



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

## Executive Summary

March 2011

**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](http://www.consumersinternational.org/our-members). CI's membership includes consumer organisations in every G20 country and region.

## Executive Summary<sup>1</sup>

In November 2010, G20 leaders meeting in South Korea made the following commitment in the Seoul Action Plan<sup>2</sup>:

*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<sup>3</sup>. And yet, over half the adults in the world are ‘unbanked’<sup>4</sup>. 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*”<sup>5</sup>.

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<sup>6</sup>. 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<sup>7</sup>. 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'<sup>8</sup>. 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.

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<sup>1</sup> A full copy of the CI report 'Safe, fair and competitive markets in financial services: *recommendations for the G20 on the enhancement of consumer protection in financial services*' is available at

<http://www.consumersinternational.org/media/669348/cifinancialreport2011.pdf>

<sup>2</sup> G20 Seoul Summit document, *Action Plan* para 41, G20 Seoul, 2010, [www.seoulsummit.kr/outcomes](http://www.seoulsummit.kr/outcomes)

<sup>3</sup> CGAP *Financial access 2009, measuring access to financial services around the world*. CGAP/World Bank 2009. p. 2

<sup>4</sup> O.P. Ardic, M. Heimann & N. Mylenko: *Access to financial services and the financial inclusion agenda around the world*; policy research working paper 5537 WB/CGAP 2011. p. 6

<sup>5</sup> Statement of Sheila C. Bair, Chairman of the Federal Deposit Insurance Corporation, on *Modernizing Bank Supervision and Regulation* before the US Senate Committee on Banking, Housing and Urban Affairs, March 19, 2009

<sup>6</sup> S. Rutledge, N. Annamalai, R Lester and R L Symonds: *Good practices for consumer protection and financial literacy in Europe and Central Asia: a diagnostic tool*; World Bank 2010, foreword

<sup>7</sup> *UN Guidelines for Consumer Protection* Adopted 1985, expanded 1999, re-adopted in General Assembly decision 54/449 ; UN 2003

<sup>8</sup> UN Guidelines *op cit.* Art 32