Briefing Paper

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Consumer Protection in the Financial Sector

Challenges and the Way Forward

This briefing paper aims to inform the readers about the overview of consumer protection in the financial sector in India, especially the challenges faced by consumers and suggestions to move ahead to ensure stable, secure and financial services to consumers.

Background

Global economy was adding an estimated 150 million new consumers of financial services each year until the financial crisis in 2007-09. Most of the new consumers are in developing countries, where consumer protection and financial literacy are still in their infancy. The need for consumer protection arises from an imbalance of power, information and resources between consumers and their financial service providers. The recent global financial crisis has highlighted the importance of consumer protection and financial literacy for stability of the financial sector[1].

The Indian economy is estimated to grow by 7.4 percent in 2009-10 according to the latest Central Statistical Organisation data. After urban penetration, financial service providers are eyeing rural consumer market, which is expected to reach US$425bn in 2010-11 with 720-790 million customers, according to a white paper prepared by CII-Technopak.[2] Today, nearly 3 million financial advisers and banking staff are selling non-banking financial products to about 188 million investors. Out of the above, 8 million investors participate in debt and equity markets, either directly or indirectly through complex and risk-bearing products like mutual funds and market-linked insurance plans[3].

Consumer protection has emerged as a key focus area of economic reform process all over the world. More than 80 percent of economies (118) responding to the *Financial Access 2010* survey have laws and regulations addressing at least some aspects of financial consumer protection. The South Asian region including India, still lags behind in financial consumer protection as shown in Figure 1.

In the recent G20 summit 2010 held in Seoul, the leaders acknowledged the need for consumer financial protection for which CUTS International was involved in the campaign with Consumers International (CI).

This calls for a robust regulatory and consumer protection regime for protecting interests of consumers of financial services. From banking system to financial regularities, India has managed to perform better than other nations. To move from a fastest growing economy to a developed one, there is a need to utilise full potential of our financial sector, which largely remains untapped due to various reasons highlighted in this briefing paper.

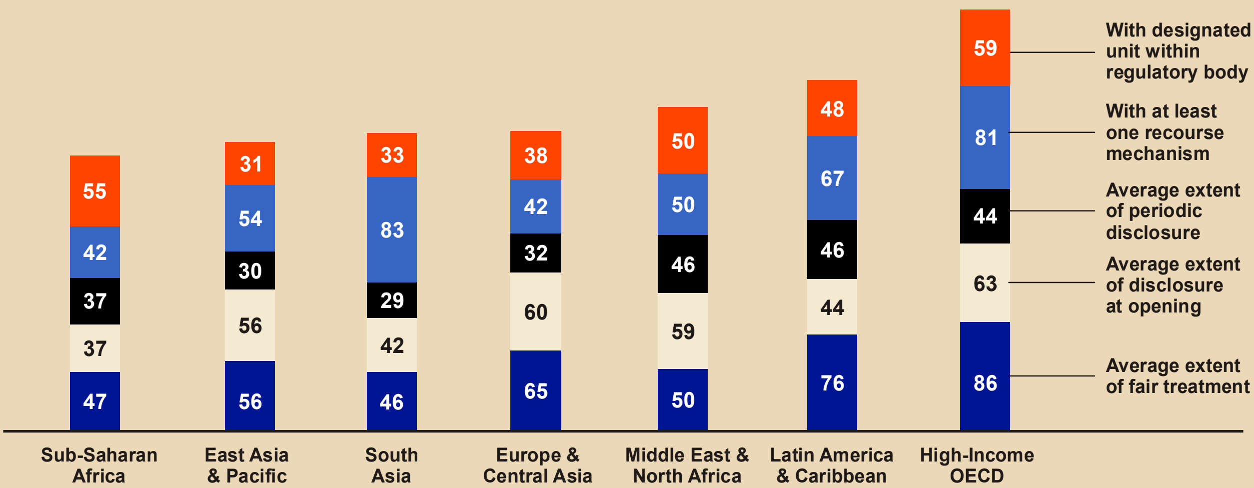
Key Challenges Faced by Consumers

In their day-to-day life, consumers avail financial services ranging from banking to insurance, non-banking finance, share market, investment funds, mutual funds, pension plans, micro-finance, commodity trading and various government funds like post office savings, bonds etc. In the development of any nation or economy financial services play a key role. The growth of the financial sector largely depends upon the confidence users/consumers have in its fairness, transparency, accountability, responsiveness, accessibility and adaptability.

Evidences of ground reality show that standards of financial services for consumers in India are far from satisfactory. Indian consumers still have no option other than to accept sub-standard services or to remain excluded from them. These challenges or issues are divided into two types: 'Practice Issues', which are practical obstacles faced by consumers in financial services; and 'Policy Issues', which are the root cause of these 'Practice Issues'.

Figure 1: Regional Differences in Consumer Protection Legislation and Implementation

% of Economies



Source: The report *'Financial Access 2010'* by Consultative Group to Assist the Poor (CGAP) and the World Bank Group

Practice Issues

- Lack of Transparency: Consumers are neither aware nor able to understand the terms and conditions that involve charges and the rate of return in financial instruments. Deceptive advertisements, small print, complicated terms, inadequately trained staff, misrepresentation etc. exacerbate the problem. This lack of transparency is mainly responsible for frauds, cheating and exploitation of consumers.
- Overcharging: Consumers are charged extra fees and commissions, for instance, in the case of credit card interest and other charges.
- Unfair Sales Practices: Consumers face aggressive sales techniques including misrepresentation and misleading assurance of services.
- Problem in Documentation: Often service providers demand documents which are not mandatory or required and thus deny services or demand bribes.
- Privacy Concerns: Consumers' personal data is sometimes shared with third parties.
- Aggressive, Exploitative and Unfair Recovery Methods: Despite guidelines from regulators and judgments by the Supreme Court, financial institutions continue with such practices. This is more prevalent in private sector banks and non-banking finance companies (NBFCs).
- Unresponsive Grievance Redressal Mechanism (GRM): Under the present first contact GRM system, consumers are not getting speedy justice, as it is not independent. It also does not have any representation of consumers.
- Financial Frauds: Use of information technology is an effective tool to improve quality of services as well as to expand the access to services, but its misuse for financial frauds create serious doubts in the mind of consumers.
- Lack of Governance: Repeated incidents of financial companies disappearing with hard earned money of investors, especially in the case of NBFCs, call for immediate attention to revive the faith of consumers and investors. The service of granting loan is largely dependent on whims and fancies of financial institutions and consumers are often exploited.
- Delays: Most of the consumers have to wait beyond the prescribed period to get their refunds, payments of insurance and other payments as well as redressal of complaints etc.

Policy Issues

- Presence of multiple regulators resulting in confusion and tussle over jurisdiction, high regulatory cost and duplication.
- Lack of initiatives for consumer awareness.
- Lack of proper monitoring and enforcement mechanism, resulting in violation of rules and regulations.
- Lack of avenues for consumer participation.
- Grievance redressal mechanism not easily accessible, speedy and responsive.
- Large number of consumers still excluded from availing financial services.

Overview of Financial Sector Regulation

The Indian financial sector is regulated by multiple regulators:

The Ministry of Finance, Government of India

The Ministry is responsible for economic and financial matters affecting the country as a whole, including mobilisation of resources for development. It works at the policy level to regulate the financial sector of the country. The Ministry has five different departments: Economic Affairs, Expenditure, Revenue, Financial Services and Department of Disinvestment.

Ministry of Corporate Affairs, Government of India
The Ministry is primarily concerned with regulating the functioning of the corporate sector. It exercises supervision over professional bodies related to financial sector such as the Institute of Chartered Accountants of India.

The Reserve Bank of India
The RBI regulates and supervises the nation's financial system. As the regulator and supervisor of the banking system, it is mandated to protect the interests of depositors, ensure a framework for orderly development and conduct banking operations conducive to customer interests and maintain overall financial stability through preventive and corrective measures. Various departments of RBI oversee India's financial infrastructure such as commercial banks and all-India development financial institutions; urban cooperative banks; regional rural banks; district central cooperative banks; state cooperative bank; and NBFCs.

Apart from regulatory functions, the RBI has following customer service initiatives to protect customers' rights:

- *Customer Service Department (CSD):* To respond to system-level customer issues.
- *Banking Codes and Standards Board of India:* To encourage transparency in lending and fair pricing.
- *Banking Ombudsman:* For resolving disputes between banks and their customers.

The Securities and Exchange Board of India
For protection of interests of consumers of security market related services, SEBI regulates the security market, redresses the grievances of consumers as well as conducts programmes for financial literacy.

Insurance Regulatory and Development Authority
Insurance Regulatory and Development Authority (IRDA) was established to protect the interests of the policyholders, regulate, promote and ensure orderly growth of the insurance industry and for matters connected therewith or incidental thereto.

Insurance Ombudsman
The institution of Insurance Ombudsman was created with the purpose of quick disposal of grievances of the insured customers and to mitigate their problems. The Insurance Ombudsman has two types of functions to perform: conciliation, and award making. It is empowered to receive and consider complaints against an insurer, for contracts of value not exceeding ₹20,00,00.

Cell for Redressal of Grievances of Policyholders
The Grievance Redressal Cell of the IRDA looks into complaints from policyholders, if they do not receive a response from insurer(s) within a reasonable period of time. If the policy holders are dissatisfied with the response of the company, they may approach the Grievance Cell of the IRDA.

Pension Fund Regulatory and Development Authority
Pension Fund Regulatory and Development Authority (PFRDA) was established to promote old age income security by establishing, developing and regulating pension funds, to protect the interests of subscribers to schemes of pension funds and for matters connected therewith or incidental thereto.

It is also pertinent to mention that confusion over the demarcation of regulatory roles between the IRDA and SEBI existed over the popular Unit Linked Insurance Plans. At present, there is a High Level Coordination Committee working as an inter-regulatory body on financial markets for better coordination among regulators.

The Ministry of Consumer Affairs, Food and Public Distribution, Government of India has also an important role in consumer protection, irrespective of sectors. Apart from awareness generation on issues of financial consumer protection, the Ministry also oversees functioning of Forward Markets Commission (FMC) which is a regulatory authority set up under the Forward Contracts (Regulation) Act, 1952. The main functions of the FMC is to keep forward markets under observation, make recommendations for improving the organisation and working of forward markets and to undertake the inspection of accounts and other documents, if necessary.

Avenues for Redressal

A consumer can approach the above mentioned regulatory mechanism or GRM set up under the regulation of that particular sector. They can also approach relevant consumer fora as any deficiency in the services by financial service providers comes under the purview of the Consumer Protection Act (COPRA), 1986.

Conclusion and the Way Forward

An effective financial consumer protection framework covers three broad dimensions. First, it protects consumers against unfair or deceptive practices by financial service providers, including advertising and collections. Second, it improves transparency through a requirement to disclose full, plain, adequate and comparable information about prices, terms, and conditions of financial products and services. Third, it establishes a recourse mechanism to address complaints and resolve disputes quickly and inexpensively.

But as mentioned earlier, the ground realities call for some urgent corrective measures for protection of financial consumers.

Following Steps are Recommended as the Way Forward

A. *Need for National Campaign for Financial Literacy*
Consumer protection and financial literacy can contribute to improved efficiency, transparency, competition, and access in retail financial markets by reducing information asymmetries and power imbalances between providers and users of financial services. India needs a national-level effort to build financial literacy.

The financial literacy is one solution to promote financial inclusion, consumer protection and participation in process of planning, implementation as well as monitoring of financial services. Financial education should be part of the good governance of financial institutions.

Presently, some sectoral regulators have started different initiatives for financial literacy on the issues dealt by them, but there is no coordination and coherence among them. It is leading to duplication of efforts. For better expenditure outcome and maximum utilisation of national resources there should be one such consolidated fund for financial literacy like the Consumer Welfare Fund (CWF) administered by the Ministry of Consumer Affairs, Food and Public Distribution, Government of India, or that money can be a part of CWF, itself.

B. *Need to Strengthen Grievance Redressal Mechanism*

Effective complaint-handling mechanisms by financial service providers and extrajudicial third-party dispute resolution mechanisms are essential parts of a consumer protection system. Fair, transparent, easily accessible, quick and responsive GRM is needed.

Present GRM in the financial sector comprise internal system of service providers and then to the Ombudsman in some services like banking and insurance etc. The internal GRM needs overhauling to make it independent of service providers and fully accountable, like done by some other regulators in electricity sector in India by appointing one independent member in the internal GRM itself.

C. *Need to Promote Financial Inclusion*

Access to formal financial services can improve the well-being of the poor. In India many of the agricultural and unskilled/semi-skilled wage labourers, micro entrepreneurs and low-salaried workers are largely excluded from the formal financial system. About 51.4 percent of farmer households are excluded from financial services. Geographically only 5.2 percent of villages have bank branches, 80 percent of Indian population does not have life or health insurance[4].

The marginalised groups are more vulnerable and prone to exploitation due to their lack of access to formal financial services. The financial inclusion policies should address their specific requirements. Presently, some initiatives have been taken for financial inclusion, like micro insurance, micro-finance, use of IT services such as mobile and electronic banking etc. These have started showing some positive signs but we have to go a long way.

D. *Need for Consumer Participation*

Consumer participation in financial services regulation is highly desirable because of their crucial role in inclusive economic development and consumer protection. But the level of consumer participation in financial sector is not satisfactory. The regulators should promote consumer participation from planning process to the implementation. Informed and inspired consumers can be effective partners in growth of the financial sector as a whole.

Information, Consultation, Partnership and Empowerment are four critical rungs of the ladder of consumer participation in the regulatory process. The role of consumer organisations in consumer protection has been widely acclaimed. Regulators should institutionalise the mechanism of consumer participation by involving consumer organisations at various stages particularly at the implementation level.

ENDNOTES

1 The World Bank's Policy Research Working Paper (5326) on Consumer Protection and Financial Literacy

2 India Brand Equity Foundation (IBEF): *http://www.ibef.org/economy/marketingstrategy.aspx*

3 The Need for Common Minimum Standards for Financial Advisers and Financial Education: A Consultation Paper issued by PFRDA

4. Financial inclusion can only be brought about through literacy - The Economic Times, October 31, 2010 *http://economictimes.indiatimes.com/features/financial-times/Financial-inclusion-can-only-be-brought-about-through-literacy/articleshow/6844390.cms*

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