Financial Services User Group's (FSUG)

response

to the Financial Stability Board (FSB) on Consumer Finance Protection with particular focus on credit – Report to the G20 Leaders

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Introduction

The FSUG is pleased to submit a response to the FSB consultation on Consumer Finance Protection with particular focus on credit. We have restricted our submission to relatively high level comments on user representation and consumer protection due to the very short time frame given to respond. It is important for future reference that policymakers ensure that any consultation process complies with best practice – this includes providing user representatives with very few financial and human resources sufficient time to respond.

User representation

The FSB suggests strengthening the role of FinCoNet to provide a voice for consumer protection authorities. FSUG supports this proposal as it is important that consumer protection is given sufficient weight within the regulatory system. It is important that consumer protection authorities are not seen as the 'poor relation' in the regulatory system compared to micro-prudential regulation and macro-prudential (financial stability) regulatory authorities.

However, it is also important to recognise that FinCoNet does not necessarily provide a voice for user representatives within national or global regulation. The problem of representation goes much deeper than is recognised in this FSB consultation. As our predecessor organisation FIN-USE highlighted there is very little user representation at EU level and within EU Member States[1].

There has been some welcome improvement with the establishment of the European Supervisory Authorities (ESAs) stakeholder advisory groups. However, as we set out in a letter to President Barroso, even now industry voices continue to significantly outweigh user voices in the EU regulatory system[2].

This needs to change. Suitable, well resourced user representation at the highest level of the policymaking process is critical for a number of reasons:

- it enhances regulatory governance and accountability by balancing the influence of powerful industry interests

- it significantly improves the capacity of user representatives to represent the interests of users at international, EU and national level and provides users with more direct involvement in the policymaking process

- it ensures policymakers abide by the principles of good consultation thereby improving the consultation process and

- most importantly, it is not tokenistic, as it improves the policymaking process by enabling policymakers to better understand the needs of users and the purpose of financial regulation, the interaction between 'consumer protection' and micro and macro-prudential regulation, and avoid 'group-think'.

1 http://ec.europa.eu/internal_market/fin-use_forum/docs/consumer_voice_en.pdf
2 http://ec.europa.eu/internal_market/finservices-retail/docs/fsug/opinions/letter_barroso-fin_user_representation-2011_08_04.pdf

Therefore, if the FSB wants to improve the effectiveness of financial regulation (specifically, consumer protection) then it should promote the establishment of proper user representation in the policymaking process and regulatory system, as well as better coordination of the activities of consumer protection authorities.

For example, FSUG is advocating the creation of an independent financial user expert group to sit within the ESA system. The role of the new expert group would be to: advise policymakers; ensure the individual ESAs avoid 'silo' regulation; provide an early warning system for supervisors; advise regulators on identifying consumer detriment and market failure; and advise regulators on the effectiveness of interventions and prioritising interventions[3].

Defining 'consumer protection'

We would also make some general comments about the way the FSB appears to be approaching 'consumer protection'. In the introduction, the FSB states that "Consumer protection is not about protecting consumers from bad decisions but to ensure that consumers can make informed decisions. Financial education, financial literacy and consumer protection policies should form the foundation of any regulatory and supervisory framework for protecting consumers particularly amid efforts to expand financial inclusion by reaching 'unbanked' customers."

In our view, this is a very outmoded approach to consumer protection and implies that the purpose of intervention is to address information asymmetries.

As we set out in our submission to the OECD consultation on draft high-level principles on financial consumer protection, regulators should abandon classical economic theoretical approaches to market regulation[4]. The classical approach assumes that the role of the regulator is to create the 'conditions' for markets to work – e.g. by addressing information asymmetries.

While helping consumer make informed decisions is important, it is critical to recognise that information solutions, financial education and literacy initiatives have very limited effect in complex markets such as financial services. It appears to have very limited impact on consumer behaviour and most importantly on market behaviour – even more so, when it comes to the protection of the most financially vulnerable or excluded consumers who are subject to the most aggressive behaviours from sub prime lenders and other non-mainstream market operators.

An over-reliance on information theory can have unintended consequences. There is an unacceptable view in some sectors of the industry that complex and potentially detrimental products can be widely promoted, provided they are transparent through disclosure. This is accompanied by an expectation that consumers can, and should, acquire the skills, knowledge and understanding required to deal with this complexity and choice, which places an unreasonable burden on the consumer. This approach is not adopted by other industry sectors.

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3 Policymakers and regulators have a number of interventions available from a regulatory 'toolkit'. These include rules, product interventions, information and education and so on. The 'art and science' of consumer protection is rather different to micro and macro-prudential regulation. Understanding the conditions in which different interventions work requires a specific set of skills which are not always available to regulatory authorities – this is why expert user representation is critical.

4 http://ec.europa.eu/internal_market/finservices-retail/docs/fsug/opinions/oecd_cons_prot_principles-2011_08_31_en.pdf

Therefore, the approach to and definition of consumer protection needs to be redefined. Of course, helping consumers make informed decisions remains an important part of consumer protection. But consumer protection should be redefined so that the emphasis is on:

– protecting users from unfair market practices

– changing the behaviours of market actors along the supply chain and

– cleaning up financial markets to get rid of toxic products.

One of the most effective mechanisms for protecting consumers is product intervention. Product intervention can take a number of forms including controlling marketing and promotions, regulating terms and conditions, and product intervention at the 'manufacturing' stage. In certain cases, product banning may be required.

More generally, regulators need to adopt a more interventionist style of regulation with a clear aim to 'make markets work' in the interests of society. This requires a clearly defined set of consumer protection objectives and outcomes.

To conclude, the aim for regulators is to intervene to change provider behaviour and improve markets. Financial education and regulatory intervention can be certainly promoted and implemented simultaneously.

We would welcome the opportunity to discuss these issues in further detail with the FSB.