
WORKSHOP ON GOOD PRACTICES OF CONSUMER PROTECTION IN FINANCIAL SERVICES

Minutes

European Credit Research Institute at the Centre for European Policy Studies
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in cooperation with the World Bank



The World Bank is a major driver of good practices in consumer protection in financial services. It has prepared an initial set of good practices in financial consumer protection as a diagnostic tool for identifying priorities for future reform in financial consumer protection. At this seminar at the European Credit Research Institute in Brussels, the World Bank presents its good practices to the European audience and seeks comments from stakeholders.

Consumer protection in financial services lies at the heart of financial sector that is efficient, competitive and fair. Three areas are important: clear and comprehensible information of consumers; cost-efficient recourse mechanisms, and education programs that allow consumers to become financially literate so that they can make informed decisions. The World Bank has conducted pilot Diagnostic Review on Consumer Protection in Financial Services in six Eastern and Central European countries so far: Azerbaijan, Croatia, Czech Republic, Romania, Slovakia and the latest one in Russia. In the process a variety of stakeholders were involved, national government officials, industry officials and consumer advocates. The program is intended to be expanded globally in 2009. It is expected to be helpful to the international community and those in emerging markets who are looking to establish common ground for minimum good practices in financial consumer protection.

More information can be found at www.ecri.eu and www.worldbank.org/eca/consumerprotection.

The Head of Research of the European Credit Research Institute (ECRI), **Nicola Jentzsch**, chaired the event and welcomed all participants on behalf of ECRI. **Ms Jentzsch** introduced the speakers and outlined the importance of consumer protection in the light of the ongoing financial turmoil. Recently, this topic has received more attention because of the variety of controversial practices that have been used by sup-prime lenders to attract more clients – the same practices

that are considered to have contributed tremendously to the current financial crisis. Consumer protection could help to prevent such practices, for instance by assuring efficient information provision on financial services to consumers, e.g. through standardized information sheets, or by applying a stronger regulation regarding credit reporting practices. Today's standards of consumer protection are not developed to this extent, but discussions have been raised.

The first presentation was given by **Sue Rutledge**, Regional Consumer Protection Coordinator at the World Bank, and also leading the team which prepared the "Good Practices for Consumer Protection and Financial Literacy in Europe and Central Asia: A Diagnostic Tool". **Ms Rutledge** presented the recently published World Bank report and outlined the underlying idea and methodology. She noted that the report had been published as a Consultative Draft and that the World Bank is interested in receiving comments and feedback from international regulators, policy-makers and other stakeholders. In particular, comments from officials from the European Commission and other European institutions would be appreciated.

Consumer protection in financial services is important, especially in emerging and developing countries, where people typically have had little experience with sophisticated financial products. In Russia, for instance, it is not uncommon to find an advertised nominal interest rate of 60%, with an effective rate reaching closer to 90%. Another example is Romania, where consumers have difficulty finding out how much a money transfer will cost before sending the funds. According to **Ms Rutledge**, the aim of consumer protection should be: (a) to deepen the financial sector and encourage people to make use of the offered products, (b) to improve market conduct practices and underwriting standards for retail financial products, (c) to increase transparency and efficiency in the financial sector and (d) to help people gain access to financial services. Using the Good Practices as guidance, the World Bank has conducted diagnostic reviews in 6 countries: Azerbaijan, Croatia, Czech Republic, Romania, Slovakia and the latest one in Russia – all countries where consumer protection and financial literacy are in need of further development. The World Bank's Diagnostic Tool has been prepared for four segments: banking, securities, insurance and non-bank credit institutions. Furthermore, the areas of private pensions, credit reporting systems and financial education have been included in the annex of the report, but will need additional work to be fully covered for the next report. For each segment, the following eight issues have been treated: (1) consumer protection institutions, (2) disclosure and sales practices, (3) customer account handling and maintenance, (4) privacy and data protection, (5) dispute resolution mechanisms, (6) guarantee and compensation schemes, (7) financial education and (8) competition issues in financial services. In consistency with the results of the report and the aims of consumer protection, **Ms Rutledge** stated that the financial sector should assure the provision of transparency, choice, redress and privacy to the consumers. In addition to the expansion of the World Bank Diagnostic Tool to other countries in the future, cross-country surveys may follow, for instance on regulatory frameworks for financial consumer protection or consumers' level of financial literacy, in order to create the full picture of the current situation of consumer protection in financial services in the concerned regions.

In the second presentation, **Dirk Staudenmayer**, Head of Unit for Financial services and redress at DG Health and Consumers (European Commission) gave an overview of the Commission's Consumer Policy Strategy 2007-2013, the central objective of which being the empowerment of the consumer. With regard to financial services – products which have become increasingly complex – this aim rests upon two pillars: financial education and pre-contractual information.

As to the former, the Commission adopted a Communication in December 2007 underlining its support for the provision of high-level financial education by Member States and financial institutions. Furthermore, DG Sanco has developed DOLCETA, a web-based learning tool for adults which is currently being enhanced by a new module in order to provide teachers in primary and secondary education with optional ready-to-use-kits for financial issues that can be incorporated into the regular curricula.

With the provision of pre-contractual information, two main objectives are pursued: The consumer has to know what he will take on, and she/he must be able to compare offers to tap the full potential of market. Focus groups launched by DG Sanco who analysed the situation in all 27 Member States found out that currently consumers dislike the technical jargon that is used in their contracts and often have to cope with an overload of information. Thus, there was unanimous consensus among the focus groups that in order to ensure sufficient consumer knowledge the essential information has to be presented in a standardised way. This viewpoint was corroborated by Eurobarometer survey, according to which 79% of consumers would consider a standard information sheet very useful. The recently adopted Consumer Credit Directive already has an annex providing pre-contractual information in standard and comparable form. Further, in the area of mortgages the Commission is testing a revised version of the so-called European Standard Information sheet (ESIS), a leaflet with pre-contractual information that according to the Home Loans Code of Conduct is given to consumers before signing a contract. This approach has also been followed for the revision of the UCITS Directive. The UCITS level 2 Directive will contain pre-contractual information in the so-called Key Investor Information document (KII). Currently, DG Markt in collaboration with DG Sanco and the Committee of European Securities Regulators (CESR) are conducting tests on this standardised format.

Another priority of Commissioner Kuneva's consumer policy is the consumer scoreboard. After an initial screening phase, the financial services sector is now in the stage of analysis. Data on bank account switching has been collected for the preparation and monitoring of a self-regulatory code of conduct for banks concerning switching of accounts. Also, bank account fees in the Member States have become a focus of attention and are studied in detail, as a survey conducted in the context of SEPA has shown that 69% of websites of the banks did not present clear information on prices.

Finally, **Mr Staudenmayer** pointed out that, in the aftermath of the financial crisis, consumers would probably want safe products on the one hand, and on the other hand thorough information about the products available – demand which could be met by providing pre-contractual information in a standardised, common format.

The question of “what consumers want” was also taken up in the post-discussion of the first presentation round. **Rodney Lester** pointed at the always existing trade-off between standardized products that might not fulfil all consumers’ expectations, and adopted versions that could result in complex and difficult to understand products. **Mr Staudenmayer** agreed and mentioned the possibility to have standardized products developed that banks may - but are not obliged to - offer, for instance checking accounts, consumer credits, etc. that inexperienced consumers understand. One concrete example is life insurance, for which a complex and large structure of laws has to be considered; hence a standardized product could be beneficial to consumers.

Toni Williams from the University of Kent raised the question regarding the potential and responsibilities on both sides of the market. More precisely: how should one think about the interaction between both sides, and what points should be focussed on? To what extent is protection beneficial to consumers? In response, **Mr Staudenmayer** pointed at the principle-based discussion on how much responsibility to give to individuals, which is the underlying philosophy of all consumer protection legislation. There is a structural imbalance in consumer protection and what needs to be done to lift both sides onto the same level is to provide tools and information. The problem is not solved by taking decisions away from consumers but by creating complaint and dispute procedures at the same time, thereby empowering the consumers.

Helena Kolmanova from the Czech National Bank stressed firstly, the need for balance between structures for consumer protection and financial supervision and secondly, the necessity of licensing deposit and credit institutes.

The second round of presentations was opened by **Rodney Lester**, former Programme Director of Non-Bank Financial Institutions at the World Bank. **Mr Lester** outlined the role of financial consumer protection in diverse market settings and emphasized the need to adapt the regulation to its context. The adaptation is necessary because each individual typically faces different decisions on financial products, depending on the stage in life (student loan, house purchase, retirement, etc.) and the complexity of product offerings differs by stage of market development. Within consumer protection policies, financial education is important, but useful approaches have yet to be developed and proved. **Mr Lester** pointed out that people had already been taught financial subjects in the past without resulting in noticeable enhancements of their educational level of financial literacy. The Law professor Lauren Willis goes as far as to say that financial education in developed markets, such as America, may be counterproductive, unrealistically building people’s confidence and encouraging them to take risky decisions without sufficient analysis. **Mr Lester** therefore suggested that the primary emphasis should be on legal and regulatory measures to protect consumers but they also should be carefully considered. In an article by J.B. Benston, six possible reasons for financial market regulation are given, amongst them: to stop failure of financial institutions, to provide adequate information to consumers, to assure fair pricing or to prevent unfair discrimination, and Benston argues that only the first reason (to stop failure) is justified. However **Mr Lester** does not agree with all of Benston’s arguments for several reasons. Financial products are different and are subject to an increased

asymmetry of information between service providers and consumers. Furthermore, competition may not insure proper functioning of the market, also due to asymmetry and cost of information. Another argument for consumer protection is the complexity of some financial service products, which are difficult to understand for the average person. In case a consumer wants to complain about a service, the legal procedure is resource- and time-consuming in many countries. In Croatia, for example, the average duration of a court procedure is nine years till a decision is taken.

In his concluding remarks, **Mr Lester** outlined the key aspects of consumer protection, which include: cheap and efficient recourse structures; clear information provision to consumers; encouragement information dispersion through actors such as media, rating companies, etc.; and the use of prudential regulation to deal with systemic risk.

At the beginning of his speech, **Eric Ducoulombier**, Deputy Head of Unit for Retail Issues, Consumer Policy and Payment systems at DG Internal Market and Services (European Commission), observed that the World Bank and EU are basically working on the same question concerning consumer protection as regards financial services. In this context, the four priorities that have been key for the EC for the past 15 years are: (1) to ensure that consumer are provided with high-quality, safe and diversified products, (2) to increase consumer confidence, (3) to empower consumers and (4) to involve consumers in the decision-making process.

Several measures have been initiated by the EC to reach those objectives. For the first priority, the EC has focussed on combining the effect of competition and protection in financial services. Examples are the payment services directive in order to support the creation of new payment systems, or sponsoring common principles on switching banking accounts. A possible area for more competition and consumer protection is responsible lending, which is taking increased importance in the current markets turmoil. The EC has been reviewing mortgage criteria for years, resulting in the publication of a green paper and white paper, but no directive so far.

Regarding the second priority on consumer confidence, **Mr Ducoulombier** judged this subject to be a very complex phenomenon, as it takes many years to establish confidence, but can be destroyed within a few minutes. Trust cannot be imposed by law; it is necessary to create an encouraging environment for consumers to built trust. This also applies to the area of redress, where several projects have been initiated by the EU, for instance a network of financial ombudsmen all following the same rules, which is crucial for cross-border activity. Furthermore, President Barroso has announced the creation of a group of "wise men" to reflect on the European supervision structure.

For the third objective of consumer empowerment, **Mr Ducoulombier** said that financial literacy and consumer protection should go hand in hand. The EC set up an expert group of 24 people with the aim of creating a database with information on financial literacy schemes for education purposes. This database is most likely to be accessible from November 2008 onwards. The EC is willing to support and take the patronage for events or other initiatives on financial literacy.

When considering information provision to consumers, there exists a risk of information overload which may miss the aim of effective information dissemination. A consumer may face the difficulty to process too much information; hence, standardized information sheets are even more important.

Regarding the fourth priority, consumer involvement, **Mr Ducoulombier** estimates that, despite recent progress, much remains to be done to improve the involvement of consumer associations into the decision-making process. This should help to overcome the asymmetry between consumers and service providers.

Mr Ducoulombier concluded that all four aspects have been key to the Commission's consumer policy in the past, and will also guide future decisions.

In the last presentation of the day, **Olle Schmidt**, Member of the European Parliament and of the Committee on Economic and Monetary Affairs, emphasized the necessity to have effective consumer education and protection. Transparency and adequate information provision to consumers are essential for the financial system. Consumers need to develop the right tools to make full use of the internal market, and they need to be aware of all options, including financial education and the possibility for redress. The Swedish financial supervisory authority has conducted a survey, finding out that only 43% of Swedes look at different bank offers, 57% do not know what products other banks offer. Even well informed customers may have problems finding offers that best suit the needs. Given this experience, several questions arise, such as: should there be voluntary information provided? How much information should be given? What kind of information is useful? How should one make the distinction between education, information and advice? When it comes to institutions, who does what? What is the role of governments? Some of those questions can be answered. One role of governments should be to provide benchmarks on the European level. The industry should fulfil its responsibility, for instance by giving lectures on their activity, possibly at people's work places. In general, the industry and consumers should find a way of working together, but in case of conflicts, the consumer should have the possibility of raising complaint. **Mr Schmidt** mentioned the ongoing discussion on a European system of dispute settlement. Many member states already have mechanisms such as the Financial Ombudsman in place, which is an independent entity settling complaints between consumers and financial service providers. Another possibility could be collective redress, to give consumers the opportunity to defend their case. Generally speaking, alternative dispute resolutions are less costly, more efficient, and often preferred by both sides.

In his concluding remarks, **Mr Schmidt** stressed that empowering the consumer makes a better and more responsible consumer; however it is crucial to have a balanced approach in order to include consumers and financial service providers.

Opening the last discussion round, **Ms Jentzsch** posed two questions: (a) whether an internal market actually increases or decreases complexity to consumers, and (b) whether it is likely that



consumers will reorient themselves towards national providers. For the first point, **Mr Ducoulombier** clearly confirmed that complexity is increased, but that more choice does not make consumers worse off, however adequate tools are needed. Regarding the second question, he mentioned that consumers so far are not blaming open borders for the current crisis, but rather the underlying financial system. Hence, there might not be a strong argument for reorientation towards national providers. **Mr Schmidt** added that the financial turmoil hopefully will not lead to more protectionism. Hedge funds and private equity are not always negative, and one should not rush to deciding on new regulation, because the current legislation may be sufficient.

In her closing remarks, **Ms Jentzsch** stated that many public initiatives go far beyond generalities; however those initiatives need to be implemented as well. Several policies are complementary, such as scorecards and diagnostic tools, and could be a useful tool if applied adequately. Even though it is impossible to say when the current financial crisis will be over and what the consequences it will have, it will surely change consumer protection policy in the future.