

IFMR Financial Systems Design Conference Series 2012



Envisioning the Future of
Financial Consumer Protection in India



1. Why financial consumer protection?

While financial access in India remains a primary concern and newer modes of distribution become reality, market participants and regulators are beginning to grapple with issues of consumer protection. This can be seen in recent debates around mis-sale of mutual funds by banks, predatory lending by non-bank financial institutions and the bundling of investment plans with life insurance (ULIPs). This leads to some fundamental questions on the future direction of financial consumer protection in India:

- How does India balance the need for financial access and innovation with the requirements of consumer protection?
- Given the product-specific regulatory structure, what are the suitable frameworks for consumer protection in finance?
- What international experiences are relevant to determining the future of India's consumer protection regime?

It seems a particularly appropriate time to address these questions, given that India is also undertaking a fundamental review of its financial sector legislation, with the creation of the Financial Sector Legislative Reforms Commission (FSLRC), whose mandate is to rewrite and harmonise all financial sector laws. In parallel, many countries around the world have embarked on reforming their consumer protection frameworks, with the US creating the Consumer Financial Protection Bureau (CFPB) and Australia and South Africa evolving the twin-peak models of financial regulation, providing us a unique opportunity to learn from emerging global experiences.

The IFMR Financial Systems Design Conference 2012 aims to stimulate discussion and debate on the possible frameworks for consumer protection in finance for India and arrive at an understanding of the most appropriate framework for India's financial system.

2. What is the current framework for consumer protection in India?

While India does not have legislation governing consumer protection for financial services, consumers have recourse to the consumer courts set up by the Consumer Protection Act, 1986. In addition, consumers of financial products and services may also resort to mechanisms set up by product and services-specific regulators. With the product-based regulatory structure, consumer protection responsibilities for financial services are embedded in multiple regulators.

All regulators have required information disclosure from institutions regulated by them: Reserve Bank of India (RBI) requires banks to clearly disclose material terms on loans, the Insurance Regulatory and Development Authority (IRDA) requires the same of insurance companies for insurance policies. The Securities and Exchange Board of India (SEBI) has extensive disclosure guidelines for securities issuance, both private and public, to provide investors all relevant information before making an investment. The Pension Fund Regulatory and Development Authority (PFRDA) has however not yet mandated disclosure requirements for pension funds. In addition, regulators have stipulated redressal mechanisms for consumer complaints. For instance, the RBI and IRDA have mandated the creation of banking and insurance ombudsmen respectively and also require that all banks and insurance companies have internal grievance redressal mechanisms. For consumers of securities, SEBI has a complaint redressal mechanism called SEBI Complaints Redress System (SCORES).

Regulators also appear to be promoting financial literacy and education schemes as mechanisms to improve consumer outcomes. For instance, the RBI recently announced the National Strategy for Financial Education aimed at promoting inclusive growth, financial inclusion and financial education.

While these form the basic tenets of India's current financial consumer protection landscape today, there are some fundamental gaps such as:

- Lack of mechanisms to deal with conflicts of interest inherent in regulators in their dual functions of prudential regulation and consumer protection
- Increasing inter-regulatory conflicts arising out of a rapidly evolving financial sector
- Lack of response to a growing body of evidence on consumer behaviour and preferences

In light of all this, the conference will aim to take a first principles view on the framework for financial consumer protection in India.

3. What is the format of the conference?

While there are many aspects to a consumer protection framework, there are three stylised approaches that policy makers can choose from:

- An emphasis on information disclosures
- An emphasis on eliminating conflicts of interest
- An emphasis on product suitability

Approach 1: An Emphasis on Disclosure

“Disclosure” refers to any requirement that the firm disclose information to the retail client that could be material to the investment decision¹.

Consumers of financial services have less information and sophistication about the financial system and financial services than the financial services providers. The imbalance of information leads to consumers being vulnerable to abusive practices. Disclosure is seen as a way to handle this information gap between the providers and the customers by providing as much information as possible in an understandable way to the customer. Information disclosure pertains to product terms including pricing, risk factors, and provider conflicts of interest. Plugging these information gaps is viewed as being critical to promote good consumer choices.

Recent research has also pointed out the limitation of disclosures and provided pointers to more effective disclosure mechanisms.

This approach believes that well-designed disclosures complemented by effective financial literacy programs enable consumers to make better decisions and improve their financial outcomes.

Approach 2: An Emphasis on Eliminating Conflict of Interest

This approach believes that the root of mis-sale of products and services is the conflict of interest between the manufacturer and distributor of financial services. It attempts to align incentives within a financial service provider or across providers involved in developing and delivering a service.

¹ Pg 4, ‘Customer suitability in the retail sale of financial products and services’, Basel Committee on Banking Supervision available at <http://www.bis.org/publ/joint20.pdf>

Conflicted remuneration² means any benefit, whether monetary or non-monetary, given to a financial service licensee, or a representative of a financial services licensee, who provides financial product advice to persons as retail clients that, because of the nature of the benefit or the circumstances in which it is given:

- might influence the choice of financial product recommended by the licensee or representative to retail clients; or
- might otherwise influence the financial product advice given to retail clients by the licensee or representative

The solution often proposed to contain this conflict is to separate the roles of advisor and agent so that the advisor is compensated only by the consumer and the agent is compensated only by the manufacturer.

Approach 3: An Emphasis on Product Suitability

Suitability is defined as the degree to which the product or service offered by the intermediary matches the retail client's financial situation, investment objectives, level of risk tolerance, financial need, knowledge and experience³.

This approach believes that mandating increases in information disclosures alone will not lead to improved consumer outcomes in light of innovation in the financial sector and growing product complexity. In such an environment, imbalances in information, expertise and power between the buyer and seller will only increase with time. This approach believes that the most appropriate way to protect the welfare of the consumer would be to put the onus of consumer protection on the seller. The seller must be held accountable for the service provided to the buyer, by ascertaining that the products sold or the advice given is suitable for the buyer considering her needs (as determined by the buyer using its expert judgment).

² Section 963A, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 available at <http://www.comlaw.gov.au/Details/C2011B00265>

³ Pg 4, 'Customer suitability in the retail sale of financial products and services', Basel Committee on Banking Supervision available at <http://www.bis.org/publ/joint20.pdf>

4 How is the conference structured?

There will be sessions dedicated to each approach (disclosure, conflicts of interest and suitability), with each session featuring keynote speaker(s) and group discussions.

Each speaker, while addressing their approach, will touch upon the following specific aspects:

1. How does the approach support product innovation and financial access in the financial system?
2. What is the legal base necessary for the approach to be realised?
3. What is the regulatory architecture and environment required for the approach to be realised?
4. How does the approach interact with consumer behaviour?

Given the small and carefully chosen group, the conference is designed to encourage conceptual conversations and free exchange of views. Views expressed at the conference will be strictly confidential. Audio and video extracts of the presentations and discussions will be used for knowledge purposes only with prior consent.

5. What is the schedule?

The conference will be held at the IFMR Trust offices in Chennai on August 31 and September 1, 2012. The schedule will be as follows.

Day 1 – August 31, 2012	
09:30 - 10:00	Breakfast and Participant Introduction
10:00 - 10:30	Introduction - Setting Context and the Future of Finance in India
10:30 - 10:40	Conference Format
10:40- 11:00	Approach 1 - An Emphasis on Disclosure - Insights from research
11:00 - 11:20	Approach 1 - An Emphasis on Disclosure - Insights from the market
11:20 - 12:30	Discussion on Disclosure based Approach
12:30 - 12:50	Approach 2 - An Emphasis on Eliminating Conflict of Interest - Insights from research
12:50- 13:10	Approach 2 - An Emphasis on Eliminating Conflict of Interest - Insights from the market
13:10-14:30	Lunch and Photo Session
14:30- 15:40	Discussion on a Conflict Elimination based Approach
15:40- 16:00	Approach 3 - An Emphasis on Product Suitability - Insights from research
16:00-16:20	Approach 3 - An Emphasis on Product Suitability - Insights from the market
16:20- 17:30	Discussion on a Product Suitability based Approach
19:30 onwards	Dinner
Day 2 – September 1, 2012	
08:30 onwards	Breakfast
09:30 - 10:30	Review of Approaches and International Experiences
10:30 - 13:15	Discussions on way forward for India
13:15 - 13:30	Vote of Thanks
13:30- 14:30	Lunch

IFMR Financial Systems Design Conference, August 31-September 1, 2012

List of Participants

Dr. Ajay Shah

Dr. Shah is a researcher at the National Institute of Public Finance and Policy (NIPFP), New Delhi. He co-leads the Department of Economic Affairs' Research Programme, undertaken in collaboration with the NIPFP. He currently works as a Consultant to Financial Sector Legislative Reforms Commission.

Dr. Ajay Tannirkulam

Dr. Tannirkulam is the Executive Director of Centre for Micro Finance, IFMR Research.

Mr. Ajit Dayal

Mr. Dayal is a Director at Quantum Advisors Pvt Ltd and Quantum Asset Management Company Pvt Ltd

Mr. Anand Sahasranaman

Mr. Sahasranaman leads the work of the IFMR Finance Foundation, working on issues of financial system design such as consumer protection and capital markets development.

Mr. Arjun Chaudhuri

Mr. Chaudhuri works with J. C. Flowers and Co.

Mr. B.V.R. Subrahmanyam*

Mr. Subrahmanyam is the joint secretary in the Prime Minister's Office (PMO) in charge of Finance.

Ms. Bindu Ananth

Ms. Ananth is the President of the IFMR Trust, and serves as the Chairman of the Board of IFMR Finance Foundation.

Mr. C.R. Muralidharan*

Mr. Muralidharan worked as a whole-time member at the Insurance Regulatory Development Authority (IRDA), looking after regulatory compliance by insurers.

Mr. C V Krishnan

Mr. Krishnan is the President of IFMR.

Mr. Dave Wallack

Mr. Wallack is the Chief Design Officer at IFMR Rural Finance.

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Dr. David Cousins*

Dr. Cousins is a Professor at the Centre for Regulatory Studies in the Faculty of Law, Monash University. Prior to this, Dr. Cousins was the Executive Director Consumer Affairs with the Victorian Department of Justice and the Director of Consumer Affairs Victoria.

Mr. Dhirendra Swarup*

Mr. Swarup is a Member-Convenor with the Financial Sector Legislative Reforms Commission. Mr. Swarup, a former civil servant, was Secretary (Expenditure) and Chief Budget Officer of the Government of India and also served as the Chairman of the Pension Fund Regulatory and Development Authority (PFRDA).

Mr. Gabriel Davel

Mr. Davel is the Director of Financial Inclusion Policy at the Alliance for Financial Inclusion. Gabriel played a leading role in the development of the National Credit Act, serving as Policy Advisor to the Department of Trade & Industry, South Africa. Mr. Davel was the first CEO of the National Credit Regulator.

Mr. Gaurav Kumar

Mr. Kumar is the Head of Origination-Micro Finance Business at IFMR Capital.

Mr. Greg Kirk*

Mr. Kirk is the Senior Executive Leader, Deposit Takers, Credit and Insurance Providers at the Australian Securities and Investment Commission (ASIC). Mr. Kirk is also the Former Director of Compliance and Campaigns, Consumer Protection at ASIC.

Mr. Jayant Sinha*

Mr. Sinha is the managing director of Omidyar Network India Advisors, where he leads overall investment strategy and operations in India

Ms. Jayshree Venkatesan

Ms. Venkatesan is the CEO of IFMR Mezzanine.

Dr. K.P. Krishnan

Dr. Krishnan is an Indian Administrative Service Officer from the 1983 Karnataka Cadre, and currently serves as the Secretary of the Economic Advisory Council of the Prime Minister of India.

Ms. Kate McKee

Ms. McKee is a Senior Advisor at the Consultative Group to Assist the Poor. Ms. McKee leads CGAP's research, writing, and policy advisory work on consumer protection, including analysis of policy/regulatory/supervision options for market conduct regulation in low-access markets

Dr. Kshama Fernandes

Dr. Fernandes is the CEO of IFMR Capital.

*Awaiting confirmation

IFMR Financial Systems Design Conference, August 31-September 1, 2012

List of Participants

Mr. M.V. Subramanian

Mr. Subramanian is the President of Rural & Inclusive Banking at Axis Bank.

Ms. Monika Halan

Ms. Halan is the Editor of Mint Money at HT Media. Monika Halan works in the area of financial literacy and financial intermediation policy and is a certified financial planner

Dr. Nachiket Mor

Dr. Nachiket Mor is the Chairman of the Boards of Sughavazhvu Health Care, and CARE India. He is currently also an independent member of a few other Boards, including CRISIL, the IKP Centre for Technologies in Public Health, and the Institute for Financial Management and Research (IFMR).

Mr. Puneet Gupta

Mr. Gupta serves is the CEO of IFMR Rural Finance.

Mr. Rajesh Bansal

Mr. Bansal is currently the Assistant Director General with the UIDAI responsible for integration of Aadhaar for the financial sector.

Mr. Ravi Narain*

Mr. Narain is currently the Managing Director and CEO of the National Stock Exchange of India Limited. He is the Chairman of National Securities Clearing Corporation Ltd. (NSCCL) and NSE.IT Ltd.

Ms. Renuka Sane

Ms. Sane is a Research Economist at the Indira Gandhi Institute for Development Research (IGIDR)

Ms. Roopa Kudva*

Ms. Kudva is the Chief Executive Officer and Managing Director of Crisil Ltd., and the Region Head, South Asia for Standard & Poor's. She is also a member of Standard & Poor's Asia-Pacific Executive Committee.

Mr. S. A. Narayan*

Mr. Narayan is the Managing Director of Kotak Securities Limited.

Mr. S. G. Anil Kumar

Mr. Anil is the CEO of IFMR Rural Channels and Services.

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List of Participants

Dr. Sankar De

Dr. De is the Clinical Professor and the Executive Director of the Centre for Analytical Finance at the Indian School of Business (ISB), Hyderabad. He teaches Advance Corporate Finance at the Institute.

Mr. Sanjiv Shah*

Mr. Shah is the Co-CEO of Goldman Sachs Asset Management (India) Private Limited.

Dr. Santadarshan Sadhu

Dr. Sadhu is the Head of Policy and Research at Centre for Microfinance, IFMR Research.

Ms. Sucharita Mukherjee

Ms. Mukherjee is a Director on the board of IFMR Capital.

Dr. Susan Thomas

Dr. Thomas is currently a faculty member at the Indira Gandhi Institute for Development Research (IGIDR), Bombay.

Mr. Venky Natarajan

Mr. Natarajan is a Managing Partner at Lok Capital.

Mr. Vineet Sukumar

Mr. Sukumar is the Head of Origination and Treasury, IFMR Capital.

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