’ during the financial crisis, conversely many ‘ordinary’ consumers had managed their affairs including savings and credit relatively well over the years, and so turning off the credit tap would be unfair to them. By way of strengthening this point, we would refer to our 2003 publication *Globalisation for all-reviving the spirit of Bretton Woods*,<sup>10</sup> in which we pointed to significant savings ratios in many countries with modest income levels, 20% of GDP in ‘low income countries’ including 15% in sub-Saharan Africa, and 26% in middle income countries, compared with 23% in ‘high income countries’. We have been informed that the current rate in India is in excess of 30%.

This suggests three conclusions: a) many individual consumers are better at managing their financial affairs than are many governments; b) poor consumers are no less competent than rich consumers, and c) regulatory intervention in the market is essential to prevent the design of financial products from defeating prudent consumer decisions. The well publicised success of the Grameen Bank is not a one off, there is scant evidence that poor consumers taken as a group, are financially incapable although of course there will always be individual examples at all income levels.

### **The case for regulation**

‘Old fashioned’ regulation, as discussed below, is due for revival rather than denigration as an unnecessary interference in the market, as has been the case in recent years. Our general approach to the degree of regulation necessary is the principle of proportionality. In financial services, the risks are high as the purchases of financial ‘products’, such as pensions or mortgages, are infrequent, large, difficult to understand and difficult to exit once committed. A high degree of consumer protection is therefore required and always will be as these are permanent features of the FS market. The one-off purchases made by consumers are very different from the repeat purchases made by finance houses. For that reason we favour the safeguards for consumers which were implicit in the clear division between investment banking and retail banking that was represented by such measures as the recently repealed US Glass-Steagall Act.

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<sup>9</sup> Commissioner Meglena Kuneva, *Restoring Consumer trust in retail financial services*. DECO 35<sup>th</sup> anniversary seminar on financial services and the consumer interest held in Lisbon, 27 April 2009

<sup>10</sup> Ian McAuley *Globalisation for all-reviving the spirit of Bretton Woods* - an examination of developments in global financial markets. Consumers International (CI), 2003

We identify several levels and components of regulation, starting with disclosure of information which itself runs along a spectrum from information to individual consumers, to information to regulators. Midway along that point, there is information to the public (including potential consumers). This may be provided by the activities of our member organisations (which include governmental consumer protection agencies) and others, publishing independent evaluations of financial service products. For this to happen there needs to be greater disclosure of performance indicators.

### ***Information to consumers***

Calls for information to consumers have a long pedigree and in theory are uncontroversial. As long ago as 1962, President John F Kennedy in his now famous message on consumer protection to the US Congress said: *“Marketing is increasingly impersonal. Consumer choice is influenced by mass advertising utilizing highly developed arts of persuasion. The consumer usually does not know how much he pays for consumer credit.”* The point is still valid and lies behind the ‘truth in lending’ principle successfully elaborated in the US covering such matters as: annual percentage rates, total charge for credit, charges included and excluded, and calculation of extortionate credit and remedies.

But even these basic principles set out so long ago are not being correctly observed. For example, even while the financial crisis was getting under way, the UK Office of Fair Trading also found that *“key information”* to consumers among high street banks on such matters as bank charges, interest and switching was *“not easy to find”*. Information to consumers about basic bank accounts, of particular interest to poorer consumers was especially lacking<sup>11</sup>. In fairness the situation was found to have improved between May 2007 when the survey was done and a follow up survey in May 2008, but this improvement may have come too late to help many consumers.

It is sometimes felt that there is the risk of information overload, and this may be so if information is provided in a mechanistic and unclear way, but this argument has been abused as an excuse not to disclose. It is possible to improve information to consumers as was done by the introduction of the ‘summary box’ adopted under US law, and subsequently emulated elsewhere.

### ***Information to regulators***

One of the most frightening aspects of the current crisis is that no one can be considered expert any more. From our conversations with colleagues and members around the world we are dismayed by the degree of ignorance of the state of global finance being expressed by even the most expert observers and actors. Governments and regulators are not in command of sufficient data to exercise their functions and the same is true even of those bodies 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.

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<sup>11</sup> Office of Fair Trading (OFT), *Summary Report of Review of 1) published information banks provide for consumers and 2) selected price comparison sites; Annex B of personal current accounts in the UK – an OFT market study*, July 2008

Some of those reporting mechanisms can be shared with consumers. For example, our colleagues in the *Bureau Europeen des Unions de Consommateurs*, (BEUC), have argued that new financial products need labeling to indicate level 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.<sup>12</sup> This service is provided by the *Caisses d'Epargne* in France using a 'traffic light' system of indicators. 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.

The 'too complex to regulate' syndrome is a real problem. The difficulties that some of the very largest international financial institutions have experienced, raise the question about whether some large financial institutions have become "too big to manage" and "too complex to regulate." It is clear that off balance sheet risk exposures contribute to this problem. It is vital to ensure systemic financial stability but this cannot happen if significant risk exposures can continue to be maintained off the balance sheet. We suggest that a system needs to be in place (at an international level) which ensures clear and transparent exposure, risk reporting and regulatory oversight of risk.

### ***Consumer protection***

Notwithstanding the above, several of our member associations, including colleagues in the US and in Australia, have made the point to us that consumer protection should go far beyond the basics of disclosure of terms to consumers. Our US member, Consumers Union, observed in presenting evidence to the Stiglitz enquiry that disclosure, while necessary, was not a sufficient condition for functioning markets and for consumer protection. They argued that proactive, affirmative consumer protection is essential for the safety and soundness of the financial system.

Consumers require proportional protection against unfair contracts, deceptive pricing information and deceptive product design. These basic requirements never go away, although they may involve a mix of sectoral (legislation peculiar to financial services, for example presentation of financial information) and generic (regulation of advertising, for example unfair contract terms legislation to protect against oppressive practices such as tied contracts).

One of the features thrown up by the crisis has been 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. Those states in the US which did not have assignee liability were clearly worse in this respect according to Engel and McCoy<sup>13</sup>. So, 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 restrain the length of the transaction chains that have contributed to the crisis).

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<sup>12</sup> BEUC *Facing up to the financial crisis*, January 2009 p4 and 5

<sup>13</sup> K C Engel and P A McCoy *Turning a blind eye: Wall St finance of predatory lending*.75 Fordham Law Review, March 2007

We see the regulatory architecture as comprising distinct regulatory functions such as prudential supervision on the one hand, and, on the other, general consumer protection including strong rules against unfair practices or product features and effective dispute resolution mechanisms for individuals. But there is also the question of the regulatory sanctions and the reach of the regulators in a world of international operators.

Our German member organisation, Verbraucherzentrale Bundesverband (VZBV), make the point that companies operating transnationally need to be monitored transnationally, singling out for special mention deposit guarantees, investor protection and cross-border redress<sup>14</sup>. For example, 30,000 German depositors have not been compensated for the failure of the Icelandic bank, Kauthing, and 40,000 investors lost their savings for old age due to the collapse of Lehmann brothers<sup>15</sup>. Such experiences are likely to lead to a retreat from the development of regional institutions with loss of the possible benefits of regional competition unless regulators in different countries improve their cooperation.

We continue to receive reports from our members elsewhere that the most basic principles of consumer protection are still not being adhered to across frontiers. Our members in Latin America have observed practices among European and American banks operating extra-territorially which would not be allowed in the US and European Union<sup>16</sup>. Here are some examples:

- Refusal by banks to provide a sight in advance of contracts which consumers need to sign to obtain credit or open accounts; general lack of information on rates, conditions or additional features of credit agreements.
- A clause in a contract issued by Banco Santander in Uruguay stating that the contract *“is not an adhesion contract in the terms of the Uruguayan Consumer Law as the consumer can freely negotiate the terms”* which our colleagues find to be in breach of Uruguayan law.
- Citibank in Peru levying a ‘fine’ on consumers when it considered that a complaint was unnecessary or must be dismissed. This is allowed neither in other Latin American countries nor in the US (and is against the spirit and the letter of the recommendations on dispute resolution as agreed during 2007 by the OECD).

Continued bad practices do not inspire confidence that the banks will reach, by themselves, the level of regulatory compliance that is necessary to protect consumers at the macro- and micro-levels. Innovation in financial service products can be genuinely creative when responding to consumer needs. But, to quote the Stiglitz committee again: *“While there has been innovation, too much innovation was aimed at regulatory, tax and accounting arbitrage, and too little at meeting the real*

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<sup>14</sup> Verbraucherzentrale Bundesverband (VZBV), *Position paper of VZBV on the context of the financial crisis*. November 2008

<sup>15</sup> Verbraucherzentrale Bundesverband VZBV, *Driving European recovery for Consumers*. Berlin, May 2009

<sup>16</sup> Antonino Serra Cambeceres, *Informe regional sobre los créditos de consumo, contratos y publicidad en bancos de 5 países de América Latina: Argentina, Brasil, Chile, Perú y Uruguay*. Consumers International (CI) 2009

needs of ordinary citizens... *Financial regulation must be designed so as to enhance meaningful innovation that improves risk management and capital allocation.*<sup>17</sup> Regulation that stops deceptive and harmful financial product features also could refocus the industry's creativity on honest competition to offer the best product at the best price, rather than just products that appear to be suitable to the individual but in fact are not.

### **Universal and affordable service**

Regulation is frequently perceived as being negative, ie stopping companies from doing abusive things. But, given the massive guarantees and state aids that we have witnessed, positive requirements are legitimate. Can one legitimately ask banks why they are **not** lending to companies or consumers that have sound applications for credit? (The question is particularly appropriate in the light of renewed lending between financial institutions.)

Regulation may be used to steer the creativity of industry through incentives promoting the development of universal service backed up by regulation. There is also the need for institutional initiatives, such as the development of credit unions, which are sometimes hampered by legislation compared with the commercial sector<sup>18</sup>. Such institutions can make a difference, the case of the Grameen bank is well known in South Asia but, for example, Jamaica also had a rate of banking coverage of almost 60% as long ago as 1997<sup>19</sup>. This is far higher than other countries of similar income level, and is doubtless due to the successful developments of credit unions, a feature of the Caribbean region.

Retail banking is both fairly universal in scope in the OECD countries and relatively simple in its basic functions, and in that sense should be relatively easy to regulate. Indeed it is sometimes described as a 'utility'<sup>20</sup> or as a 'service of general interest' in EU parlance.<sup>21</sup> Banking services have also entered the debate on universal service at a more global level too, including India and South Africa. The UK, France, Sweden, and Ireland among others have tried by legal means to broaden access<sup>22</sup>. 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 Office 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 task of providing basic banking services. In India, failure to meet coverage targets results in an obligation to buy government bonds.

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<sup>17</sup> Stiglitz UN *op cit.* para 56

<sup>18</sup> Banca Etica, see: NGLS, Civil society consultation on the work of the President of the General Assembly on reforms of the international monetary and financial system, p.19

<sup>19</sup> Claessens *op cit*

<sup>20</sup> John Kay *Making banks boring again.* In *Prospect*, January 2009

<sup>21</sup> EC *Green Paper on services of general interest*; COM (2003) 270 final, Brussels 2003

<sup>22</sup> *Universal Access to financial services: a review of the issues and public policy objectives*; Stijn Claessens World Bank in *Liberalisation and universal access to basic services*, OECD/WB Paris 2005

Such social objectives as universal service should also be applied in sectors which form part of the social infrastructure. Examples are, extension of banking to the poor, extension of energy and water networks, finance for sustainable development including mitigation/adaptation to climate change, as well as adoption of charters of good practice. Such charters already exist, such as the South African banking charter of 2003 and the CI global energy charter drawn up in 2008<sup>23</sup>. Banking services, including international financial institutions, have a role to play in that respect, by extending loans for investment purposes. To that end, the role of public banks needs to be re-emphasised to take account of the increasingly risk averse behaviour of the commercial banks. Faced by the triple requirements of resumption of lending, reduction of leverage/increased capitalisation and risk assessment /costing, there is as yet no sign that the commercial banks are responding adequately to the needs of poorer consumers, not just for FS but also for all those other vital services to which their governments have committed in various ways. Yet, such a response is a necessary prerequisite for the massive public support which is being extended to the banks.

### **Competition**

An early casualty of the crisis has been competition rules, which are being largely abandoned under the pressures of the moment. Bank mergers or government takeovers have gone through in a matter of days in the US and EU, state aids have been granted likewise. This is an astonishing development given the growing assertiveness in competition authorities over recent years. The current creation of big banking groups via mergers would normally have to be examined by the competition authorities. In the current crisis this is not happening and there is a danger of “new” banking groups having a potential to dominate the market and so make changes that would not be in the best interest of the consumers.

Although we can well envisage that in the medium term, government shares may be sold off again or nationalised banks may be re-privatised, it is unlikely that when the emergency passes, these mergers will be undone quickly. Under these circumstances as the banking sector has become more monopolized, then the degree of regulation needs to be stepped up whether under general competition legislation or through sectoral regulation. In the meantime, we fear that competition rules may come to be seen as a luxury we can no longer afford.

Given that the fiscal health of “too big” financial institutions has been a significant part of the current crisis, it would be ill-advised to allow the crisis response to result in the permanent establishment of more “too big” financial institutions. If private capital does not accept the risk of systemic failure, then these financial institutions should be transformed into smaller, less complex, more sustainable financial institutions of a size that do not pose systemic threats. There may be scope for de-merger 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. In the meantime, shareholders should be

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<sup>23</sup> Consumers International (CI), *Global Energy Charter*, November 2008

more than content just to not face the losses that they would otherwise have had to carry. If 'too big to fail' does not attract stringent obligations in return for state aid, it is the equivalent of a blackmail note.

### **The G20 proposals**

The recent G20 agreement does not go into detail regarding financial services, but does have implications for consumers at the macro-economic level. There is much in the package that we welcome but we would point out that in increasing the resources of the International Monetary Fund (IMF) the G20 is relying on an institution which has arguably contributed to the development of the policies which have led us to the present crisis. Or perhaps the more subtle criticism is that the corrective policies which the IMF has proposed have been applied inconsistently, with the full rigour of IMF disciplines being imposed upon developing countries while the rich countries, ie OECD members, have been able to pursue lax policies. Indeed, such trends as the large scale purchase of US Treasury bonds by emerging economies have amounted to low interest loans from poor countries to rich ones, in pursuit of safe havens from global instability and free of conditionality. This allowed rich countries to pursue a 'business as usual' policy which has proved to be illusory in that it postponed the acceptance of the need for reform. As we pointed out in 2003 in the context of the huge US budget deficit, *"If the US had been unable to depend on the inflow of global capital seeking a safe haven, it would long ago have had to go cap in hand to the IMF, who would have imposed strict conditionality"*. The very fact of the inflow of funds insulated the US from measures that would have been applied elsewhere.<sup>24</sup>

The IMF has lacked the resources to fulfil its original mandate of providing counter-cyclical finance and has instead been restricted to providing last resort finance, a role which has inevitably led it to be the unwelcome messenger of bad news and administrator of unwelcome measures. So, Joseph Stiglitz in his personal capacity as former World Bank chief economist argued in 2002: *"A half century after its founding, it is clear that the IMF has failed in its mission. It has not done what it was supposed to do-provide funds for countries facing an economic downturn, to enable the country to restore itself to close to full employment."*<sup>25</sup> (The Committee that bears his name effectively repeats this verdict seven years later<sup>26</sup>.) Countries facing fiscal difficulties have had to face the application of contractionary policies as a condition of IMF loans, reining in public expenditure, raising interest rates and defending exchange rates. (These are, incidentally, the opposite policies from those being advocated by the US and UK in particular at the G20 summit.)

The G20 proposal to increase the resources of the IMF is welcome in as much as the accord represents a return to the initial mission of the Fund. A more constructive, counter-cyclical role is

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<sup>24</sup> As an aside pertaining to trade policy, one could argue that the consequence was for many years an overvalued dollar which in turn led to protectionist sentiment in the US to the detriment of other trading countries. To the extent that those policies were emulated elsewhere, notably in the EU, then consumers worldwide, and producers in developing countries, have suffered from such policies as agricultural dumping, abusive anti-dumping cases, tariff escalation, etc.

<sup>25</sup> J Stiglitz, *Globalisation and its discontents*. Norton, 2002

<sup>26</sup> Stiglitz UN *op cit* para 36

needed than hitherto. For this reason, we welcome the new Flexible Credit Line, which will in effect provide insurance rather than actual hard cash (thus restoring confidence) and will not require the usual contentious loan conditions to be applied. If that confidence stabilises economies, this will have the effect of rendering the use of the guaranteed funds unnecessary. The first major beneficiaries of the new system are Mexico, Colombia and Poland, two out of the three OECD members.

In 2003 we argued for a more stable relationship between the world's major currencies and the G20 proposal for expansion of Special Drawing Rights (SDRs) goes some way towards that. However, the SDR system contains rigidities related to their allocation in proportion to countries existing IMF quotas, which in effect leaves the rich countries in control. In particular, because 85% of votes are needed for major decisions and the US has a 17% share, then in effect the US has the right of veto, the only IMF member in this position. We would therefore support proposals to reduce the threshold to 70-75%. We also welcome the Stiglitz proposal to move towards a system of SDRs expanding to form a New Global Reserve System in line with accumulated reserves. This would recognise the reality of the shift of economic power towards emerging economies with large reserves, while harnessing such reserves to promote global economic stability.

We would hope that resources would be directed to investing in tangible benefits such as the infrastructure desperately needed to arrive at the Millennium Development Goals (MDGs) rather than to subsidise rich country deficits or to rescue industries or companies which have played the 'too big to fail' card. As the International Labour Organisation (ILO) points out, industrial sector support must be subject to strict social and environmental conditionality, targeted and consistent with international trade agreements. We do not wish to see the crisis used to justify the competitive use of subsidies which have so penalised developing countries in international trade<sup>27</sup>.

The history of 'GX' resolutions is not very encouraging. For example, after the Asian crisis in 1997, at the initiative of the G7 finance ministers and the Central Bank governors, the Financial Stability Forum (FSF) was established as an informal group and it recommended that financial institutions should fully and promptly disclose their risk exposures. Clearly they have failed to do so, as was noted by Jean-Claude Trichet, President of the European Central Bank, in his keynote speech at the OECD Forum 2008. The FSF is to be reformed as the FS *Board* and expanded to include the G20 members. Its remit seems to be somewhat vague, 'promoting coordination', assessing vulnerabilities, and setting guidelines among others. Nevertheless, the OECD operates usefully with similar functions (and will, incidentally, have an important technical contribution to make).

Similarly the Basel Committee on Banking Supervision was established in 1975 after a G10 meeting. Since 1998 the Committee has been trying to redefine capital adequacy in a way that more accurately reflects risk. Originally members of the Bank for International Settlements (largely the then OECD members) signed up to these requirements. Either those definitions of adequacy have been

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<sup>27</sup> International Labour Organisation (ILO) *Discussion paper – the financial and economic crisis – a Decent Work response*; ILO 2009

insufficient or they have not been applied or they have been defeated by the ability to move risk off the balance sheet. In any event one should not overstate the argument that we are in an unprecedented situation. Previous warnings do not seem to have been fully heeded. We have to hope that this time the G20 member states really mean to do what they say. We cannot afford to let history keep repeating itself this way.

**Consumers International (CI), May 2009**