

Legal regimes for financial consumer protection in transition economies

Dr Mamiko Yokoi-Arai
Principal Administrator
OECD

Fundamentals requirement for financial consumer protection

- Good and sound prudential framework is foremost important
 - Rules to ensure capital adequacy
 - Sufficient resources and powers dedicated to the regulation and supervision of financial institutions
 - Appropriate penalties for wrong doing
 - Objective enshrined in the main legislation
 - A regulatory and supervisory structure appropriate to the financial system
 - » Ref: OECD Policy Framework for Effective and Efficient Financial Regulation

Structures of financial supervision

- Vertical (silo) model: sector based institutions. Works well where the financial system has clear demarcation between banking, securities, and insurance etc.
 - Eg., China, India
- Horizontal (twin peaks) model: institutions are established along distinct public policy goals. Supervision aimed at preserving stability is carried out by one institution, and conduct of business supervision by another.
 - Eg., Australia, Netherlands, UK
- Unified (integrated) model: a single authority covers all sectors.
 - Eg., Japan, previous UK model
- Hybrid model: some supervisors monitoring more than one segment of the market.
 - Eg., France, Italy, US



Considerations towards supervisory structure

- Expertise and resources of the market should be balanced carefully.
- Economies of scale and scope of supervision.
- Role and authority of central bank should be taken into account. Recently, bank supervision has been returned to central bank where there it is traditionally a respected player in financial markets, eg., UK.
- Extent of consolidated supervision that the financial system requires.
- Extent of issues with cooperation and coordination among the different supervisory bodies.
- The effect that gaps in the regulatory and supervisory structure have on effective supervision.



- Ref: Financial Regulation: A Guide to Structural Reform (Thomson, Sweet & Maxwell Asia)

Structure of consumer protection in the financial system

- **Institutional**
 - General consumer protection agency.
 - Each agency has authority over consumer protection in its field.
 - Combination of the two.
- On top of this, coordination with multiple financial supervisors might be necessary, creating multiple layers of coordination.



Pros (or vice versa cons) of designating financial consumer protection to a general agency or the supervisor

General agency

- Knowledge and experience of dealing with consumer issues.
- Authority and resources dedicated to consumer issues.
- Relationships with various consumer groups to address consumer detriments.

Financial supervisor

- Knowledge and experience dealing with financial sector practices.
- Relationship and authority over financial institutions. Use licensing authority to rectify detrimental behavior.
- Possibility of meshing consumer protection incentives with regulatory requirements.



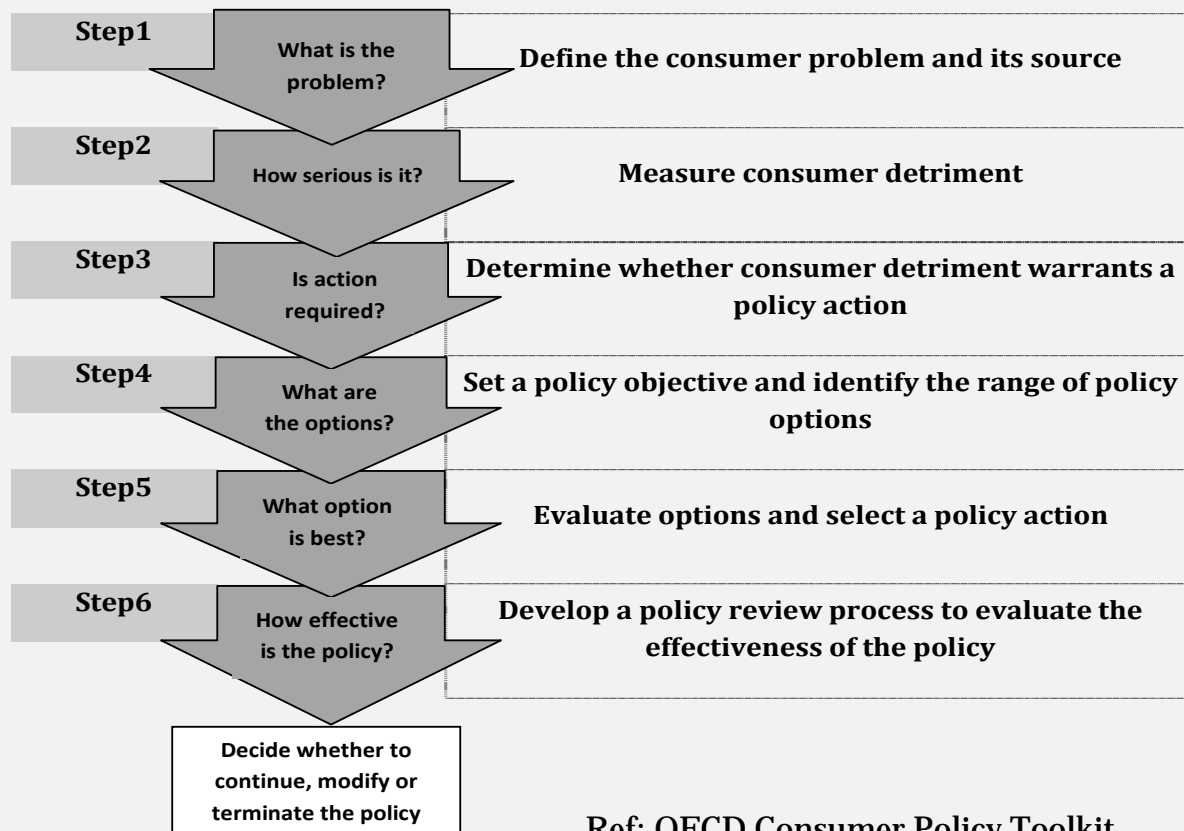
Questions to be posed on the supervisory structure affecting consumer protection

- Are policy objectives included in the legislation for consumer protection?
- Is the coordination/cooperation been clarified within the principal legislation?
- Has the relationship with the consumer protection agency been clarified in the legislation?
- Does the supervisory have authority to penalise or order financial institutions to rectify wrongdoing?
- Can regulations be issued by the supervisor to address consumer protection?
- Are all financial institutions subject to a supervisor on consumer protection issues, and does the supervisor have sufficient authority?



Figure 0.1. Consumer policy making steps

Policy process for consumer protection



Ref: OECD Consumer Policy Toolkit

Approaches for consumer protection coordination in the financial sector

- Single supervisor
- Coordination clauses in principal legislation
- Inter-agency committees (both at financial and consumer protection level).
- Exchange of MOU between agencies
- Obligation to consult and notify relevant agents on consumer issues
- Close cooperation



Draft G20 High-Level Principles on Financial Consumer Protection

- OECD and FSB were given the task of drawing up high level principles on financial consumer protection by the G20 Finance Ministers and Central Bank Governors in February 2011.
- The drafting of the principles is in its final stage, with the view of being put to the G20 in October 2011.
- While the principles are yet to be finalised, the public consultation version already highlights some of the common considerations that are being made for financial consumer protection.



Draft G20 High-Level Principles on Financial Consumer Protection

1. Legal and regulatory framework
2. Role of oversight bodies
3. Equitable and fair treatment
4. Disclosure and transparency
5. Financial education and awareness
6. Responsible business conduct and financial services providers and their authorized agents
7. Protection of consumer rights
8. Protection of consumer data and privacy
9. Complaint handling
10. Competition



Common financial consumer protection issues of transitional and other economies

- Regulatory forbearance (eg., Japan 1990s, US 1980s S&L crisis)
- Lack of disclosure and transparency
- Lack of consumer awareness
- Lack of affordable and enforceable redress mechanisms
- Implementation of laws insufficient (eg., 1997/8 Asian crisis)
- Interest of financial sector too strongly protected
- Asset price inflation spurs consumers to purchase assets on credit without sufficient knowledge of risks (eg., HK, US)
- Low interest rate of domestic currency, weak domestic economy and/or high inflation rate prompts consumers to seek financial products in foreign currency or abroad (eg., Japan forex carry trades)
- Weak consumer advocacy or consumer groups controlled by government (eg., Singapore)
- Fraudulent schemes (eg., Russian grey insurance schemes)



Measures to address financial consumer protection in weak regimes

- Provision of one page information sheets to consumers
- Strengthen supervision of financial institutions
- Clarify coordination/coordination of relevant authorities
- Deposit insurance and other compensation schemes
- Free consumer hotline
- Awareness campaign on the rights of consumers.
- Establish redress mechanisms that are affordable and enforceable
- Greater incentives for the industry group towards best practices and consumer protection



General issues of the Ukrainian regime of financial consumer protection

- Absence of safety net for consumers
- Legal gaps in protecting consumers
- Regulatory/supervisory structure gaps and coordination issues
- Weak consumer advocacy
- Non-regulation of intermediaries
- Possibly illegal information disclosure and operations
- Wrongdoing not penalised



Industry indifference to consumer interest

Consumer credit/credit cards

- Consumer credit/credit cards is a growth area in many transitional economies, with rising incomes and middle class lifestyles.
- Consumer credit often falls between supervisory cracks, being thinly regulated despite strong consumer interest.
- Instead of being regulated by a financial supervisor, consumer credit is sometimes supervised by ministry of commerce or other general business agency, making coordination with similar products difficult but therefore attractive for financial institutions.
- Various credit methods, such as revolving credit, are not easy for a consumer to understand, and should only be provided on an informed basis.



Ukraine: financial consumer protection issues

- Multiple failures in consumer protection, causing great consumer detriment.
- Recognition should be made by all parties involved, government, authorities, financial institutions, and consumers, that it is in the long-term interest to have a financial system that is sound and works, protecting consumer, and maintaining confidence in the financial system.
- Banks can be affected by high levels of consumer credit default, as they are often financing consumer credit entities, leaving them with possible high non-performing loan levels. This may expose the government to the possibility of bailing out banks and subsequent fiscal burden.
- The Ukrainian deposit insurance system is not effective as a consumer protection tool, as the requirement of prompt payment is not possible.
- Foreign financial institutions have taken advantage of the growth in the market, without providing safeguards they provide to consumers in their home markets. This is contrary to trade theory suggests that foreign banks are beneficial to financial markets bringing expertise and know how.



Areas that would strengthen financial consumer protection in Ukraine

- Revisit the legal and regulatory regime of the financial system to eradicate any gaps, and strength the avenues consumers can use to minimise detriment.
- Empower the supervisor to take necessary action against wrongdoing, and clarify rules and procedures for better transparency and improved credibility. Simultaneously, measures should be taken to ensure the supervisor is accountable to any actions it takes.
- The objective of consumer protection should be clearly enshrined in financial law, to ensure that it is the core interest of the supervisor, as prudential supervision should be.
- Incentives that promote sound behavior should be included, together with penalties that punish wrongdoing.
- At a minimum enable the supervisor to issue technical rules related to their supervisory area, to allow flexibility and timeliness in dealing with consumer issues.



Specific actions on financial consumer protection in Ukraine

- Require the industry to produce one page information sheets on the financial products being sold.
 - Ref: OECD Recommendation on good practices on financial education and awareness relating to credit
- Establish a registration system, and eventually a licensing system for financial intermediaries.
- Urge industry groups to establish basic rules, practices to give disclosure and protection to consumers.
- Consider the possibility of complaint handling and redress through a small claims court or independent ombudsman.
- Data on complaints should be collected which provides an insight into possible or future areas of detriment.
- Advertisements and marketing methods should be investigated to ensure that risks are being addressed.

