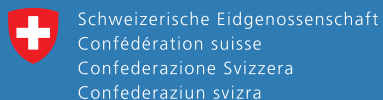


Good Practices for Financial Consumer Protection

2017 Edition



Swiss Confederation

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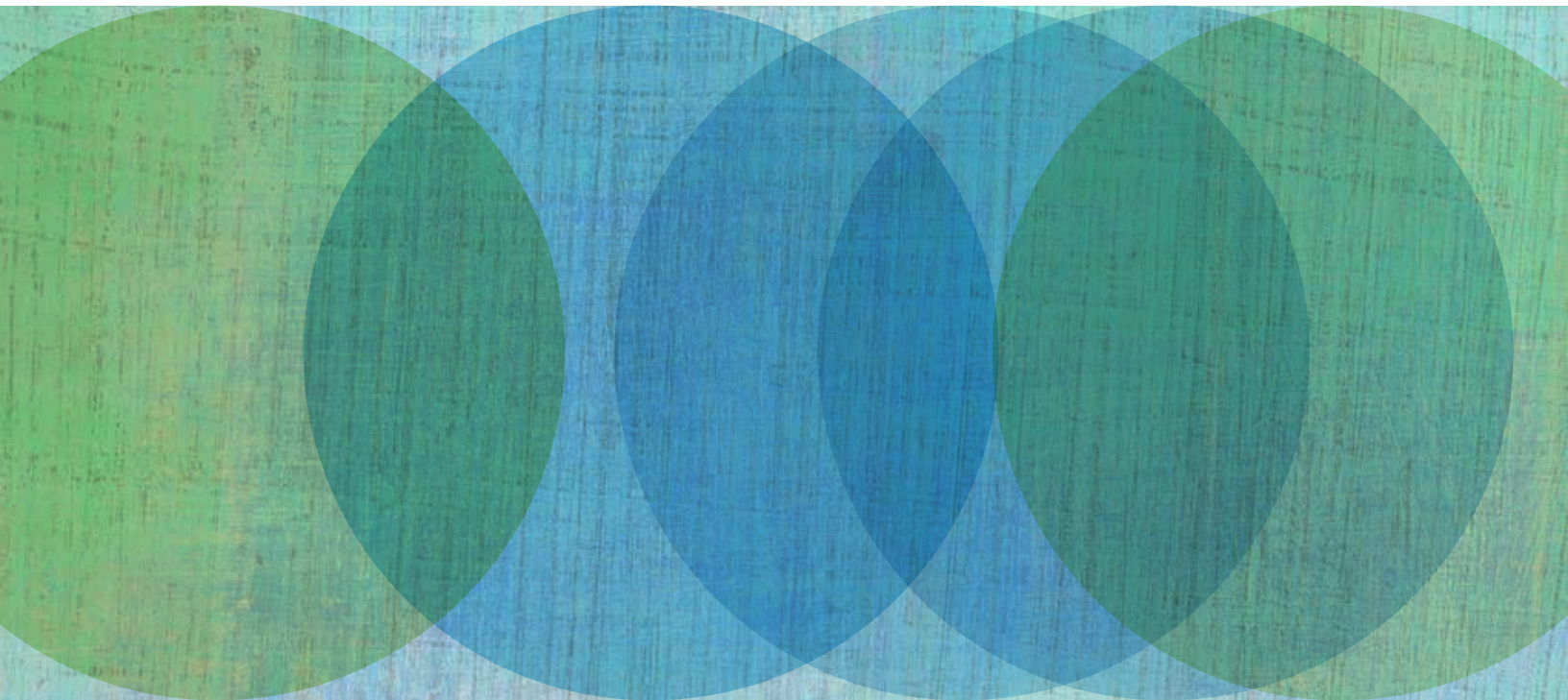
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Good Practices for Financial Consumer Protection

2017 Edition



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1818 H Street NW
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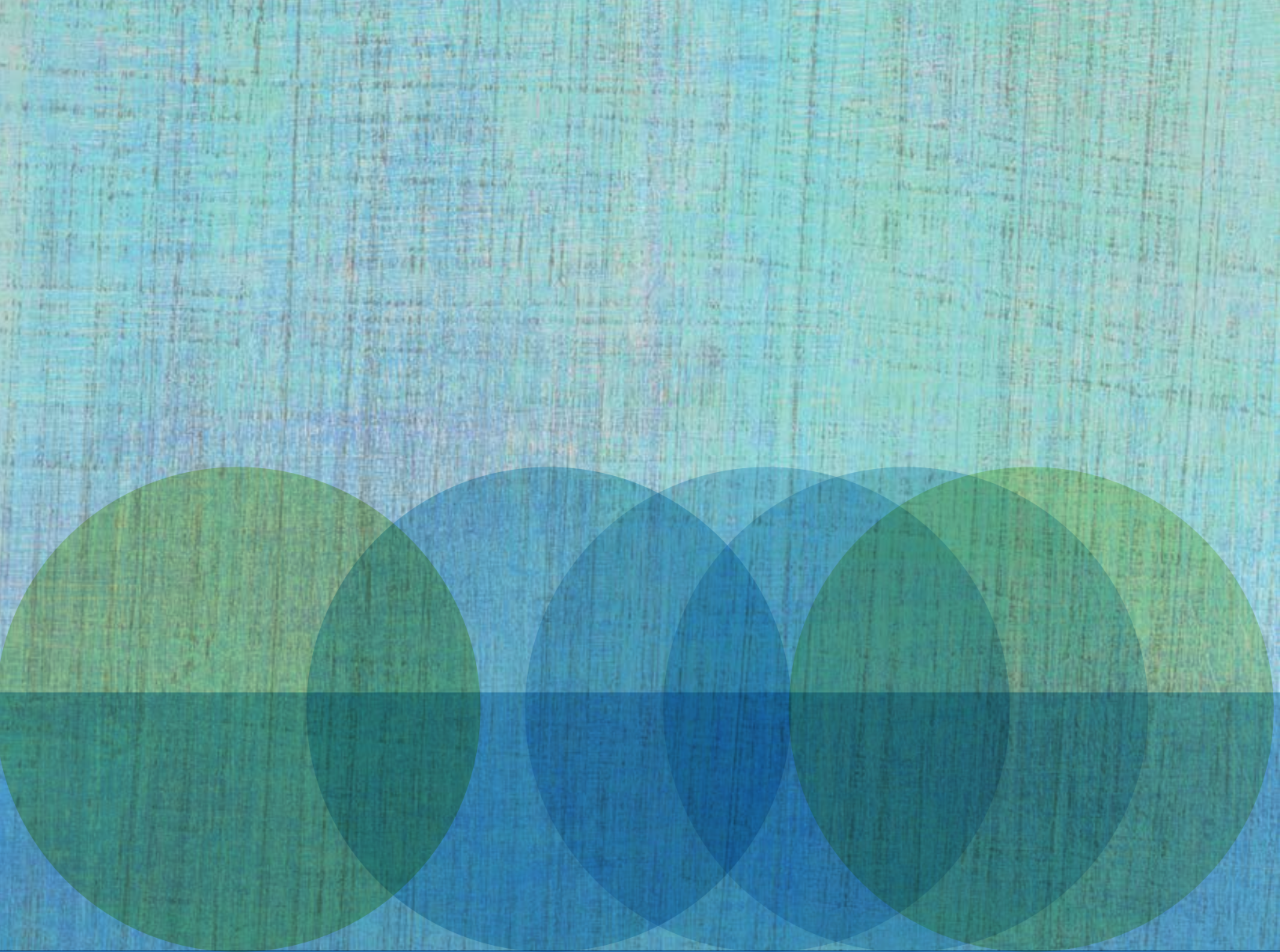
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FOREWORD

In recent years, financial consumer protection has become an increasing priority for policy makers around the world, including World Bank Group client countries. Protecting consumers from abusive practices and enabling them to make well-informed decisions regarding the use of financial products and services is an important policy goal in and of itself, but also has implications for the healthy development of the financial sector, financial inclusion, and broader economic growth. It is a cross-cutting topic with relevance across all types of financial service providers and financial products and services.

Financial consumer protection is also a rapidly evolving area. Since the 2012 edition of the Good Practices for Financial Consumer Protection, international guidance on policy approaches to protect consumers of financial services has substantially increased. Policy makers in both developed and developing countries have established new techniques to address topics such as effective disclosure of key terms and conditions and appropriate sales practices. They have as well developed new supervisory

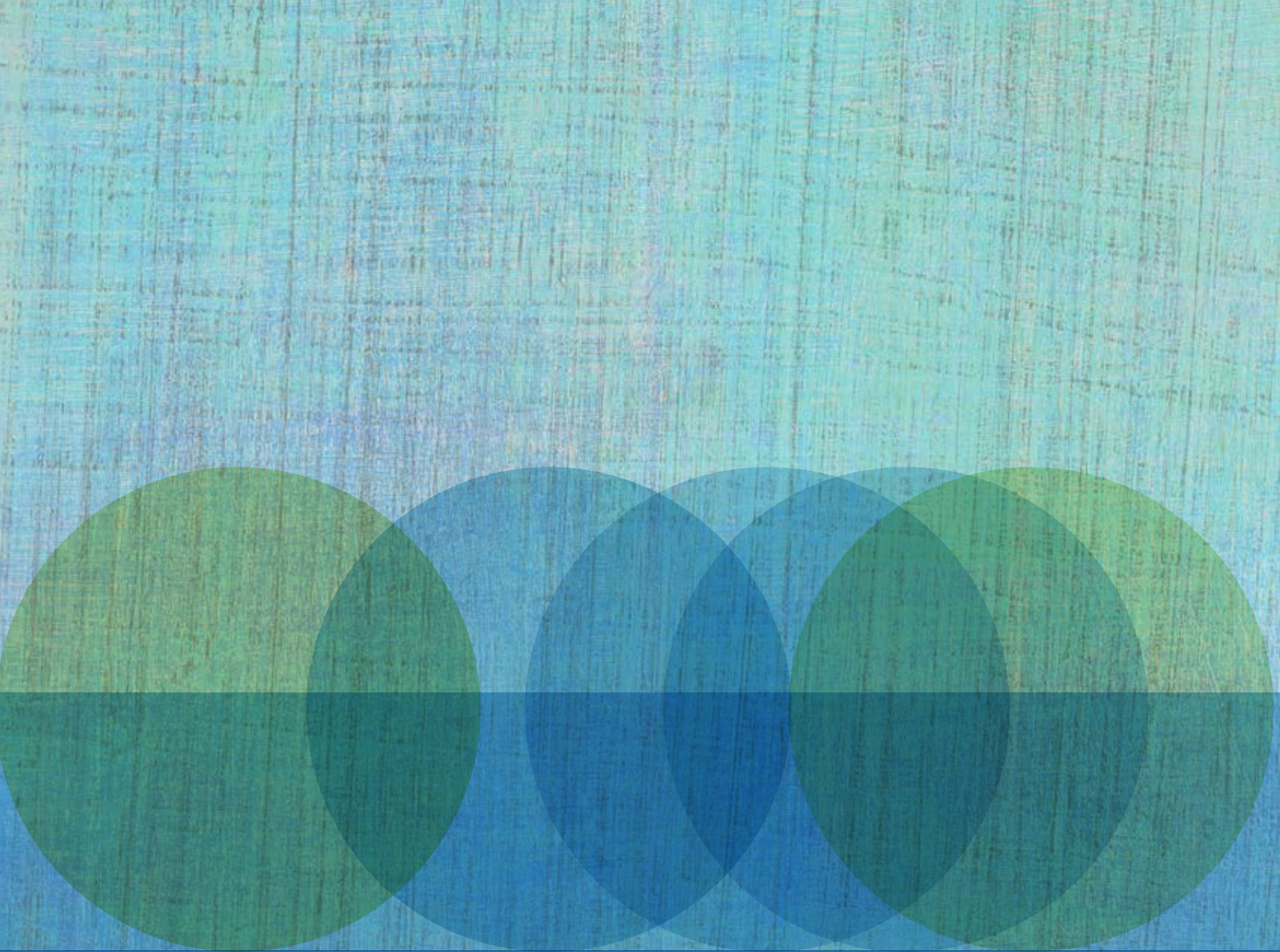
tools adapted to assessing the market behavior of financial service providers. New issues have also emerged, such as with respect to digital financial services and their implications for consumer protection.

The 2017 Good Practices for Financial Consumer Protection thoroughly updates and expands upon the 2012 edition. It is designed to complement existing tools and to serve as a comprehensive reference and assessment tool to assist policy makers, its primary audience. The report consolidates good practices from international guidance and country examples, accompanying them with practical information on policy considerations for implementation.

On behalf of the World Bank Group, I would like to sincerely thank the many government authorities, international organizations, and topical experts who generously provided their helpful inputs and suggestions throughout the development of the 2017 Good Practices. I would also like to express my gratitude to the World Bank team for their dedication in preparing this flagship publication.

Ceyla Pazarbasioglu

*Senior Director, Finance & Markets Global Practice
World Bank Group*





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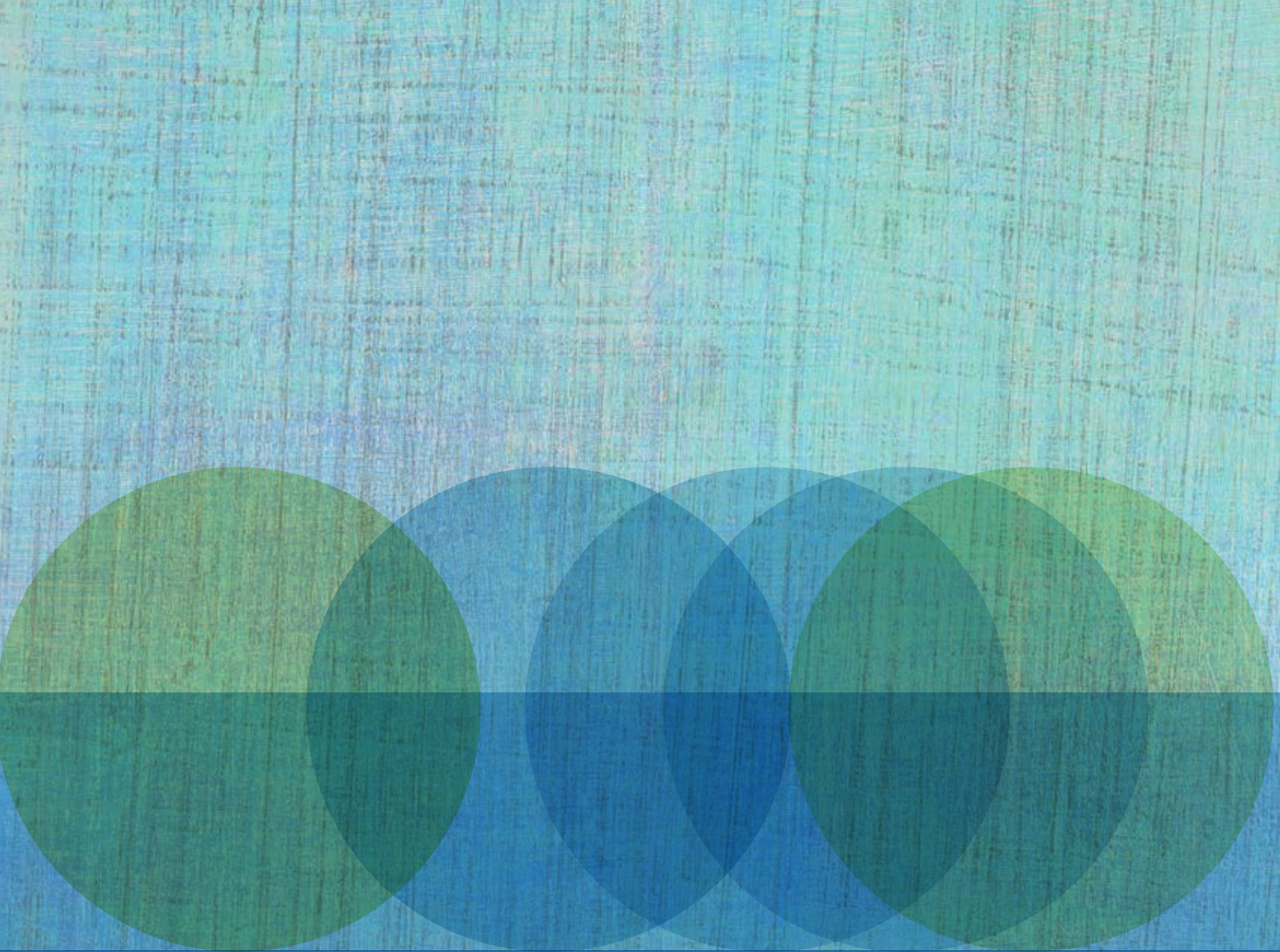
drore e Republikës së Kosovës (Central Bank of the Republic of Kosovo), Central Bank of Armenia, Central Bank of Nigeria, Comisión Nacional de Microfinanzas (National Microfinance Commission, Nicaragua), Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros (Commission for the Defense and Protection of Financial Services Consumers, Mexico), National Bank of Rwanda, Ministry of Finance of Lithuania, State Consumer Rights Protection Authority of Lithuania, Superintendencia de Bancos y de Otras Instituciones Financiera (Superintendence of Banks and Other Financial Institutions, Nicaragua), and Superintendencia de Banca, Seguros y AFP (Superintendence of Banks, Insurance Companies, and Private Pensions, Peru).

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ACRONYMS AND ABBREVIATIONS

ACH	automated clearing house	GP	good practice
ADR	alternative dispute resolution	GPII	Global Partnership for Financial Inclusion
AML/CFT	anti-money laundering/combating the financing of terrorism	IAIS	International Association of Insurance Supervisors
APEC	Asia-Pacific Economic Cooperation	INFO Network	International Network of Financial Services Ombudsman Schemes
APR	annual percentage rate	IOPS	International Organisation of Pension Supervisors
ASIC	Australian Securities and Investment Commission	IORPs	Institutions for Occupational Retirement Provision
ATM	automated teller machine	IOSCO	International Organization of Securities Commissions
BCBS	Basel Committee for Banking Supervision	ITU-T	International Telecommunications Union Telecommunications Standardization Sector
BID	basic information document	KFS	key facts statement
BNM	Bank Negara Malaysia	M&E	monitoring and evaluation
CFPB	United States Consumer Financial Protection Bureau	MFI	microfinance institution
CGAP	Consultative Group to Assist the Poor	MNO	mobile network operator
CIU	collective investment undertaking	NBFI	nonbank financial institution
COC	code of conduct	NEST	United Kingdom National Employment Savings Trust
COE	Council of Europe	NFCS	national financial capability strategy
CONDUSEF	Mexico National Commission for the Protection and Defense of Users of Financial Services	NPC	national payment council
CPMI	Committee on Payments and Market Infrastructures	OECD	Organisation for Economic Co-operation and Development
CRS	credit reporting system	OTC	over-the-counter
DB	defined benefit	P2P	peer-to-peer
DC	defined contribution	PSD2	European Union Revised Payment Systems Directive of 2015
EFT	electronic funds transfer	PSO	payment system operator
EIOPA	European Insurance and Occupational Pensions Authority	PSP	payment service provider
EN	explanatory notes	regtech	regulatory technology
EU	European Union	SMS	short message service
FCA	United Kingdom Financial Conduct Authority	SRO	self-regulatory organization
FinCoNet	International Financial Consumer Protection Organization	TCF	treating customers fairly
FSB	Financial Stability Board	TCI	total cost indicator
G20	Group of Twenty	UN	United Nations
G20 FCP Principles	G20 High-Level Principles on Financial Consumer Protection		





INTRODUCTION

Over the past decade, financial consumer protection has become an increasingly mainstream priority. A strong consumer protection regime is key to ensuring that expanded access to financial services benefits consumers, enabling them to make well-informed decisions on how best to use financial services, building trust in the formal financial sector, and contributing to healthy and competitive financial markets. The global financial crisis of 2008 highlighted the importance of financial consumer protection for the long-term stability of the world financial system. The need for financial stability, financial integrity, financial inclusion, and financial consumer protection objectives to complement one another has become an increasingly common theme highlighted by global policy makers in recent years.¹

Since then, significant advances have been made in financial consumer protection across the globe. In both developed and developing countries, policy makers are establishing and strengthening legal and regulatory frameworks for financial consumer protection and building up specialized supervisory departments. Numerous global bodies have issued guidance on financial consumer protection, including both high-level principles as well as more detailed guidance. Policy makers and international organizations are also tackling how to address new risks to consumers, such as those arising from digital channels for delivery of financial products and services, and how to develop new approaches and tools, such as incorporating behavioral insights into the design of effective disclosure regimes and developing rules regarding product suitability.

The World Bank's *Good Practices for Financial Consumer Protection* (the *Good Practices*) was developed as a contribution to the emerging global set of tools on financial consumer protection. Published in 2012, the first edition of the *Good Practices* consolidated knowledge and experience that the World Bank had gathered since 2006 through in-depth reviews of consumer protection frameworks conducted primarily in Eastern European and Central Asian countries. The first edition was designed primarily to be used as a diagnostic tool and covered the main issues that arise in consumer protection, with specialized chapters for sectors such as banking, securities, and insurance.

The 2017 edition of the *Good Practices* is also specifically designed not as high-level principles, guidelines, or "best" practices. Rather, it is intended to serve as a practical, helpful collection of "good" practices in financial consumer protection, more detailed than principles or guidelines and drawing on successful practices seen around the world. The *Good Practices* consolidates, complements, and expands upon international principles and guidance—such as the Group of Twenty (G20) High-Level Principles on Financial Consumer Protection and accompanying *Effective Approaches to Support Implementation*, the International Association of Insurance Supervisors' (IAIS) *Insurance Core Principles and Application Paper on Approaches to Conduct of Business Supervision*, as well as guidance from the G20/Organisation for Economic Co-operation and Development (OECD) Task Force on Financial Consumer Protection, the Basel Committee for Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO), the International

Organisation of Pension Supervisors (IOPS), the International Financial Consumer Protection Organization (Fin-CoNet), the International Network of Financial Services Ombudsman Schemes (INFO Network), the International Telecommunications Union Telecommunications Standardization Sector (ITU-T) Focus Group Digital Financial Services, and many others.

Since its initial development, the Good Practices has been used by the World Bank to conduct financial consumer protection diagnostics in over 35 countries to identify consumer protection issues. These diagnostics have provided a wealth of knowledge and experience, while also highlighting important revisions needed in the Good Practices. Based on a review of past diagnostics, a survey of policy makers, and interviews with key stakeholders, the following enhancements were identified as high priority in this 2017 edition:

- Incorporating new approaches, new research, and new international guidance in financial consumer protection
- Reflecting lessons learned and feedback from past diagnostics, including making the Good Practices more functional and practically applicable for policy makers
- Drawing from a broader range of country examples, from both developed and developing countries as well as from across geographic regions
- Addressing emerging issues, such as those related to digital channels, innovative products and business models, and new types of providers of financial services

The 2017 Good Practices comprehensively updates and expands on the previous edition, and is designed to serve as both a reference and a diagnostic tool for country-level policy makers, its target audience. This intended purpose informs both the structure and content of this document. Each good practice (GP) describes the key elements of a particular GP that regulators should consider acting upon, such as the elements to ensure effective disclosure of terms and conditions, or the requirements necessary to ensure that remuneration policies encourage responsible conduct and minimize conflicts of interest. Each GP is accompanied by explanatory notes (ENs) that expand on the intent of the GP, discuss policy considerations, and provide practical guidance and country examples of implementation. In addition to policy makers, the Good Practices is also intended to be useful to a broad range of stakeholders and to consolidate knowledge and experience in financial consumer protection.

A number of broad changes have been made in the 2017 Good Practices. At a structural level, this edition follows a more functional approach by merging the former chapters on the banking sector and nonbank credit institutions into a single chapter, “Deposit and Credit Products and Services” (chapter 1). The intention is to cover the full range of institutional types that provide deposit and credit products and services (including non-financial firms such as mobile network operators and white goods stores), as the same good practices for financial consumer protection should apply for all providers of such services, regardless of institutional form. This chapter is followed by others on insurance (chapter 2) and securities (chapter 4). Within each chapter, the focus is on the most common retail² products and services for that respective chapter.

A new chapter on private pensions and an annex on retail payment services have been added. Previously an annex due to its preliminary nature, “Private Pensions” (chapter 3) has been expanded and formalized to provide a comprehensive set of good practices focused on private pensions, a complex, difficult product for most consumers. An annex on retail payment services (annex A) was developed as retail payment services are one of the most fundamental, widespread services used by consumers every day. Such services raise unique issues related to consumer protection. However, international guidance and good practices are still emerging in this area. Therefore, the annex should be considered as an initial effort, with plans for further testing and refinement. Annexes on credit reporting and financial capability are also included, as these are complementary topics with relevance across the entire financial sector. Both annexes cover a subset of issues within their respective areas that are most relevant to financial consumer protection.

Each chapter consists of a common set of GPs, covering the most relevant issues that arise during the course of the relationship between consumers and providers, from initial product design to sales processes to ongoing management of customer accounts to dispute resolution. Each chapter is similarly grouped into the following broad topic areas, as many of these issues are applicable across the financial sector:

- Legal and supervisory framework: legal framework, institutional arrangements and mandates, supervisory activities, enforcement
- Disclosure and transparency: format and manner of disclosure, disclosure of terms and conditions, notifications of changes in rates, terms, and conditions

- Fair treatment and business conduct: unfair terms and conditions, unfair practices, product suitability, customer mobility, agents, compensation of staff and agents, fraud and misuse of customer assets
- Data protection and privacy: lawful collection and usage of customer data, sharing customer information
- Dispute resolution mechanisms: internal complaints handling, out-of-court formal dispute resolution mechanisms

Within these general topic areas, the GPs in each chapter are then tailored to the specificities for each respective sector, as the nature of products and services, the related risks to consumers, and regulatory approaches to address these risks vary by sector. For example, the annex on retail payment services includes GPs on unauthorized and mistaken transactions and on liability for loss. As pensions are long-term commitments by nature, consumer risks can also differ. The private pensions chapter therefore addresses good disclosure practices regarding the pay-out phase. Securities typically involve more complicated products, for which the duty of care of advisors is an important consideration.

In response to feedback from regulators and supervisors, GPs that were deemed critical have been added or expanded. In particular, new GPs on institutional arrangements and mandates, supervisory activities, and enforcement have been added, while GPs on disclosure and transparency and fair treatment and business conduct have been significantly expanded. These new or expanded GPs are intended to capture new and emerging risks as well as rapid advancements in strategies for effective financial consumer protection. For example, the GPs cover how to adapt supervisory tools and techniques for financial consumer protection issues, or what rules should be put in place to prevent mis-selling or to ensure appropriate compensation policies that do not incentivize behavior that may harm consumers.

Issues related to digital financial services have been interwoven throughout the Good Practices. Digital finance is a broad concept, encompassing digital delivery channels, digital business models, and digital products. Digital finance heightens certain traditional concerns and presents new risks to consumers as well, due to characteristics such as the high speed of transactions, remote nature of service, automated decision-making, the role of intermediaries, and the involvement of non-financial entities. Financial consumer protection concerns that are raised by digital finance include transparency and electronic disclosure; product suitability; provider/agent liability; alternative data,³ big data, and data protection and

privacy; effective recourse; and safety of consumer funds. These issues cut across the financial sector and are therefore addressed in each chapter where relevant. For example, issues related to digital credit business models and electronic disclosure are highlighted in the chapter on deposit and credit products and services, while issues related to e-money, such as unauthorized or mistaken transactions, are highlighted in the annex on retail payment services.

In response to feedback from users of the Good Practices, and in order to serve as a more useful reference, the ENs that accompany each GP have been revised and expanded significantly. The GPs are crafted to apply globally to the largest extent possible. This means that elements of the GPs will be aspirational for some countries. To make the Good Practices more applicable for a global audience, the ENs provide country examples and case studies drawn from both developed and developing countries and from across geographic regions. The ENs also include more references to relevant international guidance and research.

In particular, the ENs have been expanded to provide more insights regarding implementation. As noted previously, the Good Practices takes an activity-based approach, aiming to create a level playing field and comprehensive protection for consumers regardless of the type of provider with which they engage. However, in many countries, implementation of all GPs for all relevant providers will be challenging in practice. Regulatory requirements are obviously not implemented in a vacuum. They entail compliance costs for providers and implementation costs for supervisory authorities, who are often juggling multiple policy objectives. Excessive regulation can harm financial inclusion, raising product costs and limiting the range of accessible services. Excessive regulation can also lead to lax or ineffective enforcement, with a variety of negative impacts on consumer and provider behavior.

To make the Good Practices more practically useful, the ENs discuss tradeoffs, compliance costs, and the need for proportionality and provide illustrative country examples. The ENs explore areas where tradeoffs arise and proportionality needs to be closely considered, particularly when supervising large numbers of small, sometimes semi-formal nonbank financial institutions (NBFIs) as well as non-financial firms that may vary greatly in legal form, scope of operations, and regulatory oversight. Concrete strategies are provided for optimizing resources and prioritizing efforts effectively and efficiently, such as utilizing a tiered approach to licensing and registration and employing risk-based supervision. There is also greater emphasis on leveraging data to inform evi-

dence-based policy making and communicating and learning from industry participants and consumers to ensure that policy actions are balanced, proportionate, and effective.

This edition of the Good Practices has undergone an extensive internal and external review process. As noted earlier, numerous stakeholders were consulted during the initial stages of developing the 2017 Good Practices, as well as throughout the drafting stage. Advance drafts of each chapter were then shared with a wide range of internal and external stakeholders, including national-level policy makers, standard-setting bodies, NGOs, and topical experts, and over a thousand comments were received from 44 institutions (as noted in the Acknowledgments). The extensive feedback and numerous suggestions, examples, and references were incorporated into the final text, helping to strengthen and refine the final document.

The Good Practices should be read with a few important caveats in mind. The Good Practices does not and cannot cover everything that could be considered relevant to financial consumer protection. As noted previously, the GPs focus on good practices that can be broadly applied to the most common retail financial products and services. Further tailoring will be required for specific products and services, and some examples of this are included in the ENs. Topics such as prudential concerns and competition are generally not covered in the Good Practices, although such topics have an impact on consumer protection and consumer welfare. As the Good Practices focuses on those areas that fall within a financial sector authority's remit, complementary roles to be played by consumer associations, industry associations, the media, law enforcement, and the judicial system are only lightly touched upon but are important in contributing to the overall success of any financial consumer protection framework. Compliance issues at the provider level are also not discussed in detail, although ensuring that providers effectively implement consumer protection requirements (for example, through internal audit and compliance functions and appropriate corporate governance policies) will necessarily underlie implementation for all of the GPs. Finally, country context plays a major role in translating good practices into approaches that work on the ground in specific circumstances. In particular, legal tradition will play a role in determining how to design appropriate policy approaches. Country examples and, in some cases, legal references provided in the Good Practices are for helpful, illustrative purposes only and should not be considered "best" practices or transplanted wholesale to another country without adaptation and careful consideration.

A further note on the relationship and variation between chapters is warranted. As indicated above, each chapter is divided into similar topic areas. Where possible, the language for the same GP has been generally harmonized across chapters. This results in some necessary redundancy and duplication across chapters. As the Good Practices is intended to serve as both a reference and a diagnostic tool, each chapter is designed as a stand-alone reference for policy makers working in that particular sector, as this better reflects the reality on the ground in most countries, where multiple financial sector regulators with their own respective regulatory ambits often exist. At the same time, there are noticeable differences across chapters, in both the GPs and the depth of content in accompanying ENs. This is due to the fact that in the 2017 Good Practices, each chapter is more closely aligned with the international guidance developed for that respective sector. The chapters therefore reflect the fact that different sectors have taken different approaches to the topic of financial consumer protection, with some sectors providing more detailed guidance on a wide range of issues, while others have focused on high-level principles or targeted specific issues to date.

For consistency and simplicity, a few defined terms are used in this document, such as *authority* and *consumer*. The term *authority* is used in place of government agency, institution, or regulator, as this term is broader and more generally applicable across a range of countries. The term is used as short-hand to refer to whatever agency, institution, or regulator in a country has been designated as the authority for financial consumer protection. Depending on country context, this could be the same authority as the prudential regulator, a separate authority, or even multiple authorities. Where it is necessary to differentiate between financial consumer protection regulatory or supervisory activities, the term *regulatory authority* or *supervisory authority* is used. The term *consumer* is used primarily to refer to individuals, but the Good Practices is not necessarily limited to individuals only. Microentrepreneurs and small enterprises often face the same consumer protection issues as individuals and require the same basic protections. The term *consumer* is also used generically to refer to both potential and existing customers. Where the term *customer* is used, it refers to an existing customer who has purchased a product or service.

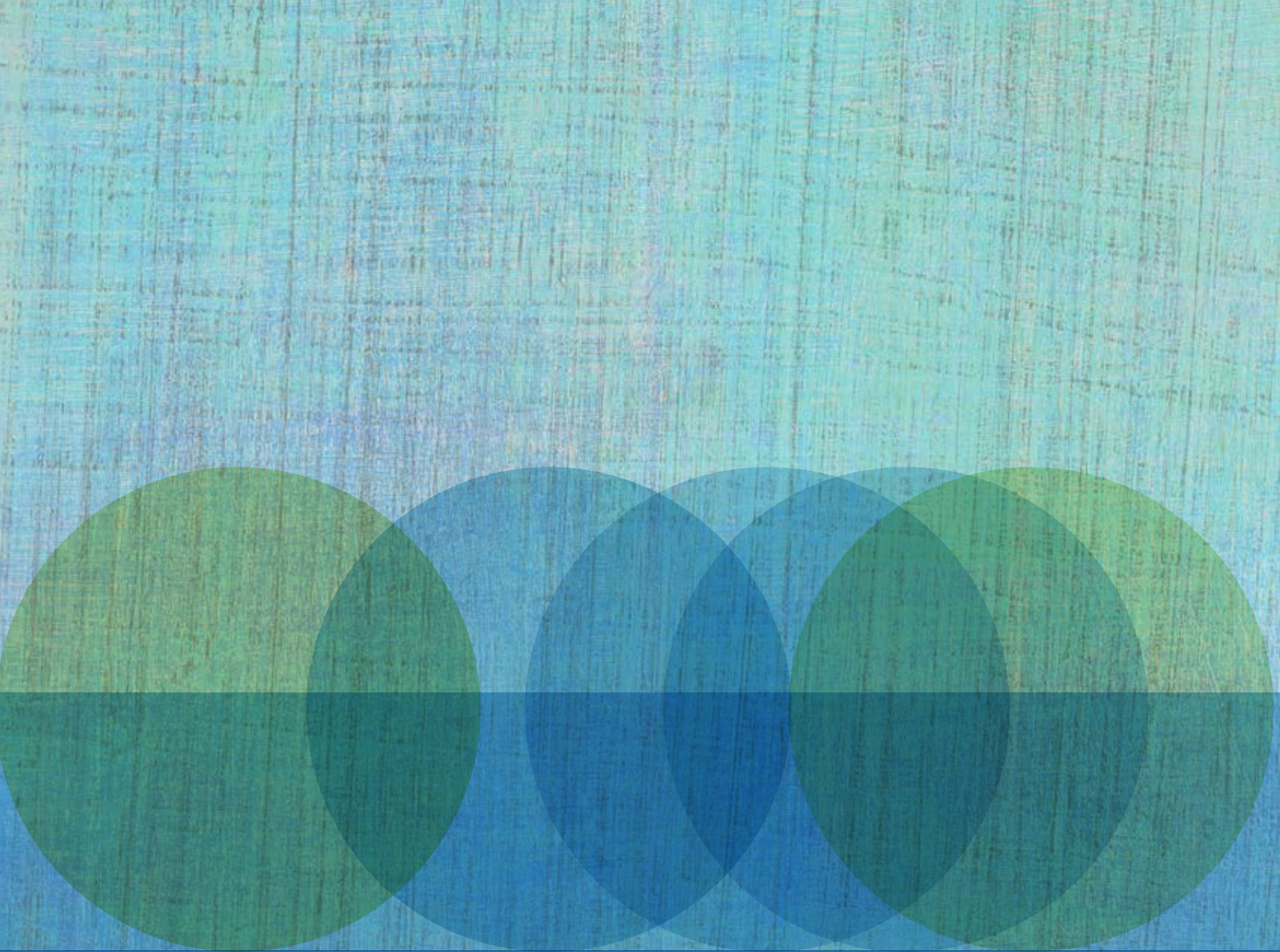
Finally, financial consumer protection is a rapidly evolving field, with new insights and approaches continually emerging. Inevitably, not all new insights are reflected in this document. For example, new consumer research and behavioral insights have helped to increase the effectiveness of disclosure (as well as to highlight its inherent lim-

itations). Risk-based supervisory approaches to financial consumer protection are being developed in many countries. Innovative products, channels, and business models are emerging, such as crowd-funding and peer-to-peer lending, the use of blockchain and distributed ledgers, and the use of alternative data and big data analytics for credit scoring. While posing exciting opportunities for

financial inclusion, many of these innovations present potential risks to consumers. These risks are still being articulated, and consensus regarding appropriate regulatory approaches is still developing. Such topics are touched upon where possible and will be monitored closely with a view to their inclusion in future editions of the Good Practices.

NOTES

1. For example, see the white papers *Global Standard-Setting Bodies and Financial Inclusion: The Evolving Landscape* (Global Partnership for Financial Inclusion, March 2016) and *Global Standard-Setting Bodies and Financial Inclusion for the Poor: Toward Proportionate Standards and Guidance* (Global Partnership for Financial Inclusion, September 2011).
2. In the Good Practices, the term *retail* is used to refer to products and services primarily provided to individual consumers as opposed to corporations.
3. *Alternative data* refers to non-financial information used to assess the creditworthiness of consumers or to determine consumer profiles and market targeted products. Such data can include utility and mobile phone bills, mobile airtime consumption history, electronic payments, and social media.



DEPOSIT AND CREDIT PRODUCTS AND SERVICES

This chapter focuses on the consumer protection issues and practices applicable to retail deposit and credit products and services, regardless of provider type. Public trust is crucial for the development of any country's financial sector, and having effective access to suitable financial products and services has an important impact on the financial and general welfare of a country's citizens. Transparent pricing, complete as well as simply presented information, consumer choice and mobility, fair terms and conditions and business conduct, and effective dispute resolution mechanisms can spur public trust in the financial sector. However, the vast majority of consumers are at a significant disadvantage in business relations with any financial service provider and require appropriate and comprehensive protection.

The following good practices (GPs) are aimed at helping policy makers not only to ensure fairness in the delivery of deposit and credit products and services to the widest possible range of consumers, but also to curb poor business conduct and ineffective dispute resolution mechanisms. The ultimate goal is to increase and maintain consumer confidence and trust in the financial system. Where applicable, the GPs and related explanatory notes incorporate and build off of guidance from international standard-setting bodies and organizations, such as the Basel Committee for Banking Supervision (BCBS), the Committee on Payments and Market Infrastructures, the Group of Twenty (G20)/Organisation for Economic Co-operation and Development (OECD) Task Force on Financial Consumer Protection, and the International Financial Consumer Protection Organization (FinCoNet), as well as from other relevant organizations such as the Consultative Group to Assist the Poor (CGAP) and

the International Telecommunications Union Telecommunications Standardization Sector (ITU-T).

This chapter is relevant to banks as well as nonbanks, including nonbank financial institutions (NBFIs) such as microfinance institutions (MFIs), consumer finance companies (for example, credit card companies, consumer lenders), leasing firms, payday lenders, mortgage lenders, pawnshops, financial cooperatives, and credit unions. It is also relevant to nonfinancial firms providing credit services such as mobile network operators, white goods stores, and auto loan providers. Banks and nonbanks are covered in a single chapter for two main reasons. First, the lines between the bank and nonbank sectors are increasingly blurred, with both sectors offering basic products and services to a variety of consumer segments, from credit to payments, and investment advisory to deposit services. In particular, in many countries a wide array of NBFIs as well as nonfinancial firms provide retail credit, raising consumer protection issues that are similar to issues raised by banks providing retail credit. Second, addressing all bank and nonbank providers of credit and deposit products and services in the same chapter is consistent with the general principle that all consumers are entitled to protections based on common principles, regardless of the providers they choose (or have access to).

However, the above does not mean that the approaches to implementing common principles, including the amount and type of regulatory and supervisory resources used, will always be the same for banks and nonbanks. Practical implementation challenges are quite likely to arise, and some principles may be aspirational when applied to all providers. In numerous jurisdictions,

bank prudential supervision tends to receive and will continue receiving the bulk of attention and resources by financial supervisory authorities, given banks' systemic importance, among other considerations. Due to these circumstances, this chapter offers insights for authorities who are undertaking the challenging task of building a harmonized, proportional institutional, legal, regulatory, and supervisory approach to balance consumer protection with prudential, competition, financial inclusion, and other policy goals in diverse deposit and credit markets, regardless of provider type. In addition, the chapter highlights occasions where the application of common principles entails special considerations that may depend on the provider type.

A key complexity introduced by nonbanks that vary greatly in their legal forms and scope of operations is whether and which providers should be covered by financial consumer protection legal, regulatory, and supervisory frameworks. This chapter presents an ideal situation where all bank and nonbank providers of deposit and credit products and services are subject to a clear financial consumer protection legal framework. Moreover, it suggests that large nonbank providers (in numbers of consumers served) be subject to supervision or at least monitoring by a financial supervisory authority with a mandate for consumer protection, rather than a general consumer protection authority or other authority outside the financial sector. However, in practice, countries will obviously need to consider different approaches due to their particular and varied contexts. For some countries, it may not be feasible to achieve the "ideal" situation where a comprehensive legal framework provides complete coverage of nonbanks. In the chapter, examples and materials are offered to assist countries to effectively operate within and to improve environments where legal frameworks may be fragmented and institutional arrangements quite diverse.

It is crucial to note the use of the terms *financial consumer protection authority* and *authority* in this chapter. As indicated in the introduction, these terms refer to any authority (or authorities) that has a mandate to implement the financial consumer protection legal framework in a country, specifically with regard to deposit and credit products and services and their providers. This could include prudential authorities such as central banks but may also include authorities outside the financial sector, such as general consumer protection agencies. In many countries, a combination of different authorities will be working toward similar goals, thus requiring coordination and collaboration to achieve comprehensive and harmonized implementation of consumer protection

principles. While a few countries have created a separate authority dedicated to financial consumer protection, this approach is not specifically advocated for all countries, nor will all countries be able to adopt it. The term *financial consumer protection authority* is therefore not used in this chapter to refer solely to a dedicated, separate authority. This chapter does not advocate for any particular approach for institutional arrangements and mandates, and while it calls for technical and operational independence of the consumer protection "function," it recognizes that in many countries, independence could be sought within the structure of existing supervisory authorities that have other mandates.

When dealing with a large, diverse, and dynamic sector, another consideration that is particularly relevant for developing countries is the limited capacity of regulatory and supervisory authorities. As noted above, while there should be an effort to apply similar principles to all providers, authorities will need to be strategic and establish priorities to be able to balance different statutory mandates (such as consumer protection, competition, systemic stability, curbing financial crimes, and financial inclusion) with limited staff and resources, while being proportional to the specific risks posed by different types of providers. Supervisors in low-capacity countries may face difficulties in introducing consumer protection principles overall, as these require specialized expertise and a higher level of subjectivity compared to prudential supervision, which can be challenging, at least in the first years of implementation. Technology, and in particular the use of regulatory technology ("regtech"), could help supervisors alleviate some of the implementation challenges.

The GPs included in this chapter have been crafted specifically to enable their use across a wide range of countries, across various income levels, and at different stages of financial sector development. Certain GPs may represent more aspirational goals in some countries, or goals that can be achieved only over the long term. This chapter provides examples of implementation, prioritization, and proportionality challenges, although it cannot offer comprehensive guidance on these multifaceted and context-specific issues. Each GP and its accompanying explanatory notes are drawn from a range of countries partly to reflect the diversity of markets and alternative approaches, including those that aim to balance financial inclusion and consumer protection goals. Country examples are cited to provide readers with further useful references. In all cases, country examples should be considered examples only and not necessarily representative of "best" global practices.

Both banks and nonbanks are trying out new products, channels, technologies, and partnerships to serve existing clients as well as new consumers who may have been previously excluded from the financial sector. This chapter highlights the need to pay special attention to these targeted consumer segments, the new channels being used to deliver deposit and credit products and services, and innovative business models that are emerging globally under the catch-all terms “digital finance,” “digital financial services,” and “fintech.” For instance, providers may serve vulnerable and inexperienced consumers in urban and rural settings, expanding the frontier of financial inclusion on the one hand, while creating particular consumer protection challenges on the other. Moreover, new types of nonbank providers have been leading innovations in digital credit,¹ and many banks are continuing on the path toward full digitalization. Both trends bring certain consumer protection concerns. Lastly, new types of partnerships between

banks and nonbanks are furthering the disaggregation of the financial services value chain and blurring the lines of responsibilities. As these pervasive trends could increase the complexity of implementing financial consumer protection principles, authorities should strive to ensure protection of consumers of digital financial services by adapting their legal and regulatory framework where necessary.

This chapter should be read in conjunction with annex A, “Retail Payment Services.” The annex covers GPs for financial consumer protection regarding retail payment services. There are close interlinkages between such services and deposit and credit products and services, particularly with respect to mobile money, whose classification as either a payment or banking service may vary. This chapter touches upon e-money services such as mobile money; further details can be found in the retail payment services annex.

A: LEGAL AND SUPERVISORY FRAMEWORK

A1: LEGAL FRAMEWORK

- a. There should be a clear legal framework that establishes an effective regime for the protection of consumers of retail deposit and credit products and services.
 - b. In the event that the legal framework takes an institution-based approach—that is, respective financial sector laws cover specific types of financial service providers—efforts should be made to ensure that the overall legal framework provides sufficiently comprehensive coverage and to avoid conflicts or lack of clarity.
 - c. The authority or authorities responsible for the implementation of the financial consumer protection legal framework (the “authority”) should make efforts to license or register financial service providers offering retail deposit and credit products and services in an efficient manner (for example, via a tiered approach) in order to obtain basic information from such providers.
 - d. Where financial service providers are required to be licensed by the authority, the authority should have the power to establish minimum entry criteria. The licensing process should, at a minimum, require that
 - i. The applicant’s beneficial owners, board members, senior management, and people in control functions demonstrate integrity and competence; and
 - ii. There are appropriate governance and internal controls in place, including specific controls to mitigate consumer protection risks.
 - e. The legal framework should include provisions establishing the responsibilities, powers, and accountability of the supervisory authority (or authorities) in charge of implementation of the legal framework.
 - f. The legal framework should be developed as a result of a consultative process that involves the industry, relevant authorities, and consumer associations.
-

Explanatory Notes

All financial service providers (banks, NBFIs, and nonfinancial firms) offering deposit and credit products and services should be subject to a law (or more than one law) that establishes minimum and specific standards for protecting consumers. Many countries have general consumer protection laws that apply to all types of products and services, but such laws are often not specific, clear, or comprehensive enough to provide effective protection to consumers of financial products and services. For instance, they usually do not allow for the creation of detailed consumer protection regulations by financial regulatory authorities.

It is good practice to have legal provisions that deal specifically with consumer issues in the financial sector and to determine in broad terms which authority (or authorities) will be responsible for implementing these provisions. Numerous approaches can be used to achieve these objectives, each with its own pros and cons. Irrespective of approach, the ultimate goal is a legal framework that provides effective protection. One approach is to have a stand-alone legal framework in the form of overarching financial consumer protection law(s), as in Canada, Colombia, Mexico, and Peru.² Stand-alone financial consumer protection law(s) usually cover a variety of provider types and products and offer a higher degree of transparency, flexibility, and clarity for authorities to implement overarching principles through specialized regulations, supervision, and enforcement.³ This approach is likely to be more effective than others in avoiding regulatory gaps and conflicting provisions across different laws. Ideally, the financial consumer protection legal framework should be activity-based—that is, covering all providers of similar products and services. Countries may also have separate laws that address specific products and services, such as laws on credit products and services, as in Australia, Ghana, Sierra Leone, South Africa, the United Kingdom, and the United States.

While an activity-based approach, via either a comprehensive stand-alone law or product-specific laws, can be more effective in achieving broad coverage and better clarity, this approach may not be feasible in all countries. In many countries, financial sector laws may take an institutional approach—that is, they cover specific types of providers (such as banks, finance companies, MFIs). As a result, some types of providers may not be covered by financial consumer protection provisions (though they may still fall under a general consumer protection law, if one exists). In such instances, regulators should make concerted efforts to ensure that the multiple laws addressing financial consumer protection are comprehensive enough to cover all providers of deposit and credit products and services, as well as all relevant consumer protection issues. Efforts should also be made to harmonize

their provisions to the extent possible to avoid gaps, conflicts, ambiguities, or an unlevel playing field. Careful planning and execution will also be needed to create a functional institutional arrangement to implement the overall legal framework, such as determining which authorities will cover which parts of the financial sector, what powers they will have, and what coordination mechanisms are needed. (See A2.)

As emphasized in Principle 1 of the G20 High-Level Principles on Financial Consumer Protection (G20 FCP Principles),⁴ an important consideration with regard to a financial consumer protection legal framework is its coverage. Lack of coverage can happen even where a stand-alone financial consumer protection law exists. For instance, in Canada, Colombia, Mexico, and Peru, the financial consumer protection law applies only to providers that are required to obtain a license/authorization to operate from a prudential regulator.⁵ It may be practical to limit coverage to prudentially regulated financial service providers, but this will result in some nonbank credit providers (such as retail stores and fintech credit providers) and even NBFI deposit takers (such as credit cooperatives or rural banks serving low-income populations) being left out. Given the increasing importance of nonbank actors in providing deposit and credit services to a larger group of the population (including low-income and low-literacy individuals), it is worth considering practical options to bring them under the financial consumer protection legal framework in some fashion.

Consideration should also be given to the challenges in adapting institution-based legal frameworks to address fast-evolving digital finance models that combine nonbanks and banks (for example, products linked to one another, such as digital credit, or insurance products linked to mobile wallets or bank accounts). An activity-based legal framework may provide more flexibility in addressing the emerging realities of digital financial services.

The legal framework should clarify whether and which types of providers are subject to licensing or registration requirements. While banks must obtain a license from a prudential regulatory authority prior to commencing operations,⁶ in many countries some types of NBFIs and nonfinancial firms may not even be required to register⁷ with any financial sector authority in order to provide deposit or credit product and services. To the extent possible, all types of providers of deposit and credit products and services should at least be required to be registered with the financial consumer protection authority. Registration accompanied by minimum regular reporting is particularly relevant if the legal framework requires providers to obtain a license only when their operations reach a certain threshold—that is, a tiered licensing system, further discussed below.⁸ While not imposing entry requirements, registration permits the authority to maintain a register with basic

information about each provider. Although registration does not entail supervision, it can facilitate ad hoc or regular data collection, which may be useful, for example, to develop a comprehensive mapping of the deposit and credit markets and to monitor indebtedness levels, financial inclusion and geographical coverage indicators, and overall market development.

If licensing is imposed, the licensing process provides an opportunity for the authority to form an early assessment of management's ethical standards and the provider's preparedness for complying with the applicable financial consumer protection laws and regulations. If the authority is a prudential authority with a consumer protection mandate, consumer protection aspects could be added to the existing licensing process.⁹ Adding consumer protection as an element of licensing could potentially benefit other mandates, since some aspects of consumer protection may be closely related to the long-term financial soundness of a provider.

In many countries, deposit and credit markets are very large and expanding. This may require a tiered approach to registering and licensing, as illustrated by the following theoretical tiered structure:¹⁰

- **Tier 1:** Banks and certain NBFIs are required to obtain a license by the authority prior to commencing operations, regardless of the size of their operations. Minimum entry requirements are imposed, and operation cannot be ceased without prior approval by the authority.
- **Tier 2:** Certain NBFIs and nonfinancial firms (which are registered already) are required to obtain a license if their operations meet certain thresholds of size and/or complexity. This entails meeting minimum entry requirements, which could be lower than or the same as requirements applicable to the next tier up.
- **Tier 3:** Certain NBFIs and nonfinancial firms are only required to register. They can commence activities without prior approval by the authority and are required to register with the authority within a timeframe determined by the authority. Registration does not entail meeting entry requirements. Regular reporting of basic information may be imposed for monitoring purposes. Ceasing operations entails only a notification to the authority.

In Cambodia and Uganda, for instance, tiered microfinance regulations require MFIs with portfolio values above prescribed thresholds to apply for a license, while others are subject to registration only. Most likely, this tiered system would similarly affect the implementation of consumer protection regulations for MFIs in these countries. While pragmatic alternatives, tiered approaches need to be balanced against the risk of regulatory arbitrage.¹¹ In deciding appropriate tiers and related thresholds, consideration should be given to how supervisory strategies can reduce such risks. (See A3.)

Where the financial consumer protection authority is separate from the prudential supervisory authority and registering or licensing are imposed by both, efforts should be made to streamline the overall process to avoid unnecessary regulatory burden and to increase efficiency. This can be done by mutual consultations before requiring documentation from a provider for registration or licensing purposes. The license by a prudential authority may replace the need for licensing or registration by the financial consumer protection authority.

Finally, as in any area of law or rule making, financial consumer protection laws can benefit from international guidance (including model laws)¹² and peer-country analysis. However, they should be fully tailored to a country's unique context. Transplanting model laws or other country's laws is likely to be ineffective.

A2: INSTITUTIONAL ARRANGEMENTS AND MANDATES

- a. **The authority (or authorities) in charge of implementing the financial consumer protection legal framework should have an explicit and clear legal mandate for consumer protection.**
- b. **The authority should have legal powers to**
 - i. **Issue binding regulations for financial consumer protection, as well as guidelines or other instruments under these regulations; and**
 - ii. **Implement and enforce the application of the financial consumer protection legal and regulatory framework.**
- c. **The authority should have an adequate allocation of resources and be operationally independent from external interference from political, commercial, and other sectoral interests.**
- d. **Appropriate legal protection should be established to protect the authority and supervisory staff from personal litigation in the good-faith exercise of their supervisory duties.**

- e. **Any overlap between the legal mandates of different authorities implementing the financial consumer protection legal framework, as well as between such authorities and prudential, competition, and other authorities, should be minimized.**
- f. **If a single authority is responsible for both prudential and consumer protection regulation and supervision, there should be coordination between these functions.**
- g. **There should also be effective coordination between different authorities implementing the financial consumer protection legal framework, as well as with other authorities that could have a relevant role in financial consumer protection, including authorities outside the financial sector, if relevant (for example, telecommunications regulator).**
- h. **The authorities should liaise with relevant consumer and industry associations, as well as with the media, when appropriate, to ensure that they play an active role in promoting financial consumer protection.**

Explanatory Notes

Institutional structure

No single model of institutional arrangement for financial consumer protection is optimal in all countries. Nevertheless, in all cases, the institutional arrangement for protecting consumers of deposit and credit products and services should aim to facilitate the implementation and enforcement of consumer protection laws, including the issuing of regulations, across all bank and nonbank providers in a consistent, thorough, and timely manner. In practice, this will depend greatly on the number and types of authorities with a mandate to implement the legal framework, their respective mandates and remits, the resources available to them, and the effectiveness of the coordination between them. The authorities responsible for implementing the financial consumer protection legal framework, regardless of their nature and specific mandate, are referred to in this chapter as “financial consumer protection authority” or “authority” (or “authorities”).

There are different options for a country’s institutional arrangement. All options require careful consideration of the existing institutional setup for broader financial sector regulation and supervision. For example, a comprehensive, activity-based financial consumer protection legal framework could provide the basis for creating a separate financial consumer protection authority covering all types of providers of financial services, including of deposit and credit products and services.¹³ This model minimizes regulatory gaps, increases consistency in the implementation of laws and regulations, and reduces the risk of conflicts of interest that could arise when the consumer protection function is performed by a financial sector authority that also has a prudential mandate. (See further discussion below.)

However, a specialized financial consumer protection authority that focuses exclusively on implementation of the financial consumer protection legal framework may not be possible or appropriate in many countries. In many

cases, as in Armenia, Brazil, Georgia, Ghana, Malawi, Nigeria, and Portugal, a multiagency institutional arrangement will prevail in which existing financial sector authorities such as central banks and other authorities with a prudential mandate become responsible for consumer protection for different bank and NBF sectors.

Coverage

Nonbanks will often present the biggest challenge for the implementation of a financial consumer protection legal framework because, unlike banks, there is generally no single framework for their regulation. In the case of banks, it is common for the bank prudential supervisor to assume consumer protection responsibilities. However, in some countries, there may exist both a large number and a wide variety of nonbanks providing deposit and credit services. Some of these nonbanks may fall under the bank prudential supervisor, while others may fall under the remit of another financial sector authority or outside the remit of any prudential supervisor (for example, nonfinancial firms providing credit or financial cooperatives under ministries of agriculture or finance).

As stated in A1, all providers of deposit and credit products and services should ideally be covered by the financial consumer protection legal framework. Similarly, all providers should ideally also be under the remit of some type of authority with the power to enforce the financial consumer protection law (or laws). Where this is not possible, efforts should be made to at least bring nonbanks that present higher risks to consumers (such as large providers of consumer credit or large financial cooperatives) under the remit of a financial supervisory authority with a consumer protection mandate. Other authorities, such as general consumer protection agencies, are often focused primarily on the protection and safety of consumers regarding nonfinancial products and services, such as food safety, and may lack the power to license or register financial service providers or to conduct supervision or take enforcement action against non-compliance. Where

other authorities do have supervisory powers, they will likely lack adequate expertise and resources to conduct supervision at a level similar to that of financial supervisory authorities.

Mandate and powers

Irrespective of which institutional arrangement is selected for financial consumer protection, it is important that the authority has a clear legal mandate and sufficient regulatory, supervisory, monitoring, investigatory, and enforcement powers to achieve its goals. For example, the authority should have enforcement powers over all providers of deposit and credit services within its remit, including those that are only registered and not licensed or supervised by it. (See A1.)

Addressing potential conflicts of interest

Attention is warranted to the potential conflicts of interest that could emerge between the consumer protection and the prudential functions when placed under the same authority, as will often be the case. For example, consumer protection supervisors may benefit from disseminating observed bad practices, including by naming and shaming individual providers. They also may disseminate the reasons for applying heavy fines for misconduct. Such publicity can potentially lead to improvements in the business standards of the concerned provider as well as its peers, who may try to avoid similar exposure. In contrast, prudential supervision is usually more secretive due to the sensitivity of the findings about a provider's financial soundness, on which the public and, in particular, depositors rely.

These potential conflicts of interest are the primary justification for the separation and independence of the two functions, either by having separate authorities or by at least separating the functions internally within the same authority. As in prudential supervision, consumer protection should benefit from technical and legal independence, adequate budget and financing, and resources and an adequate level of authority to achieve its goals. One strategy to achieve these objectives is placing the consumer protection function at the same hierarchical level as prudential supervision and establishing different lines of reporting. This approach can help to minimize potential conflicts of interest, biased decision making, or inadequate resource allocation, and also allows for specialization of staff. This approach has been observed in many countries, including Armenia, Chile, Hong Kong, Malaysia, Portugal, and Singapore. When starting up a new authority or department dedicated to financial consumer protection, provisional arrangements can be used to address a short-term lack of capacity or resources, such as technical assistance from and joint inspections with prudential supervisors.

Intra-authority and inter-authority coordination

As clearly stated in Principle 2 of the G20 FCP Principles, establishing a good level of coordination and cooperation across different departments, whether under a single authority or across authorities, should be a priority. One example is the coordination mechanism established in the United Kingdom between the Financial Conduct Authority (FCA) and the Prudential Regulation Authority through a memorandum of understanding.¹⁴ A similar understanding was reached between the Australian Prudential Regulatory Authority and the Australian Securities and Investment Commission (ASIC).¹⁵ Coordination can cover, for instance, sharing of information and supervisory findings.

Coordination is also important between the financial consumer protection authority and other authorities relevant to financial consumer protection, such as the competition authority, the payments authority, and other sectoral authorities (insurance, securities). Competition is closely related to consumer choice and protection as well as financial inclusion, so it is important that authorities coordinate to monitor competition issues in retail markets or to take actions, particularly when the competition authority's mandate extends to financial consumer protection, as is the case in Australia,¹⁶ Brazil,¹⁷ El Salvador,¹⁸ and Singapore.¹⁹

In addition, given the increasing convergence of telecommunications and information technologies and the financial sector, particularly in the supply of digital deposit and credit products via new channels, there is a growing need for coordination with the telecommunications regulator and related authorities. Mobile phone networks are increasingly important as a channel for financial services, and many consumer protection and competition issues may arise, particularly when mobile network operators compete for the provision of financial services. Examples of formal coordination in this regard include Ghana, India, Myanmar, Nigeria, Tanzania, and Zambia.²⁰

Interacting with industry and consumer associations

Liaising with industry associations is an increasingly important practice, particularly in situations where unregulated NBFIs or nonfinancial firms provide deposit and credit services similar to those provided by regulated providers. The authority can issue nonbinding "guidelines" or liaise and cooperate with industry associations to use moral suasion as a means of implementing standards similar to those applicable to regulated providers. For example, the Central Bank of the Philippines has worked to implement standardized disclosure formats in the unregulated microfinance sector. The State Bank of Pakistan and the Securities and Exchange Commission of Pakistan coordinate with the Pakistan Microfinance Network on a range of issues with regard to microfinance providers. Industry-based initiatives can help to minimize the impact of regulatory and institutional gaps that stem from the existing legal framework for

financial consumer protection. (See A6.) In order to encourage good practices in unregulated markets in particular, authorities may, for instance, work with industry bodies toward the development of assessment and certification tools that mirror the standards applied to regulated providers, or the adoption of internationally developed principles, such as those created by the Smart Campaign for the microfinance industry.

Finally, civil society, domestic and international consumer associations and advocacy organizations, and the

media can help raise awareness of instances of malpractice by financial service providers to discourage misconduct. In the European Union (EU), there are consumer associations that deal with financial services; some even receive funding from the European Community.²¹ Like the European Community's consultative bodies,²² the Consumer Financial Protection Bureau (CFPB) in the United States has also created consultative groups with the participation of consumer associations and other relevant stakeholders.

A3: REGULATORY FRAMEWORK

- a. **There should be a comprehensive regulatory framework that elaborates on the law to protect consumers of deposit and credit products and services.**
- b. **At a minimum, the regulatory framework should include**
 - i. **Disclosure and transparency;**
 - ii. **Fair treatment and business conduct;**
 - iii. **Data protection and privacy; and**
 - iv. **Dispute resolution mechanisms.**
- c. **Such regulations should be legally enforceable and binding on providers of deposit and credit products and services.**
- d. **The regulatory framework can use a principles-based approach, a rules-based approach, or a hybrid approach.**
- e. **The regulatory framework should be consistent, including across regulations issued by different authorities with respect to similar products and services.**
- f. **Regulations should be written in a manner that minimizes ambiguity and the possibility of differing interpretations.**
- g. **The formulation of regulations should involve consultations with a range of relevant parties.**
- h. **Regulations should benefit from consumer research and behavioral economics.**
- i. **Regulations should take into account international guidance and standards and benefit from research regarding the regulatory practices of other countries. However, model laws and other countries' regulations should not be transplanted without customization to a country's particular context.**

Explanatory Notes

The financial consumer protection regulatory framework should be comprehensive in order to encompass the range of consumer protection topics relevant to retail deposit and credit products and services offered by various types of bank and nonbank providers. However, for practical purposes, if a country lacks a comprehensive regulatory framework and the authority faces resource or other constraints in promulgating new regulation, a phased approach can be utilized in which topics and provider types are prioritized according to the most pressing issues observed in the particular country, while longer-

term plans are made for the gradual improvement of the regulatory framework.

Regulations should be written in a manner that minimizes ambiguity and the possibility of differing interpretations to provide certainty for providers, supervisors, and the general public; facilitate compliance and enforcement; and reduce the regulatory burden on providers. The overall regulatory framework should be consistent, so priority should be given to harmonizing different regulations if needed, including regulations for similar products and services issued by different authorities.

Rule making should follow a consultative process. There should be active engagement with industry and consumer associations, if relevant, either through permanent consultative groups (see A2) or ad hoc consultation during each regulatory reform. Studying examples of regulatory approaches in other countries, as well as model regulations and laws, can assist in the rule-making process. However, transplanting regulations or model laws/regulations from one jurisdiction to another is likely to be ineffective and inappropriate; each country context will require a different and tailored approach.

Given the rapid expansion of digital financial services worldwide, it is crucial that authorities make efforts not only to cover all the topical areas of consumer protection as listed in clause A3(b), but also to ensure that such protections apply to and, if needed, are adapted for the unique aspects of digital financial services, both to allow for innovation as well as to protect consumers from new risks. For example, existing regulation may need adjustment to ensure that protections are clearly extended to consumers using digital channels and agents. (See C7.) Regulation that requires paper-based disclosures or in-person interactions between consumers and providers may also need reforms to accommodate remote interactions and the use of agents. Digital credit, which often relies heavily on automated credit decisions based on alternative scoring models and can involve new types of providers, may require particular attention from authorities to ensure that regulations appropriately protect consumers of digital credit—for example, with respect to data protection and privacy.²³ In addition, regulation should ensure that providers of digital finance keep records of consumer

transactions, marketing materials, and other forms of disclosure; have such records available for the supervisor; and provide copies to consumers upon request. Lastly, good practices for retail payment services, such as clear rules for providers to reverse mistaken transactions in a timely manner, are crucial in responsible digital financial services. (See annex A, “Retail Payment Services.”)

Whenever possible, rule making should incorporate the findings of consumer testing and research to ensure that regulations produce the desired results. For instance, the Central Bank of the Philippines, the National Commission for the Protection and Defense of Users of Financial Services (Condusef) in Mexico, the Bank of Ghana, the Central Bank of Rwanda, and the National Bank of the Kyrgyz Republic have all tested proposed new disclosure formats such as key facts statements (KFSs) to assess their usefulness to consumers.²⁴ New findings from the application of behavioral economics to financial regulation can also contribute to building a more effective regulatory framework. The CFPB in the United States, the FCA in the United Kingdom, and ASIC in Australia have all taken behavioral research into consideration when designing or reforming regulation.²⁵

Regulation (as well as laws) should take into account guidance and knowledge produced by international organizations such as FinCoNet, the OECD, the Financial Stability Board (FSB), and the BCBS. With respect to digital financial services, the recommendations of the Consumer Experience and Protection Working Group, part of the broader ITU-T Focus Group on Digital Financial Services, are also useful.²⁶

A4: SUPERVISORY ACTIVITIES

- a. Consumer protection supervision should be risk-based to optimize the use of supervisory resources and increase effectiveness.
- b. Supervision should be comprehensive, proactive, and mostly forward-looking, aimed at identifying emergence of poor practices.
- c. The authority should collect and use high-quality and timely data, including data reported by providers in a standardized, electronic format.
- d. The planning of consumer protection supervisory activities should be conducted on a regular basis within a documented framework and following a set process.
- e. Supervisory procedures should be based on specialized supervision manuals to ensure standardization and consistency.
- f. The authority should deploy an adequate range of supervisory tools and techniques, such as market monitoring, off-site and on-site inspections, and thematic reviews.
- g. Although it may play a role in facilitating the resolution of individual consumer complaints, the authority should focus primarily on regulatory and supervisory activities.

- h. The authority should evaluate its supervisory approach, tools, and techniques, as well as supporting information systems, on a regular basis, to enable its staff to assess institution-specific and market-wide risks effectively.**
- i. Supervisory staff should meet high professional standards and have sufficient knowledge and appropriate expertise and training to carry out financial consumer protection supervisory activities.**

Explanatory Notes

Risk-based and forward-looking

To optimize the use of scarce resources, financial consumer protection supervision should strive to be risk-based, with prioritization of riskier consumer issues and providers. A risk-based consumer protection supervisory system follows the same basic concepts as risk-based prudential supervision, such as the concepts of inherent risk and risk mitigants. However, consumer risks are intrinsically different from prudential risks, and the criteria for prioritization of providers and topics for supervisory purposes will also differ. There are many possible methodologies, such as the “Treating Customers Fairly” framework used by United Kingdom’s FCA and the Hong Kong Monetary Authority.²⁷

It can be helpful to take a forward-looking view by identifying emerging and potential future risks stemming from current market practices and trends and taking supervisory actions to avoid materialization of, or to minimize, such risks. ASIC in Australia, FCA in the United Kingdom, and the Authority for the Financial Markets in the Netherlands all include forward-looking risk analysis in their business plans, with identification of priority areas of action for the next year or so.

The emergence of new types of business models and nonbank providers of deposit and credit products and services that have different systems, risk cultures, governance, commercial strategies, and internal processes may require reevaluation of institutional risk mappings compared to the risk mapping of traditional banking businesses. New strategies, technologies, business alliances, and outsourcing arrangements in disaggregated value chains may also be used by banks, which may change their consumer risk profile. For instance, banks and other providers may rely extensively on retail agents and agent network managers to deliver their services, so supervision needs to account for the consumer risks arising from the use of agents and how the provider manages and supervises these outsourced parties.²⁸ Attention should also be given to the impact of new technologies on consumer risks. For example, the use of automated decision making through artificial-intelligence applications to offer consumer loans or give financial advice may require adaptations in the risk-based model or in auditing techniques.

Quality and timely data

Quality data are essential for a cost-effective, risk-based, and forward-looking supervisory system. The core of supervisory data is the data reported by providers on a regular basis. The authority should outline a detailed data needs/frequency map linked to its supervisory objectives and determine the specific uses that each data point will have. Bank and nonbank providers should be required to assign an official responsible for the quality and completeness of regulatory reporting. Quality data also require standardization and electronic formats, following common definitions determined by the authority—for example, the definition of complaints versus enquiries.

Many authorities are also expanding their data-collection systems to add a broad range of unstructured data, such as “big data” (including data available internally at the authority, such as documents analyzed during licensing). This is becoming increasingly possible by leveraging regtech solutions. Data useful for financial consumer protection supervision can also include other sources beyond regulatory reports, such as information publicly available on the Internet about deposit and credit products and services, such as consumer model agreements and price tables, or complaints data from alternative dispute resolution (ADR) schemes for the financial sector.

In many countries, collecting quality data on an ongoing basis through regulatory reports may pose a practical challenge due to inadequate management information systems at financial service providers and at the authority as well.²⁹ Nonbanks may present particular challenges in this area. For instance, small financial cooperatives and MFIs may be only partially computerized and may be unable to produce regulatory reports in an automated manner. Although, in theory, all regulated providers should have systems to produce quality regulatory reports, given the varying levels of sophistication to be found in nonbank sectors, the authority may need to take a gradual approach. In the first stage, the focus could be on introducing a computerized reporting system and imposing reporting requirements for a more limited range of data (for example, standardized consumer complaints statistics) covering only a few types of major providers, such as banks and large NBFIs. Over time, the system for collecting quality data can be expanded and improved. Regtech

solutions can help supervisors address challenges and speed up this process.

To obtain data from unregulated/unlicensed markets, the easiest option would be to require financial service providers to register with and regularly report to the authority. When this is not possible, the authority may consider leveraging data already collected by other organizations, such as industry associations, or request industry bodies for their collaboration to collect data on an ad hoc or regular basis.

Supervisory tools

The authority should use a tailored mix of supervisory tools and techniques, which could include market monitoring, off-site and on-site inspections, thematic reviews, and research and mystery shopping. Off-site tools are particularly important, as further described below. The authority should also strive to check the quality of data reported by providers through off-site and on-site consistency and integrity checks.³⁰

One supervisory tool that is used more often in consumer protection than prudential supervision, and that provides important insights about industry practices in a relatively cost-effective manner, is thematic reviews. Thematic reviews are assessments or studies of a particular issue, such as internal complaints handling, account-switching procedures, or a specific type of sales channel, across a sample of providers. Thematic reviews can be effective in highlighting cross-cutting consumer protection issues and allowing authorities to formulate and disseminate good practices specifically to address such issues. Particularly in countries where a principles-based approach to the regulatory framework is employed, dissemination of good practices can clarify the authority's expectations about the implementation of the regulatory framework where regulatory requirements are not explicit. Such dissemination can occur through workshops and meetings with the industry.

Another supervisory tool more specific to financial consumer protection is mystery shopping,³¹ which is used by authorities in Malaysia, Singapore, Portugal, the United Kingdom, the United States, and other countries to identify problems arising during the interactions between providers and consumers. It can even be a joint effort by multiple authorities, such as in the case of mystery shopping on banks' sales practices conducted by the Hong Kong Monetary Authority and the Securities and Futures Commission in 2011.³²

Supervisory activities

In general, supervision should be comprehensive. It should include a range of relevant consumer issues and a broad range of activities to address those issues. Application of activities will vary in intensity according to each provider's complexity and size. Activities may include the following:

- Assessing business practices and their relationship with the provider's governance structure, corporate culture, revenue and growth model, risk management structure, internal controls, as well as staff and executive compensation policies
- Scrutinizing the main products and services throughout the product cycle (research, design, marketing, sales, contracting, and post-sales)
- Assessing the effectiveness of internal complaints-handling mechanisms, including how the analysis of complaints statistics is used at the corporate level to improve practices, products, and services on an ongoing basis
- Assessing the level of compliance with legal and regulatory requirements
- Assessing the level of compliance with the provider's own policies and possibly with industry self-regulation or codes of conduct
- Assessing the role and impact of the most relevant third parties involved in service design and delivery, or consumer interaction functions, such as agents and sales consultants
- Requiring proportionate corrective or preemptive measures or improvements by financial service providers in a timely manner

Supervisory coverage and strategic use of resources

Given that supervisory resources are often scarce, supervision of large numbers of nonbanks will need to be strategic and focused (in addition to being risk-based). A number of strategies can be employed. For example, the authority can use a tiered approach for institution-focused supervision: low-risk (small) nonbanks can be subject to reactive supervision—that is, action can be taken only when a problem or instance of non-compliance is spotted by whatever means, including the media, self-assessments, and consumer reports, while larger or riskier nonbanks can be subject to ongoing and preemptive supervision. The Korean Financial Services Commission registers all MFIs and monitors the industry as a whole but does not supervise them individually on an ongoing basis. Similarly, the FCA in the United Kingdom does not conduct active supervision of all 73,000 regulated firms. Rather, most firms are subject to reactive supervision and thematic evaluations only.³³ Other strategies and tools that can be useful include mandating that providers conduct and report self-assessments of regulatory compliance regularly and report material breaches immediately.

Another potential model for supervision of numerous small financial service providers is the "auxiliary supervision" model, in which industry bodies are legally required

to assume some supervisory role under the oversight of the responsible authority. This model is more commonly found in supervision of financial cooperatives, although experience has been mixed. In any type of supervisory approach taken for small and numerous financial service providers, the authorities should look for opportunities to leverage industry-based tools or initiatives that could reflect the supervisory methodology adopted for other types of service providers, such as client-protection certifications or risk assessments.

When supervising large numbers of nonbanks, off-site work such as market monitoring, firm-specific off-site assessments (including self-assessments), and off-site thematic reviews should generally be prioritized. On-site work should be employed selectively and strategically, based on intelligence gathered off site about the provider's risk profile and market conditions.

BOX 1

Financial Consumer Protection Supervision of NBFIs in Brazil

The Conduct Supervision Department of the Central Bank of Brazil has developed an off-site methodology and system to assess the regulated NBFIs sector (and small/medium banks) remotely, covering the most important topics in consumer protection and anti-money laundering/combating the financing of terrorism. For this assessment, some data are collected from individual financial service providers on an on-demand basis, to complement data gathered on an ongoing basis, such as consumer complaints and financial data. In addition, the Central Bank's communications department makes a daily clipping of all news related to the financial sector, including NBFIs, which is closely followed by those in the Conduct Supervision Department. On-site activities are performed only when high risks are identified as a result of the off-site review and monitoring.

Complementary actions such as engaging actively with the media and consumer associations and other third parties can be used by authorities with limited resources to further their supervisory objectives by disseminating supervisory activities, broadcasting supervisory findings, highlighting good and bad practices, and clarifying supervisory expectations. (See A7.) As noted earlier, disseminating good and bad practices identified in thematic reviews can help the authority achieve its supervisory objectives without draining resources.

Many supervisory authorities directly facilitate complaints and enquiries from consumers. Usually, the authority refers the consumer complaint to the provider for resolution (as opposed to being directly involved in resolution) and may monitor the process, including assessing the quality of the final response to the consumer. While the resulting complaints data may be useful as an input to supervision, playing a role in the resolution of individual consumer complaints can often take up significant staff resources and time. If the authority has sufficient resources and chooses to facilitate complaints handling, this function should be separated from supervision to avoid draining specialized supervisory resources. Complaints handling does not replace the need to establish a strong consumer protection supervisory function. It should also be clearly understood that the authority's role in facilitating consumer complaints does not substitute for the requirement for service providers to have their own internal complaints-handling mechanisms, whose effectiveness should be one of the priority areas of supervisory scrutiny.

Staff assigned to financial consumer protection supervision should receive adequate training and be duly qualified to carry out supervisory activities. It is common to assign former prudential supervisors to newly created financial consumer protection authorities or units, given their supervisory skills. However, even experienced prudential supervisors will require specific training and specialization to effectively shift mindsets from a prudential focus to a consumer protection perspective.

A5: ENFORCEMENT

- a. The authority should have clear powers to negotiate and impose preemptive and corrective measures in the course of its supervision to address non-compliance and instances of misconduct.
- b. The authority's enforcement powers and tools, and its actions taken against financial service providers, should create a credible threat of enforcement against lack of compliance with the legal and regulatory framework.
- c. The authority should have an adequate range of enforcement powers and tools to allow it to investigate and address various situations adequately.
- d. The authority should strive to be gradual, proportionate, timely, and consistent in the application of its enforcement powers.

- e. **There should be effective coordination between the areas (or authorities) responsible for supervision and those responsible for enforcement, including relevant enforcement agencies.**
- f. **The authority should have the power to refer cases to the judiciary as well as to other agencies for civil or criminal action.**

Explanatory Notes

With regard to weaknesses and minor breaches or misconduct found in the normal course of supervision, the supervisory authority should have sufficient powers to require timely corrective measures or preemptive improvements in business practices, processes, or products. Imposing corrective measures should involve requiring a time-bound corrective plan agreed upon with the financial service provider. Implementation of the plan should then be monitored by supervisors. If practices and breaches continue and the corrective plan is not implemented, the supervisor may consider use of its enforcement powers, following a proportionate and gradual approach advocated in these GPs.

The credible threat of enforcement is an important tool to deter poor business practices that hurt the interests of consumers, and to help promote a culture of change in financial service providers. Providers must believe and expect that the authority will take proportional and timely action against non-compliance with financial consumer protection laws and regulations. A credible threat is usually not possible without a clear mandate in law and regulation regarding financial consumer protection and appropriate procedures to use enforcement tools (see A2[b], above). Many countries may need to undergo legal reforms to ensure that the authority is endowed with the appropriate mandate, powers, and tools for enforcement.

Enforcement tools are called different names and vary widely across countries, and may include the following:

- Imposition of conditions or restrictions or suspension of a regulated activity
 - Imposition of conditions, restrictions, or cancellation of registration or license to operate
 - Disqualification of management to carry out regulated activities
 - Compensation and refunds to affected customers
- If enforcement takes too much time to be implemented, is not taken against certain providers (for instance, due to political pressure), or is too light (for example, low maximum fines established by law), the authority's credibility can be damaged. In such circumstances, the danger is that providers may conclude that the potential benefit of misbehaving or not treating consumers fairly is higher than the potential damage of enforcement. Lack of flexibility in the legal framework (for example, if it imposes unduly harsh penalties for most situations) may inhibit the authority from starting enforcement actions. Laws and regulation that are too detailed or prescriptive in their description of enforcement—for example, by listing all situations that could be considered a breach of the law or regulation and the corresponding enforcement action—give little room for needed flexibility.
- Being gradual, proportionate, timely, and effective requires that the authority have available a range of enforcement tools, as well as a conducive organizational structure and set of procedures to facilitate use of the appropriate tool for the particular occasion. The law should give the authority the necessary flexibility to use enforcement tools in a gradual and proportional manner, taking into account variables such as:
- The seriousness of the detected infringement or breach
 - The potential or actual damage to consumers
 - The revenues or benefits resulting from the infringement/breach
 - Information offered by the financial service provider with respect to the infringement, such as whether contradictory or false information has been given
 - Whether the financial service provider is subject to supervision, or only monitoring or registration
 - Whether previous similar breaches were detected and have already been subject to corrective measures or enforcement actions in the past
- Cease-and-desist orders
 - Reprimands, such as confidential caution or reprimand letters, reprimand meetings with the authority, or public reprimand notices
 - Enforceable undertakings—that is, the power to apply an enforcement measure such as a fine in case an action agreed upon between the supervisor and the provider in a binding document is not implemented by the provider within an expected timeline
 - Suspension or withdrawal of a product or advertising material
 - Fines
 - Suspension, dismissal, or replacement of management or staff

While the authority should aim to be consistent in adopting enforcement measures across different types of providers, it may decide—law permitting—to have a tiered system in which the breaches of less intensively supervised entities result in relatively stricter enforcement actions as a means of deterrence.

Unduly slow or inadequate internal procedures can also affect the effectiveness and timeliness of enforcement—for example, requiring clearance from the highest level of the authority or requiring the same formalities for every enforcement action regardless of the gravity of the situation. In addition, in order to avoid the costs and time involved in full, formal enforcement, the authority should

have the power to adopt summary proceedings when appropriate that end in settlement agreements with financial service providers. As an illustration, while the Central Bank of Brazil is required to go through a full administrative procedure subject to appeal to apply a maximum penalty of only about US\$100,000, the Central Bank of Ireland can apply fines up to 10 percent of a firm's turnover through a summary procedure. The United Kingdom's FCA is transparent about prioritizing settlement agreements over full, formal enforcement procedures.³⁴ Both Ireland and the United Kingdom encourage early resolution of cases by offering a discount to the proposed settlement value.

A6: CODES OF CONDUCT AND OTHER SELF-REGULATION

- a. **The legal and regulatory framework should allow for the emergence of self-regulatory organizations (SROs), including industry associations.**
 - b. **Providers of deposit and credit products and services that are unregulated with respect to consumer protection should be encouraged to design, adopt, disseminate, and enforce codes of conduct (COCs) or other types of self-regulation (although this should not be viewed as a substitute for regulation).**
 - c. **Self-regulation related to financial consumer protection adopted by regulated providers of deposit and credit products and services should be created in consultation with the relevant authority.**
 - d. **COCs and other self-regulation should be written in plain language and without industry jargon to ensure that consumers and providers can understand them easily.**
 - e. **COCs and other self-regulation should be publicized and disseminated widely, so that they are known to consumers.**
 - f. **To the extent possible, the authority should take actions to encourage or check compliance by providers with self-regulation and should use self-regulation when evaluating a provider's conduct.**
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Explanatory Notes

COCs and other types of self-regulation by SROs such as industry associations should be encouraged, particularly for nonregulated providers of deposit and credit products and services. Such COC should be updated as needed to follow market developments, such as the digitization of financial services. Although it cannot be considered an alternative to regulation, self-regulation can potentially help to promote minimum consumer protection or conduct-of-business standards that can be similar to, or even stricter than, existing regulatory standards. Self-regulation can also be issued with respect to regulated providers, imposing additional obligations on them. To the extent possible, self-regulation should be developed in consultation with the authority.

In India, regulated NBFIs are required to abide by COCs issued by SROs and recognized by the Reserve Bank of India. Similarly, in Hong Kong, authorized institutions are required to comply with the Code of Banking

Practice issued by industry associations and endorsed by the Hong Kong Monetary Authority.³⁵ In the code, it is specifically noted that the principles of the code apply to any subsidiaries or affiliated companies of regulated institutions providing banking services, even where such entities are not licensed or regulated by financial sector authorities. Banks in the Philippines,³⁶ South Africa,³⁷ and many other countries also have COCs issued by their respective industry associations. Other examples include COCs issued by international associations, such as the International Factoring Association, the World Council of Credit Unions, and the Smart Campaign and its Client Protection Principles.

However, experience with self-regulation in many countries has not always been encouraging. The main reasons for this include lack of capacity, resources, and expertise; conflicts of interest; limited membership; and lack of enforcement powers by the SRO. To address these common weaknesses, mechanisms for improving compliance

with, and effectiveness of, self-regulation should be encouraged by authorities. Possible actions to address this issue include the following:

- The authority approves and/or endorses the self-regulation.
- The self-regulation is submitted to an external independent external evaluation.
- Compliance with the self-regulation is monitored by the authority with respect to regulated providers, or the self-regulation is partially or entirely incorporated into the supervisor's own risk-based supervisory methodology.
- The self-regulation is widely disseminated to the general public by the SRO, the financial service providers who have committed to it, and the authority.
- The self-regulation is disseminated and made available to consumers by each financial service provider during consumer interactions.
- The SRO is vested with powers to check compliance of each member provider with the self-regulation (or commission an independent evaluation), disseminate the results, and impose sanctions in cases of non-compliance.
- All members of the SRO are obliged by the internal rules of the SRO to comply with the self-regulation.
- The providers periodically report implementation of the self-regulation to the SRO and to the authority.
- The SRO produces and disseminates annual reports on the implementation of the self-regulation, highlighting areas of non-compliance.
- Consumers are allowed to file complaints against providers (including in external dispute resolution mechanisms) for failing to abide by any provision of the self-regulation.

A7: DISSEMINATION OF INFORMATION BY THE AUTHORITY

- a. **The authority should make readily available to the general public, at no cost, minimum relevant information to help it achieve its statutory goals and increase its transparency and accountability. This information should ideally include**
 - i. **A clear description of its regulatory and supervisory mandate and remit, and the role of other authorities, if applicable, as well as whether any providers of deposit and credit products and services are not covered by any authority with regard to consumer protection;**
 - ii. **Its annual reports with statistics about supervised sectors and a description of its supervisory objectives and supervisory activities undertaken in the past year;**
 - iii. **A list (or access to a database) with all registered/licensed providers of deposit and credit services, and their regulatory/supervisory status; and**
 - iv. **Laws and a compilation of all regulations on financial consumer protection.**
 - b. **Resources permitting, the authority should strive to publish additional information that can help to achieve its objectives, such as aggregated statistics on consumer complaints or examples of supervisory findings and enforcement actions.**
 - c. **To the extent possible, the authority should coordinate with a variety of stakeholders, such as industry and consumer associations, the media, and other government agencies, to increase the reach of the information it disseminates.**
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Explanatory Notes

Disseminating information is important to increase supervisory effectiveness in financial consumer protection and to provide additional tools to assist in consumers' decision making. Publicizing information may be even more important with regard to NBFIs and nonfinancial firms, as these are more diverse sectors—that is, more types of financial service providers offering more types of deposit

and credit products—some of which are operating in a fast-changing environment, which may make it difficult for the public to access updated information.

This GP lists potential types of information that should have priority in being publicized by the authority. Dissemination should occur by means of the authority's website, although newspapers, social media, and other channels may be used as well. The range, depth, and complexity of

information to be published, and the channels and materials used, will depend on the resources available to the authority, although it should strive to disseminate on its website at least the items listed under clause A7(a), above, as digital channels are lower-cost and potentially have greater reach.

Compiling financial consumer protection laws and regulations in a single document or online location is of fundamental importance. The Association of Supervisors of Banks of the Americas has found that it is difficult to have a full picture of the regulatory framework for financial consumer protection in its member countries, as these frameworks are often highly fragmented and not compiled or described in a single place.³⁸ This can often be the case in many other regions as well. A helpful example can be found in Colombia, where the financial supervisory authority maintains a compilation of all current regulations imposed on banks and NBFIs, including consumer protection rules, in a single document known as the Single Banking Circular.³⁹ In the United Kingdom, the FCA's webpages not only explain the regulatory and supervisory framework applicable to regulated firms in different sectors (for example, consumer credit)⁴⁰ but also provide sourcebooks summarizing such frameworks.

For the benefit of consumers and the general public, and in line with international standards set for prudential supervisors, the authority should publish a list of all registered and licensed providers of deposit and credit products and services and keep it updated. Resources permitting, the list should have links to the websites of each provider, as is the case with ASIC's online register,⁴¹ the Bank of Portugal's list of authorized entities,⁴² and the register of credit providers kept by South Africa's National Credit Regulator.⁴³

For the sake of transparency and accountability, the authority should publish annual reports with a summary of its regulatory, supervisory, and enforcement work. For example, the Banking Conduct Supervision Department of the Bank of Portugal publishes biannual reports on market conduct supervision, reports on market monitoring and complaints, and even impact evaluation reports on some key regulatory measures.⁴⁴ Annual reports may also highlight the performance of providers in complying with the legal and regulatory framework for financial consumer protection.

If resources and data availability permit, the authority may also consider publishing a wealth of additional information, such as:

- Warnings about recent fraudulent schemes or major problems faced by consumers
- Analytical sectoral reports
- Tips for choosing between different products and services
- Fees and charges calculators
- Comparative information on fees and prices of the most common retail products

Publishing aggregated consumer complaints statistics generated by internal complaints handling units at providers and external dispute resolution mechanisms, and related analyses, such as emerging consumer issues in certain sectors and trend analyses, may help the authority improve its effectiveness in increasing awareness among consumers and have a deterrent effect on providers. Examples include the complaints database/statistics published online by the CFPB in the United States,⁴⁵ the Central Bank of Brazil,⁴⁶ and Mexico's Condusef.

Publicizing supervisory findings and enforcement actions, including settlement agreements, may have a deterrent effect and encourage better practices by providers. It also helps to increase supervisory accountability and manage public expectations with regard to the authority's approach, particularly with regard to less intensively supervised or unsupervised nonbanks. Mexico's Condusef publishes enforcement measures, as does the Central Bank of Ireland,⁴⁷ the Monetary Authority of Singapore,⁴⁸ the FCA in the United Kingdom,⁴⁹ and the CFPB in the United States.⁵⁰ The Authority for the Financial Markets in the Netherlands also publicizes its enforcement and corrective actions on its website.⁵¹

Examples of tools to facilitate consumer choice and other general descriptions of consumer rights can be found in the web portals of Peru's Superintendence of Banks, Insurance, and Pension Funds,⁵² the Malta Financial Services Authority,⁵³ the Bank of Portugal,⁵⁴ the Central Bank of Armenia,⁵⁵ and many other authorities. Further examples can also be found in the effective approaches to support the implementation of Principle 4 of the G20 FCP Principles.⁵⁶

B: DISCLOSURE AND TRANSPARENCY

B1: FORMAT AND MANNER OF DISCLOSURE

- a. Any advertisement, sales material, or other form of communication or disclosure by a financial service provider to a consumer (whether written, oral, or visual) should be in plain and easily understandable terms, not misleading, and should use at least the language that is prevalent in the geographic area in question.
- b. Any written communication (including in electronic formats) should use a font size, spacing, and placement of content that makes the communication easy to read for the average person.
- c. Key documents such as consumer agreements, forms, receipts, and statements (including those provided in electronic format) should be provided in a written form that can be kept or saved by the consumer.
- d. Written, oral, and visual communications should contain and highlight key features of a given product or service.
- e. The regulatory framework should establish the timing of key disclosures to the consumer, particularly during the shopping, precontractual, and contractual stages.
- f. Standard indicators for total cost and total net return, and standard methodologies for the calculation of such indicators, should be established by the authority in order to ensure consistency across providers and enable consumers to compare products properly.
- g. Adaptations to regulatory requirements should be considered to allow for innovation in product design and delivery with respect to digital financial services, while mitigating potential risks to consumers due to disclosures that may be less comprehensive, more difficult to read, and harder to store.
- h. In addition to key product features, communication materials should, whenever possible, disclose
 - i. The regulatory status of the financial service provider;
 - ii. The contact information for the internal complaints handling mechanism of the financial service provider; and
 - iii. The contact for the relevant external dispute resolution mechanism, if any.

Explanatory Notes

The format and manner—including timing—of disclosure are as critical to achieving transparency as the content of disclosed information. Disclosure often becomes ineffective due to factors such as small font sizes, convoluted language, and an excess of information. In most instances, less is more. Attention to the format and manner of disclosure is also relevant for oral, visual, and electronic communications. In addition, it is important that disclosures are made at the appropriate time to be of use to the consumer, especially during the shopping stage as well as right before a consumer agreement is signed. It also crucial that regulations governing the format and manner of disclosures to consumers are applicable and adapted to digital financial services. The same general principles should apply for both paper-based and electronic documents, though policy makers will need to consider adaptations necessary for digital financial services. This GP applies across all means and types of disclosure and com-

munication between financial service providers and consumers, including in contracts, forms, statements, receipts, or any other communication, whether printed or electronic or delivered by telephone, radio, or TV or in person, and is relevant to B2–B6, below.

Plain language

The need to use clear, objective, and simple language cannot be overemphasized with respect to basic retail deposit and credit products and services. In South Africa, the National Credit Act stipulates that documents must use “plain language”—that is, language for which “it is reasonable to conclude that an ordinary consumer of the class of persons for whom the document is intended, with average literacy skills and minimal credit experience, could be expected to understand the content, significance, and importance of the document without undue effort.”⁵⁷ Understandable language requirements are important for all consumers, but particularly for those who are inexperi-

enced in the financial sector, have low incomes or low literacy, and often face additional challenges in understanding what is being communicated to them. Where the use of technical terms is necessary, such as when describing more complex products, such terms should be explained in a comprehensible manner for the average consumer.

Highlighting/standardizing disclosure of key features

Disclosures and communications should give prominence to such key features of a product/service as price, risks, return, amounts due, and access conditions and restrictions to induce the consumer to pay attention to such features and, if needed, seek further clarification with the staff or agent of the financial service provider. In written documents, key terms and conditions can be highlighted by using differentiating format such as font size and bold font, as well as placement. When communication is displayed in the facilities of the financial service provider or other related entities, it should be displayed conspicuously and in large enough size to make it easy for the consumer to see—for instance, displayed next to the entrance or cashiers, or in front of a waiting area.

Disclosure of key features for the most common deposit and credit products and services, such as consumer and microfinance loans and savings and checking accounts, should be standardized by regulation to permit easy comparison across different financial service providers. This could include, for instance, common nomenclature for basic services regarding checking and savings accounts that are subject to fees.

Consideration should also be given to standardized methods for price disclosure that will work most effectively for target clienteles, particularly those that are more vulnerable. For instance, many middle- to low-income consumers may more easily understand prices that are disclosed as a monetary value—for example, as a monthly loan installment or the total cost of the loan, a more tangible, relatable figure for many than rates such as annual percentage rate (APR). However, APR and other rates can and should complement the monetary value, as APR is more comparable across providers and may be useful to some consumers for purposes of comparison shopping (as well as for other positive externalities, such as increasing competition and transparency across providers within a market). As a result of focus groups and broad consultations, the financial regulator in Peru has imposed standard methodologies for price disclosure for loans, savings accounts, and insurance that provide rates—that is, APR—along with such monetary values as the monthly loan installment payment with respect to a standardized total loan value.⁵⁸ Some jurisdictions have also been working to develop comprehensive cost indicators that summarize the overall annual indicative cost of a transaction account.⁵⁹

Regardless of the methodology, it is important that the standardized price disclosure reflects the total cost of a product or service, so that consumers understand the all-inclusive cost of the product or service and do not end up paying more than what has been advertised. The same principles apply for net return in the case of savings products, so that consumers understand the full benefits of the product. The standardized formula for calculating total cost should include all known up-front and recurring charges, rates, fees, and the costs of embedded third-party products and services, such as credit life insurance premiums, over the life of the product or service.

Depending on the circumstances, key features of a product or service may be better conveyed orally. For instance, it is common practice among many MFIs to arrange informational meetings with groups of consumers during the precontractual stage to explain payment schedules, cost of loans, and how group guarantees operate. For consumers with low levels of literacy or familiarity with financial terminology, oral communication may be particularly important during the precontractual stage, during the signing of the contract, and whenever requested by the consumer, particularly for product features that may be difficult to understand. Examples of such features include mandatory savings, compulsory credit life insurance, and the consequences of late repayments.

Form and format

Long, detailed agreements can be challenging and overwhelming for most consumers. In line with Principle 4 of the G20 FCP Principles, it is recommended that in instances where customer agreements are more than several pages long, such agreements should be accompanied by a KFS highlighting the main features. (See B5.) Likewise, the ITU-T Focus Group Digital Financial Services recommends that providers of digital financial services use a KFS in the beginning of contracts and through other means.⁶⁰ Conversely, terms and conditions should ideally not be so scattered across multiple documents that the ability of the consumer to understand the product is impaired. Preferably, key information should be provided in a consolidated fashion, while supporting or complementary information should be made easily accessible.

Regulatory requirements on format and manner of disclosure, including for sales and advertisement materials, should be flexible enough to be adapted to different delivery channels. For example, a minimum font size for a marketing leaflet will differ from an acceptable font size for a TV commercial. With regard to oral, visual, and electronic disclosures, particular attention is required to avoid disclosure becoming meaningless. This can readily happen when radio or TV advertisements convey required disclosures in an extremely fast manner that is nearly impossible for any consumer to understand. Any animated

visual or oral prerecorded communication should therefore be required to provide information at a reasonable speed or for a reasonable period of time to allow the consumer to listen to or read it with ease. Consideration will also be needed for consumers with disabilities, such as the sight or hearing impaired.

The timing of key disclosures and communications should also be addressed by regulation. Providers should be required to provide key information early in the shopping and precontractual stage in order to ensure that such information does not arrive too late in the decision-making process to be utilized by consumers. For example, Bank Negara Malaysia (BNM) conducted a study on the effectiveness of product disclosure sheets and found that in many cases, disclosure sheets were provided to consumers only after a decision had already been made to purchase the product, negating its intended impact. The Competition Authority of Kenya has mandated that all digital credit products make key disclosures about terms and conditions (including the cost of bundled products) prior to the “signing” of the loan agreement. The EU Consumer Credit Directive⁶¹ requires that lenders provide information on the essential features of the product being offered “in good time” before an agreement is entered into. The precise time period may depend on the circumstances of the transaction, but the intent is to give consumers adequate opportunity (in a nonpressurized setting) to consider disclosed information before deciding to enter into an agreement.

Digital financial services and electronic channels

In general, the regulatory framework should allow for disclosures in electronic format. In some cases, this may require specific regulatory reforms. The question of whether a printed document is the default form for disclosure—that is, whether the consumer needs to opt in to receive electronic documents rather than hard-copy documents—will vary from country to country and according to product types and their main delivery channels. In some instances, such as with respect to the vast majority of digital credit and electronic deposit products in developing and emerging countries, electronic disclosure is the default format in practice.⁶²

Disclosure requirements should not form undue barriers to ethical and healthy innovation in product design and service delivery, though policy makers will need to consider what unique challenges may arise with respect to digital financial services. For instance, short message service (SMS) messages are being used as transaction receipts in many countries where mobile money is offered and linked to deposit accounts or loans. Although usually more difficult to read and understand than a paper-based receipt, they should not be considered invalid as a result. Similarly, digital credit introduces par-

ticular challenges for effective disclosure, as noted by the ITU-T Focus Group Digital Financial Services,⁶³ such as regarding the content and timing of electronic disclosure. The concept of less is more is particularly important for digital financial services, where information is often displayed on small mobile phone screens. For example, it may not be feasible or appropriate to view a loan agreement via mobile phone.

Policy makers will need to balance policy objectives to allow for innovations that benefit financial inclusion while maintaining adequate protections for consumers utilizing digital financial services. In particular, policy makers should consider in which circumstances consumers may be put in a weaker position when disclosures are made in electronic formats that are less comprehensive, more difficult to read, and/or cannot be saved, and consider what adapted requirements may help mitigate or safeguard against consumer risks. For example, where fulsome disclosure is not feasible at the first instance via electronic channels, providers could be required to provide access to more comprehensive written materials at a later stage, perhaps by sending a fuller set of terms and conditions to the customer’s mailing address or making them available online or at a physical outlet. A cooling-off period could be applied in the interim. (See also C5, “Customer Mobility.”) Complementary regulatory requirements could also be considered regarding recordkeeping for digital transactions, including transaction receipts and other documents that can be provided upon request to customers and used to support disputes, as well regarding transaction reversibility (further discussed in annex A, “Retail Payment Services”).

With respect to products offered via mobile phones, policymakers may also wish to consider the appropriate design of user interfaces, an issue that also relates to product design (see C4, “Product Suitability”). The design of user interfaces for both smartphones as well as basic feature phones can greatly affect the ability of consumers to access and understand key information, as well as to use key features of a product or service. To the extent possible, user interfaces should therefore be designed to be clear, user-friendly, and intuitive.

Costs to providers

Disclosure requirements should also be sensible to avoid excessive cost to providers with little or no appreciable benefit in terms of consumer understanding. For instance, in South Africa, it was determined to be impractical to require that all disclosure documents be prepared in all local languages. Rather, the law requires that consumers receive documents in an official language that the consumer can read or understand, to the extent it is reasonable to prepare such documents in terms of expense, regional circumstances, and the needs and preferences of target customers of the provider.

Consumer testing

As with many other types of regulation (see A3), rules on the form and content of disclosure should benefit from consumer testing through focus groups and interviews, so that they are designed to be as effective as possible.⁶⁴ Consumer behavior research can provide important

insights as to the effectiveness of certain disclosure formats and channels regarding their impact on consumer decision making, including research aimed at testing effectiveness for products used by particularly vulnerable consumer segments—for example, loans targeting pensioners, student loans and accounts.⁶⁵

B2: ADVERTISING AND SALES MATERIALS

- a. In addition to the general requirements in B1, financial service providers should be required to ensure that their advertising and sales materials
 - i. Do not contain misleading or false information; and
 - ii. Do not omit information that is important to a consumer's decision to purchase any of their products or services.
- b. Financial service providers should be legally responsible for all statements made in advertising and sales materials.

Explanatory Notes

It is important to ensure that all advertising and sales materials (printed, online, billboards, newspapers, flyers, TV, telemarketing, oral, and others) follow the minimum standards for format and manner of disclosure set out in B1. Specifically, easy comparability of total cost (for credit products) or net return (for deposit products) should be ensured, and materials that may mislead consumers with false or incomplete statements should be avoided, including not making it clear who the legal provider of the financial service is when agents or brokers are involved. Advertising and sales materials should not be allowed to mislead and exploit consumers' behavioral biases to the advantage of the financial service provider. For example, deferred interest promotions by credit card providers that fail to state that interest charges referring to the entire period will apply if a payment is late or if the balance is not paid by the end of the promotion should not be permitted. It is also important that sales and advertising materials contain relevant information such as the regulatory status of the financial service provider and the contact information for internal and external redress mechanisms. Nonetheless, the supervisor should be flexible when designing and enforcing regulatory requirements for different types of communications and materials in order to ensure they remain relevant, proportional, and effective for each particular type of advertising or sales material.

As emphasized in Principle 4 of the G20 FCP Principles, misleading statements (for example, zero interest loans) and the omission of key product features and information are all too common in sales materials used for consumer credit by a range of providers. In the case of NBFIs and nonfinancial firms, this is partly due to the fact that

many NBFIs are not regulated or supervised (see A1 and A2), coupled with the rapid growth in nonbanks. Even in the heavily supervised banking sector, it is common to find sales materials that exploit consumer biases to influence behavior, deliberately omitting key information or elements of cost in standardized price disclosure formulas mandated by regulation (for example, the cost of credit life insurance), emphasizing certain characteristics of the product, such as a particular period of high returns paid in savings accounts, or downplaying other characteristics (for example, the fees charged on savings accounts). Imposing and enforcing standards for advertising and sales materials is fundamental to protect consumers of deposit and credit products and services. Particularly where consumer agreements are overly long and difficult to comprehend (or, conversely, are made up of piecemeal documents) or are received too late in the process, consumers may have already made decisions after relying on misleading or incomplete advertising and promotional material. Rules on advertising and sales materials are increasingly important in fast-growing markets targeting middle- and low-income segments, including microloans delivered through mobile phones and mortgage loans (in some countries). These consumers, who often have little experience with regulated financial service providers, may be more vulnerable and thus more easily swayed toward a decision to purchase a product or service that could ultimately harm their financial well-being.

For example, in the United Kingdom, regulation forbids advertising of any interest rate without disclosing the applicable APR (as opposed to displaying only the nominal interest rate). Similarly, in Portugal, APR and gross annual nominal rate have to be disclosed.⁶⁶ Several directives in

the European Union hold financial service providers responsible for the content of their public announcements, including marketing and advertising communications and materials. Providers are subject to penalties for making any false or misleading statements. In Brazil, the European

Union, Portugal, and Malaysia, sales materials for loans cannot claim loans are “zero interest” or “free” if there are any applicable charges, even if these charges apply only after a certain interest-free period.

B3: DISCLOSURE OF TERMS AND CONDITIONS

- a. The regulatory framework should require that consumer agreements contain key terms and conditions, including at a minimum the following items:
 - i. The regulatory status of the financial service provider
 - ii. The rights and responsibilities of the consumer, including the conditions that may lead to termination of the agreement
 - iii. The rights and responsibilities of the financial service provider
 - iv. All interest rates, costs, fees, and charges (including from third parties) that arise or may arise from the agreement, when they can be applied, and how they are calculated
 - v. How and when the terms and conditions may be altered unilaterally by the financial service provider
 - vi. If, when, and how the consumer will be notified about changes to the agreement (see B6)
 - vii. The penalties and any other remedies the financial service provider may seek to impose in the event of a perceived breach of the agreement by the consumer
 - viii. The contact information for the provider’s customer service
 - ix. How disputes with the financial service provider can be resolved and the contact information of the internal and external third-party complaints handling mechanisms (see E1 and E2)
- b. A printed or electronic copy of the final agreement containing at least the information listed in clause B3(a) should be provided by the financial service provider to the consumer at signing.
- c. In addition to the information listed in clause B3(a), the regulatory framework should require specific disclosures in product or service agreements according to the type of product or service being contracted.
- d. To facilitate communication of key terms and conditions to the consumer in the most commonly offered retail products, financial service providers should be required to use KFSs (see B4) in addition to the product or service agreement.
- e. Prior to signing of the agreement, financial service providers should be required to explain the key terms and conditions orally to the consumer on request or where deemed necessary based on a customer’s circumstances.
- f. The regulatory framework providing for clauses B3(a–d) should be applicable to consumer agreements signed electronically.
- g. The relevant terms and conditions of a guarantee should be disclosed to guarantors prior to the guarantee is entered into.

Explanatory Notes

Disclosure and transparency are critical consumer protection policy objectives. They help to increase consumer comprehension, allowing consumers to understand and choose appropriate products to fit their circumstances. Disclosure and transparency also increase market competition by allowing for comparison shopping by consumers and greater transparency and competitive pressures

across providers, which may help to lower prices and improve the quality of products offered. A well-designed disclosure regime can be a more effective, market-friendly policy approach than interest rate caps to address issues with pricing and competition.

The terms and conditions that should be required to be disclosed to a consumer can vary depending on the product or service, its mode of delivery, and the target

consumers. A careful balance between general and detailed requirements must be achieved in the regulatory framework to fit most products and delivery channels while leaving room for adaptation to particular situations. Minimum standards should exist for key terms and conditions with more universal applicability, while specific regulations may be needed for disclosure of certain items for specific products (as listed below). With respect to interest rates, costs, and fees and charges, disclosures should specify when these terms are final. Also, policy makers should consider potential implementation challenges that regulation may pose to products and services delivered through electronic channels, especially when they target low-income consumers with limited levels of literacy. Balance is again needed to achieve sufficient disclosure and transparency for electronic channels without impeding innovations in service delivery, particularly where innovation can benefit financial inclusion.

Before the signing of an account agreement, in addition to the general information listed in B3(a), the provider should inform the consumer of key terms and conditions such as:

- Charges or fees for account opening or minimum balances
 - Account maintenance fees
 - Applicable interest yield
 - Ability to check the account balance
 - Responsibility of the consumer to keep his/her personal information confidential, including PINs and passwords linked to the account
 - Type and amount of transactions allowed free of charge, if any
 - If an overdraft facility is included and the fees and costs in case this facility is used
 - Applicable charges for issuing and clearing a check and whether charges vary according to the value of the check
 - Consequences and costs to the consumer of drawing a check with insufficient funds
 - Procedures to countermand or stop payment on a check by the consumer
 - Liabilities of the parties in the event of check fraud
 - Liabilities of the parties in the event of an unauthorized transaction on the account and the applicable procedures that should be followed by the consumer in such an event
 - Fees and other costs, if any, applicable to each type of transaction or service allowed to be charged against the account and how each one will appear in the account statement
 - Any limitation on account functionality, such as on the number of withdrawals per month
 - Procedures and costs, if any, for the consumer to close the account
 - What constitutes an inactive account and the consequences to the consumer if the account becomes inactive, including applicable charges
 - Existence of any depositor protection schemes ([see section F](#))
- Before the signing of a loan agreement (including for digital credit), in addition to the general information listed in B3(a), the provider should inform the consumer of key terms and conditions such as:
- Total and frequency (for example, monthly) of installment payments, or minimum monthly repayment in the case of revolving credit
 - Total cost of credit, with a breakdown of all costs of each installment as well as the total cost (or minimum monthly repayment in the case of revolving credit), including APR, total interest payment, total principal, and third-party charges and fees, such as broker charges or mortgage insurance
 - Applicable initial rate of interest and, in the event a variable rate of interest is being offered, when and the basis on which the initial rate may vary, how and when the consumer is informed of the new rate, the basis upon which the new rate is calculated, and the maximum possible rate
 - Guarantees that need to be provided by the consumer
 - What additional product(s), if any, such as a current account, a guarantee, or an insurance policy, the provider either requires the consumer to acquire or else bundles as part of the loan package
 - The terms and conditions of all linked or bundled products sold together with the loan, including the providers of such products and their costs to the consumer
 - Policies regarding late payment and prepayment, including related procedures and costs
 - Policies regarding transfer of service
 - In the case of revolving credit lines, including credit cards, the applicable credit limit ([see also B5, "Statements"](#)), and the charges applicable when the consumer pays less than the total amount due

- Any cooling-off period (see C5, “Customer Mobility”)
- Procedures in the event that the consumer requests that the loan be transferred to another financial service provider, and the costs involved
- In the case of mortgage loans, disclaimer to distinguish preliminary estimates of terms and conditions from official loan estimates, if applicable; closing costs; and whether there is a homeowner insurance requirement.

As noted in B1, digital credit introduces particular challenges for transparency. Often the terms of the loan are incomplete and/or displayed on a small screen and there is little or no opportunity for information to be provided in person or by phone by a staff of the financial service provider. In addition, the rapidity with which the agreement is entered into, and the remoteness and anonymity that may characterize digital credit transactions, may lead consumers to inadvertently accept costly or inappropriate products due to behavioral biases. The ITU-T Focus Group Digital Financial Services recommends an open dialogue between authorities and financial service providers to find solutions to address consumer biases with better disclosure tactics based on consumer research. Effective disclosure of key facts prior to the contractual stage becomes ever more important.

Bundling to create “baskets” of various financial products and services can also reduce price transparency and comparability across providers. Disclosure rules should be designed to ensure timely and effective disclosure of terms and conditions and clear disclosure of the cost of bundled products, including with respect to digital credit products. For example, in Italy, financial service providers that bundle or tie loans with other products are mandated to follow specific provisions, including that consumers are made fully aware of the fact that the package consists of different products and that APR takes into account the costs of the tied/bundled products.

Disclosure requirements for products that can have a significant financial impact on consumers, such as mortgage loans, or that are used with high frequency and offer revolving credit lines, such as credit cards, should be particularly well crafted and, whenever possible, consumer

tested for their efficacy. In the United States, for instance, the 2013 “Know Before You Own” disclosure rule for mortgage loans issued by the CFPB aimed at substituting previous overlapping disclosure forms required by different laws, simplifying and increasing effectiveness of disclosure, and facilitating comparison across providers.⁶⁷ As this example illustrates, policy makers should consider the format, content, and timing of disclosure in tandem to achieve desired policy objectives.

As a means of ensuring minimum content in consumer agreements, the authority may consider requiring that financial service providers send all new standard (generic) consumer agreements for its analysis (although not necessarily for approval). For example, this step is taken in Bolivia, Malaysia, Mexico, Pakistan, Peru, and the Philippines. However, this can be a labor-intensive and time-consuming activity, and its benefits are not always clear. By contrast, the Central Bank of Brazil analyzes consumer agreements only when, as part of its supervisory plan, it identifies specific retail products for which the agreements warrant a full or partial review. An example is the review it conducted of the costs of consumer loan prepayment and the formulas used to calculate the present value of a consumer loan when it is being transferred from one lender to another at the request of the consumer. The authority may want to analyze consumer agreements only when new products or services are being launched, a new financial service provider is licensed, or when the authority suspects improper practices are occurring. Some authorities may choose to impose—or suggest—standard agreements for certain retail markets, with the objectives of simplifying disclosure while ensuring disclosure of key terms and conditions, allowing comparability, and prohibiting certain product features and practices. (See C1, “Unfair Terms and Conditions.”) Another complementary measure is for the authority to require standard consumer agreements for key products be made available online by providers for consumers and others to peruse at their convenience, as done in Peru, thereby addressing the timing issue by ensuring that consumer agreements are available early in the shopping stage.

B4: KEY FACTS STATEMENTS

- a. For common retail deposit and credit products, financial service providers should be required to produce KFSs that summarize the main characteristics of the product.
- b. To increase effectiveness of disclosure, the regulator should set minimum standards for KFSs to be used in relation to different products (see B1), including on
 - i. Conciseness (preferably one to two pages) and use of plain, easy-to-understand language
 - ii. Standardized formulas for disclosure of all-inclusive total cost or return

iii. Standardized formats/templates

iv. Standardized content

- c. Financial service providers should be required to produce a customized KFS with the particular terms and conditions for a specific individual, on request as well as before and at signing.
- d. KFSs should be signed by the consumer and given prominent placement when attached to the agreement.
- e. Financial service providers should be required to provide KFSs through convenient channels, including at least the channel through which the particular product is provided.
- f. Financial service providers should be required to retain copies of KFSs signed by the consumer for a reasonable number of years.

Explanatory Notes

In many instances, and for a variety of reasons—including suggestions given by a salesperson—consumers may not read the contractual terms and conditions of an agreement. Even when consumers attempt to read the terms and conditions, they may not understand them, or often the length of the agreements may intimidate them, particularly in the case of less-sophisticated or low-literacy consumers, or when products are delivered electronically. KFSs are an important tool to try to fill this gap. KFSs are increasingly viewed as important so that, before agreeing to acquire any deposit or credit product or service, consumers can appreciate the costs, risks, and benefits to them of the product or service and compare the features of a specific product with that of other providers. KFSs are therefore useful for both the shopping and the precontractual stages. However, KFSs are not a substitute for a full, written agreement, which should always be provided to the consumer as noted in B3.

KFSs should be required for the most widely utilized retail deposit and credit products, such as consumer loans and current and savings accounts, including when such products are delivered through electronic channels. Moreover, the same (or substantially similar) KFS template should be used across banks and NBFIs for the same products, including when the providers are regulated by different departments of the authority or by different authorities, to make it easy for consumers to compare products across providers. Ideally, KFS requirements should be simple enough so that they can be met by all types of providers offering the same or similar products.

This GP should be read in conjunction with **B1**, **B2**, and **B3**, particularly regarding standardized price disclosures. The authority should require that KFSs be concise (preferably not exceeding one to two pages) and provide standardized formats and content for KFSs, including the obligatory use of standard terminology for key terms. At a minimum, KFSs should inform consumers regarding the identity and regulatory status of the financial service pro-

vider; the identity of the agent (if applicable); key product features and risks; standardized, all-inclusive price disclosure; and potential consequences if the consumer fails to comply with the terms of the contract by, for example, missing a loan installment payment or incurring a negative balance). As noted in B1, where feasible, key elements of the KFS should also be communicated orally to the consumer. This is crucial for low-income, unsophisticated, or illiterate consumers.

The same format of KFS can be used to produce a generic KFS as well as a customized KFS. A generic KFS does not have personalized information such as specific rates and terms for a loan; rather, it should include average rates and terms for a particular product, so that it can be handed out more widely to potential consumers earlier in the shopping stage, increasing the likelihood of consumer comprehension and comparison shopping. A customized KFS with specific rates and terms is prepared for a particular prospective customer who applies for or inquires about a product after the consumer has provided some basic personal information, such as the desired loan amount. If an agreement is reached, a final KFS should be signed by the consumer and the provider staff and given prominent placement when provided to the consumer along with the agreement itself. For example, in Armenia, fields for the customer's signature are placed in multiple locations in the KFS, next to key terms as well as at the end of the KFS, in order to increase the likelihood that the consumer reviews the full KFS and pays attention to important terms.⁶⁸

If documentation is electronic, the provider should still ensure that the KFS is prominently displayed. Adaptations may be required for digital channels, such as for credit products offered via mobile phones, given the more limited visual format. Adapted approaches could include shorthand (but standardized) disclosures, use of icons to convey a key term or concept in an easily digestible manner, and layered messaging—that is, making summary information available on an initial screen and more detailed information available by clicking through to additional screens.

As noted in B1, regulators should leverage consumer testing and incorporate behavioral research to design and test standardized KFS formats, as well as to pursue periodic improvements. However, KFSs should not vary too much or too often, in order to give consumers the chance to get familiar with them, as well as to simplify compliance for providers.

Some types of unregulated NBFIs and nonfinancial firms might offer services that are covered by KFS regulations when provided by regulated providers. If the unregulated market is deemed significant—for example, because it serves a large number of consumers—or if it

competes with regulated providers, the efficacy of KFSs will be limited if only regulated providers are required to use them. In such situations, collaboration with industry bodies could be sought to align the practices in unregulated markets with regulations applicable to similar regulated services, including the application of KFSs across both regulated and unregulated markets for key retail financial products. For example, the Central Bank of the Philippines has worked with the association of MFIs, which covers unregulated entities, to promote implementation of the same KFS format for consumer loans that is used by regulated providers.

B5: STATEMENTS

- a. Financial service providers should be required to provide the consumer with periodic written statements of every account the provider operates for the consumer, free of charge.
- b. Financial service providers should be required to provide the consumer with a closing statement when an agreement is terminated or concluded.
- c. The financial service provider should preferably make statements available using at least the channel through which the product was sold—that is, aligned to the manner in which the agreement was initially signed.
- d. The frequency with which statements are provided should be commensurate with the type of product, its term, and the type of clientele.
- e. Statements should list all types of transactions, values, and dates concerning the account during the time period of the statement; state opening and closing balances, interest rates, and fees and penalties charged; and highlight any impending risk for the consumer or changes in account rules or product terms and conditions. (See B6.)
- f. Providers should also be required to provide information on account balances upon request by the customer.
- g. Generally, statements should also inform the consumer regarding
 - i. The regulatory status of the financial service provider and the contact number for its customer service and complaints handling mechanism; and
 - ii. The contact information for the external dispute resolution mechanism.
- h. The regulation should impose specific requirements for statements linked to the most commonly used retail deposit and credit products and services. This may include the standardization of minimum content, format, and terminology, as well as frequency, timing, and manner of delivery.

Explanatory Notes

In general, statements need to be self-explanatory, comprehensive, objective, and clear. (See B1.) This is particularly important in the case of transactional accounts such as credit card, current, and savings accounts and loan accounts that can carry finance charges, penalty interest, service fees, and other consequences in case of default, delayed payment, overdraft, or level of transactions (including inactivity).

As with other types of disclosure, including cost and price, it is important that statements provide information in a manner that can be understood easily and is consistent across providers of similar products. For example, after a review of the abbreviations and terminology used by banks in current account statements, the Central Bank of Brazil decided to standardize the terminology of basic transactions and the respective abbreviations used in statements. Similarly, after a review of existing statements

found that the format and content of statements were difficult to understand and contained many technical terms, the Central Bank of Armenia developed standardized statements for certain retail products.⁶⁹ However, regulation should not be too strict in terms of frequency, format, and method of issuance of statements, in order to accommodate different business models and modes of service delivery to different consumer segments. This is particularly important when a single regulation covers several different types of products, including products delivered primarily through electronic means.

Another policy consideration is cost to the financial service provider. In many developing countries, there are serious constraints to delivering paper-based statements due to high costs or the lack of reliability of the postal and courier services, or due to consumers not having formal fixed addresses. In such cases, alternative approaches to consider include requiring that financial service providers make paper-based statements available for collection by customers at branches or other outlets or on demand, or that providers substitute paper-based statements with free electronic versions. While statements delivered through mobile phones may be less convenient to read and permit less information to be conveyed compared to paper-based statements or statements accessed through a computer, they should be as readable as feasible given the technology.

Whenever possible, the choice between electronic versus paper-based delivery should be left to consumers. With the increased use of digital channels to access and manage deposit and credit accounts, some consumers may wish to receive, access, or download statements more or less frequently, rather than on a monthly basis. Financial service providers should offer ready electronic access to an up-to-date statement at any time, at a minimal cost or free of charge. Regulators should recognize rapid developments in financial services delivery and new modes of interaction between financial service providers and consumers. For example, providers should not be prohibited from using opt-out clauses that make electronic statements the default option when products are delivered entirely electronically, as in the case of digital credit. In such cases, there is a valid assumption that consumers will not expect paper-based statements.

In addition to establishing general requirements for the form and frequency of statements, regulations should impose specific content requirements for statements for at least the most common retail deposit and credit products and services. In general, statements for deposit products such as savings accounts and current accounts should, with regard to the period covered and depending on the type of product, do the following:

- List the opening and closing balances and any repayment made in the period
- List all transactions in the period
- Indicate the counterpart for each transaction, such as a retail establishment where a credit/debit card purchase was made
- Provide details on the interest rate applied to the account
- Provide details on the fees, exchange rate, and other charges incurred by the customer in each transaction
- Indicate any changes applied to the interest rates or fees (see also B6)

In case abbreviations are used, they should easily relate to a specific service and be listed, along with their full meaning, in an easy-to-find and understandable document that is accessible online or provided in printed form free of charge by the financial service provider and through a range of channels. See also B6 in annex A, “Retail Payment Services.”

In addition to the items noted above, credit card (and any revolving credit line) statements should set out the credit limit, total amount due, due date, minimum payment required, and total interest cost that will accrue if the cardholder pays less than the total amount due. These statements should be as standardized as possible across bank and nonbank providers. Some countries, such as Australia and the United States, also require that credit card statements prominently display the number of months or years in which customers would be able to pay off the total balance should they continue to pay only the minimum amount.

Loan account statements, including for mortgages, should indicate the amount paid during the period; total amount paid to date; total outstanding amount due; allocation of payment to principal, interest, or other costs; amount in arrears; and, if applicable, up-to-date accrual of taxes paid. It should also include information on all applicable fees, penalties, and interest rate.

Policy makers should also consider certain exceptions to requirements regarding statements. For example, it is not meaningful to implement a requirement for periodic statements for very short-term loans, such as the one-month loans typical of microcredit. It is also not reasonable to require issuance of periodic statements after an account is considered inactive or dormant, though notifications should be required if dormancy triggers any fees or penalties. (See B6, below.) For example, in Portugal, providers must issue statements at least monthly for retail deposit and credit products, with the exception of current accounts that have had no transactions in the past month. In such cases, the provider must issue at least one statement per year.

B6: NOTIFICATION OF CHANGES IN RATES, TERMS, AND CONDITIONS

- a. Financial service providers should be required to notify their consumers, at least in writing (including in electronic form), and also orally or through other channels or means if deemed necessary, prior to changes in
 - i. The interest rate to be paid or charged on any account (for example, loan, current, savings) of the consumer;
 - ii. Any noninterest charge on any account of the consumer (transaction fees, overdraft fee); and
 - iii. Any other key product feature or previously agreed term or condition (procedures for cancellation, prepayment of loans, transfer of loan servicing).
 - b. Financial service providers should also be required to notify their consumers in case their transactional accounts have become inactive or dormant, and the related consequences, including applicable charges.
 - c. The nature and extent of the change, particularly its potential impact on the consumer, should dictate the required format and the length of time for advance notice, and whether personalized, individual notification to the customer is required.
 - d. If the revised terms are not acceptable to the customer and were not foreseen in the original agreement, the regulatory framework should guarantee the customer's right to exit the agreement without penalty, provided such right is exercised within a reasonable period, as established in the original agreement.
 - e. Along with the notice of the change, financial service providers should inform customers of their foregoing rights and how they can be exercised.
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Explanatory Notes

No broadly accepted minimum notice period for communicating changes in contract terms and conditions or other key information to consumers applies in all circumstances. Requirements can vary by country from no minimum notice to three months' advance notice. The minimum reasonable notice period will depend on factors such as the potential impact of the change on the consumer. For example, an increase in the overdraft fee may have less impact than a transfer of loan servicing that requires the consumer to make loan payments to a different location. Reasonable notification requirements will also depend on the conditions of service delivery and physical access to the financial service provider. For instance, consumers in isolated areas may need greater advance notice when the change would potentially cause them to terminate the agreement and if termination requires the consumers to go to a physical access point, such as a branch.

Although notification to a customer of any proposed change should be in writing, different modes of communication may be used depending on the factors mentioned above. Potential modes of communication include letter, email, or SMS. For instance, notice of a change in the fee charged for making a withdrawal from an automated teller

machine (ATM) could be given in an impersonal, general fashion via a message on the ATM screen, which the consumer should be required to acknowledge before the withdrawal is conducted.

How and the extent to which terms and conditions may be changed should be clearly articulated in the original consumer agreement. In cases where the interest rate is variable, the minimum notice to be given of a change in the rate should also be stated in the agreement. Changes in prices, terms, and conditions that do not comply with what is contractually stipulated must not bind the customer and must give the customer the right to exit the agreement without any penalty and without burdensome procedures, within a reasonable timeframe. The time given for the customer to exercise the foregoing right should also be proportional to the potential impact of the change and the specific conditions of service delivery. In addition to these rights, the authority should consider strategic and targeted limitations on the breadth and types of unilateral changes that can be made by providers, even if customers are given the right to exit the agreement when they do not agree with the change. (See C2, "Unfair Practices.")

C: FAIR TREATMENT AND BUSINESS CONDUCT

C1: UNFAIR TERMS AND CONDITIONS

- a. **Financial service providers should be prohibited from using any term or condition in a consumer agreement that is unfair. Such terms and conditions, if used, should be void and legally unenforceable.**
- b. **Except where expressly permitted by law, in any agreement with a consumer, a term should be deemed to be unfair if it excludes or restricts any legal requirement on the part of a financial service provider to act with skill, care, diligence, or professionalism toward the consumer in connection with the provision of any product or service and/or any liability for failing to do so.**
- c. **Ambiguities in contractual terms and conditions should be construed in favor of the consumer.**

Explanatory Notes

Balanced rules should be in place regarding contractual terms and conditions, product suitability, product regulation, and fair practices, in order to ensure that consumers are treated fairly and offered a product or service appropriate for them. The objective of this GP is to reduce the scope for financial service providers to abuse their dominant position relative to consumers with respect to contractual terms and conditions dictated by the provider. This issue is separate from the unfair exercise of those terms, which is discussed in C2. Average consumers are not usually able to identify or fully understand contractual terms and conditions that may be detrimental to them. Furthermore, in the limited instances where consumers are able to do so, they are most likely unable to negotiate different terms with the financial service provider. Most consumer agreements, such as those for current accounts and credit cards, are not customized to individual consumers. This type of contract may even receive a special denomination by law, such as “adhesion contracts.” Regulation and supervision should be used to curb patently unfair terms and conditions, especially in countries where consumers have no effective means to defend themselves after entering into a contract that has unfair terms. This GP also becomes increasingly important in digital finance, given the speed with which contracts are electronically signed by consumers, possibly without prior review of the terms and conditions.

Defining *unfair*, *deceptive*, *abusive*, *unbalanced*, and other such terms is not straightforward, but many countries have established parameters by regulation or legislation and have prohibited certain contractual clauses or certain styles in which contracts may be written. In the United States, the Dodd-Frank Act considers an act or practice abusive if it materially interferes with the ability of a consumer to understand a term or condition of a financial product or service or takes unreasonable advantage of a consumer’s: (1) lack of understanding of the material

risks, costs, or conditions of the product or service; (2) inability to protect his or her interests in selecting or using a financial product or service; or (3) reasonable reliance on the person offering or providing the product or service to act in his or her interests.

In the European Union, the Unfair Terms in Consumer Contracts Directive 93/13/EEC considers a term unfair if it causes a significant imbalance in the parties’ rights and obligations arising under the contract, to the detriment of the consumer. This excludes the price and quality of the product, provided that these are conveyed in a plain and intelligible language.⁷⁰ However, the price and quality of the product can be taken into consideration in the assessment of fairness of other contractual terms. For example, terms that are considered fair for high-value contracts with sophisticated consumers might be considered unfair for low-income consumers. Also, general terms and conditions in the EU context may be questioned as abusive if their language is incomprehensible, not plain, or lacking in clarity, and any ambiguity is construed in favor of the consumer. In Germany, regulations provide a definition of “ineffective clauses” and a catalogue thereof.⁷¹ A similar law has existed in the United Kingdom since 1977.⁷² In the United States, forced arbitration clauses are prohibited in mortgage contracts, and the CFPB is considering prohibiting these clauses in other types of contracts as well.

Other examples of unfair terms that can be common in the financial services industry include the right of a financial service provider to revise, at any time and without prior notice, the minimum amount and the minimum time for a time deposit, and the right of a financial service provider to close any account of a consumer at any time, without notice or cause given to the customer and without incurring any liability in so doing.

Supervisors in Bolivia, Malaysia, Mexico, Pakistan, Peru, and Portugal analyze consumer agreements on an ongoing basis with the purpose of identifying abusive clauses. The ITU-T Focus Group Digital Financial Services

recommends that authorities review consumer agreements “on a regular basis, such as every six months and as informed by consumer complaints.”⁷³ New technologies for data analytics and machine learning may help them do so in a less time-consuming manner. (See A4.) However, in some cases, this practice may not be feasible if the authority has scarce resources. *Ex post* selective analysis may be more appropriate in such cases, where supervisors analyze select types of consumer agreements and take

action against the provider of the service based on such analyses (which is done in Australia, Brazil, the United Kingdom, and the United States). In addition, some countries, including Mexico, Poland, and Spain, maintain a register of financial consumer contracts that display clauses considered to be abusive or prohibited. Such registers can then be used by consumers to ascertain whether the clauses of a contract they are about to sign or have signed include abusive or prohibited clauses.

C2: UNFAIR PRACTICES

- a. **At all stages of the relationship with consumers, financial service providers should be required to treat consumers fairly.**
- b. **Financial service providers should be required to consider the outcome for consumers of their products, services, procedures, strategies, and practices to ensure compliance with clause C2(a).**
- c. **Financial service providers should be prohibited from, and held legally accountable for, employing any practice that could be considered unfair.**
- d. **The regulatory framework should also prohibit specific unfair practices related to particular retail deposit and credit products and services.**
- e. **Bundling and tying practices should not be permitted when such practices unduly limit consumer choice or hinder competition.**

Explanatory Notes

Besides having terms and conditions in consumer agreements that are fair, financial service providers also need to ensure that their relationships with consumers are fair, just, and honest, including when third parties such as agents are involved. This is to avoid disrespectful, discriminatory, or abusive practices that may not be in direct conflict with the contractual terms and conditions. Treating consumers fairly should be an affirmative obligation for financial service providers and an integral part of their corporate and risk culture. Assessing how this culture is translated into practice at the provider level is an important item in a supervisory authority’s activities. For example, regulators such as the FCA in the United Kingdom and the BNM in Malaysia require regulated entities to demonstrate how the concept of “treating customers fairly” is embedded in their business model and practices, from the product research to the post-sales stage.

Special attention should also be drawn by the authority to the particular needs of, and difficulties faced by, vulnerable groups—for example, low-income, inexperienced, physically disabled, or socially or economically marginalized consumers such as indigenous people, rural populations, and women. Depending on a particular country’s context, specific protections for vulnerable groups may be included in the regulatory framework. Discrimination of

any kind—including, for example, poorer treatment due to a consumer’s faith, political affiliation, or sexual orientation—should be prohibited.

Many unfair practices—including aggressive sales tactics such as unsolicited SMS loan offers increasingly used in digital credit, abusive loan collection (physical or moral threats to the borrower), and the sending of credit cards to consumers who have not requested them—can pose significant problems for consumers and lead to overindebtedness and other outcomes negative to consumer welfare, although the practices are unrelated to the actual contractual terms. Effectively identifying those unfair practices that pose the greatest threat to consumers will depend in great part on how well the authority is able to access and analyze data regarding consumer complaints.

The regulatory framework should have specific prohibitions of unfair practices with respect to particular types of products. For example, the credit card industry in many countries has over time seen a number of harmful practices arise (and corresponding policy responses to address such practices). Problems such as charges on unsolicited cards become more serious when the target customer segment consists of low-income consumers and where credit cards can be offered by a variety of bank and non-bank providers. Measures have been taken by countries such as the United States⁷⁴ and Brazil, which brought pre-

viously unregulated credit card issuers under the purview of the Central Bank of Brazil, to update the rules applicable to credit cards to address these issues. For example, regulators should consider prohibiting bank and nonbank credit card providers from engaging in the following common unfair practices:

- Sending unsolicited preapproved credit cards to current or potential customers and charging them for any fees related to cards that have not been accepted by the consumer
- Applying new higher penalty interest rates to the entire existing balance, including past purchases made at a lower interest rate
- Automatically increasing credit limits without prior consent by the consumer
- “Double-cycle billing” or using compound interest by which card issuers charge interest over two billing cycles rather than one

Regarding deposit accounts, common unfair practices may include the following

- Continuing to charge maintenance fees on inactive accounts that have reached a zero or negative balance
- Applying automatic overdraft facilities and imposing fees and charges related to such facilities without prior opt-in consent by the consumer

Regarding credit products, policymakers should consider requiring fair practices or prohibiting unfair practices such as the following

- Encouraging use of interest rates applied over the declining balance of the loan, as opposed to flat rates
- Requiring use of opt-in clauses for facilities that auto-deduct payments and fees (when loans are tied to deposit accounts)
- Prohibiting the employment of abusive loan collection practices (See C10.)

In many countries, payday lending is an emerging area of concern for policy makers, and should be monitored to identify specific unfair practices that should be addressed.

As noted previously, policy makers should also closely monitor developments in digital credit, as the speed and remoteness of digital credit may take advantage of behavioral biases and give rise to new types of practices that may be deemed unfair to consumers. Discrimination and other unfair practices may also be embedded in the algorithms supporting digital credit scoring models. (See section D of annex A, “Retail Payment Services.”) The authority will need to work to ensure that the principle of fair practices is clearly applied to digital financial services and that providers are made liable for any unfair impacts

of new screening models. Policy makers’ efforts could benefit from seeking feedback from consumers, such as through consumer research, so that balanced regulations can be crafted.

However, identifying unfairness is not always straightforward. In some cases, it will be the role of the authority to set minimum standards and procedures to define, at least in the first instance, whether any given practice is unfair or not. For example, in some countries, MFIs require female loan applicants to have a male cosigner, thereby creating hurdles for women to access loans. Due to prevailing cultural norms, this practice may be considered acceptable in some countries, while in other countries such practice may be deemed unacceptable.

Bundling and tying,⁷⁵ which are becoming more common in developing and emerging consumer finance markets, including digital credit and insurance, either should not be allowed when they unduly limit consumer choice or hinder competition or, at a minimum, their negative effects should be counteracted by regulation, such as with respect to transparency. Product tying may weaken competition by reducing customer mobility and discouraging the entry of new and particularly smaller financial service providers.⁷⁶ Bundling also reduces price transparency and comparability across providers, such as by creating “baskets” of various financial products and services. For example, after observing the lack of comparability of checking account service packages, the Central Bank of Brazil issued a regulation to standardize the composition of packages of basic services targeted to middle- and low-income consumers specifically to allow for better comparability of component products and services.

When consumers are required to purchase a product such as a checking account or an insurance policy as a precondition for receiving a loan, they should ideally be free to choose the provider of the secondary product, or at least be given the minimum information required to compare different providers of the secondary product. Information regarding the tied product and the right of choice should be made known to borrowers during the shopping and precontractual phases, and the financial service provider should not sway or pressure consumers toward a particular provider on the basis of its own commercial agreement with that provider.

When a choice among different providers for the secondary product is unavailable, the financial service provider should not be prohibited from tying products, but all key features, as well as the identity of the provider of the tied product, should be disclosed. For example, a financial service provider offering microloans in a remote area may not find more than one insurance company willing to provide cost-effective credit life insurance to such customers. Another common example of a fair tied product is mortgaged property insurance. On the other hand, a

lender that requires a borrower to open a current account in a specific bank only for the purpose of servicing the loan could be considered unfair. Tying also may be imposed on consumers even when not included in the consumer agreement.

Providers of a wide range of services increasingly use agents, including other financial service providers or retailers, to increase the outreach of their service delivery. It is important that the financial service provider be prohibited

from shifting or abdicating to third parties its contractual responsibilities to treat consumers fairly when its products and services are not delivered directly by its own staff or in its own facilities. Attention to this issue is particularly relevant when the provider uses intermediaries such as agent network managers, as responsibilities and risks may be shared with the intermediary based on a contract between the provider and its agent.

C3: SALES PRACTICES

- a. **Financial service providers should be required to have and comply with adequate, formal sales policies and procedures.**
 - b. **Financial service providers should be required to ensure that mis-selling, misrepresentations, aggressive high-pressure sales, and discrimination are not used during the sales process.**
 - c. **Financial service providers should be held accountable for downplaying or dismissing warnings or cautionary statements in written sales materials.**
 - d. **Financial service providers and their sales representatives should be required to disclose to a consumer any actual and potential conflicts of interest, particularly when the consumer receive advice before entering into a consumer agreement.**
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Explanatory Notes

It is crucial that salespeople use well-designed materials that follow B1 and B2. However, though important, sales materials may not be the most important element in a consumer's decision to acquire a financial product or service. Rather, there is evidence that consumers may make their financial decisions based on their level of trust in the person selling or advertising the product. In some cases, consumers may disregard information in sales and other disclosure materials provided in accordance with regulatory requirements, instead relying entirely on what the salesperson says. Salespeople may take advantage of this behavioral bias and be dismissive of the consumer's need to read and understand important disclosures. Salespeople may also employ aggressive, high-pressure sales tactics to influence a consumer's behavior.

Similarly, when credit is commercialized entirely through digital means, financial service providers may use tactics that take advantage of expected consumer behavior to drive sales. For example, digital credit providers in several countries use unsolicited SMS messages to advertise their products. If the same SMS includes a link giving almost instant approval/access to a small loan, consumers may be more willing to take the loan, with little regard paid to the actual terms of the loan. As noted previously, the speed of delivery and the ease and anonymity of the credit offer may make borrowing decisions less intentional.⁷⁷

Therefore, it is important that financial service providers have sales policies and procedures that align with good practices and strongly and clearly emphasize ethics in sales, including the need for consumers to be duly informed and treated fairly by salespeople. Discrimination of any kind—for example, of people from certain ethnicities, social backgrounds, or gender—should be prohibited. The sales process should aim to ensure that consumers acquire products and services that are suitable to them (see C4, below), thereby reducing the risk of mis-selling. It also should discourage or prohibit aggressive, high-pressure sales tactics, such as unsolicited and numerous phone calls to potential borrowers, harassment in public settings, exploitation of a consumer's hardship situation to offer products, and misrepresentations.⁷⁸

A financial service provider's sales policies will not be effective, however, unless properly enforced. For this to happen, clear mechanisms are needed to punish misbehavior by salespeople and other staff. Also, staff compensation and performance policy must be consistent with ethical sales processes. For instance, a compensation policy that is centered on aggressive monthly sales targets for each type of product may lead to unethical sales behavior. (See C8, "Compensation of Staff and Agents.") Finally, financial service providers should be required to qualify their sales staff accordingly. (See C6, "Professional Competence.")

C4: PRODUCT SUITABILITY

- a. **Where appropriate, before providing advice or concluding an agreement regarding a deposit or credit product or service, financial service providers should be required to gather sufficient information about the consumer to enable it to provide a product or service suitable for the consumer's needs and financial capacity.**
- b. **Financial service providers should take reasonable steps to ensure that, taking into account the facts disclosed by the consumer and other relevant facts about the consumer of which it is aware, any product or service it recommends is suitable for that consumer.**
- c. **Regulatory requirements regarding product suitability should be flexible and balanced in order to avoid overburdening providers or excluding certain consumers, as well as to accommodate innovations in digital financial services.**

Explanatory Notes

Product suitability is an important component of responsible finance. Achieving product suitability puts the onus on financial service providers to ensure that there is compatibility between what is being offered to a consumer and the consumer's specific needs and profile. While product suitability requirements may be aspirational in some countries, there are different degrees to which such requirements can be put in place. For example, initial efforts can focus on reasonable and appropriate consumer assessments. Fin-CoNet has identified as good practice requiring financial service providers to reasonably assess the interests of a consumer prior to extending any credit facility.⁷⁹ Similarly, Principle 6 of the G20 FCP Principles notes that financial service providers should assess the "financial capabilities, situation and needs of their customers" before providing them with a product, advice, or service.

With respect to credit products, a key element of product suitability is the concept of responsible lending, which is centered on balancing affordability with the financing needs of the consumer. In consumer and microfinance lending, providers sometimes may not assess a potential borrower's payment capacity sufficiently. Such assessments should be required, and reassessments could also be required when the product being offered increases the consumer's debt substantially. Particularly for NBFIs clients who often operate in the informal sector and for environments where the scope of credit reporting may be limited and not extend to all NBFIs, providers should clearly explain to consumers that it is their responsibility and in their benefit to provide accurate and truthful data.

Financial service providers often offer standardized loan products to a range of consumers with different financing needs and income streams that differ in their size and frequency. As a result, such loans frequently end up being of inadequate size or term, leading consumers to seek parallel or sequential loans. This situation is observed

with microfinance and payday loans in many countries. Borrowers often either take on a sequence of loans following a new loan, or roll over their loans, sometimes incurring high costs and fees as a result. Responsible payday lenders could avoid these situations by offering larger loans with more appropriate repayment schedules from the start, or by referring the consumer to another lender. However, financial service providers may have little incentive to address product suitability, since many consumers may not know what an appropriate loan would be, do not know how to protect themselves after the loan is taken, or are wary of requesting changes for fear of losing access to current and future loans. Appropriate policy action may therefore be called for to address such practices.

As recommended by the ITU-T Focus Group Digital Financial Services, to the extent possible, providers should also be responsible for ensuring the suitability of their offerings when commercializing new types of credit powered by technology, such as digital credit. Digital credit is often extended remotely and based on credit-scoring methodologies that use a range of alternative data and differentiated algorithms. There is usually little or no interaction or exchange of information between the potential borrower and the financial service provider. While most digital credit products are very low value and may have limited financial impact on consumers, larger loans may use similar technologies and bring hardship for the consumer if not suitable.

Although the principle of suitability should create an obligation for financial service providers, the regulatory requirements related to product suitability should be balanced and proportionate to the risks and complexity of the products being offered, to avoid undue burdens to both providers and the supervisory authorities. For instance, where possible and appropriate, financial service providers should be required to gather information about a prospective consumer in order to offer a product or ser-

vice that is suitable for that consumer. But the amount and type of documentation collected and kept by the provider will need to vary according to the type of product and the type of customer.⁸⁰ Rigid requirements can create barriers or undue costs to providers serving a wide range of consumers—for example, low-income consumers who are not able to comply with some documentation requirements.⁸¹ Furthermore, since terms such as *adequate*, *suitable*, *responsible*, and *affordable* can be interpreted differently by different providers, the authority should provide clear guidelines on the interpretation of such terms to provide clarity and ensure consistency in supervisory oversight. Finally, as markets are evolving quickly, particularly in developing and emerging countries, suitability requirements should also evolve for innovations with the potential to support the growth of financial inclusion and responsible finance. Supervisors should identify emerging good and bad practices and adapt rules accordingly.⁸²

A related approach to product suitability that puts a stronger onus on financial service providers relates to affordability and overindebtedness, increasingly important topics globally, particularly where consumer credit markets are rapidly expanding. Overindebtedness can have many negative social, economic, and political consequences. Hence, policy makers in several countries—including Brazil, Peru, and the United States—have established measures such as maximum debt-to-income ratios for certain types of loans.⁸³ However, particular care will be needed when employing more direct policy approaches, such as debt-to-income-ratios and product regulation (discussed below), in order to ensure that such policies are balanced and proportionate, impose appropriate requirements calibrated to the level of risk and complexity of products, and are not unduly limiting access to financial services.

Beyond requiring providers to take steps to determine product suitability, an emerging area of regulation to address issues with unsuitable products more directly is product regulation. Product regulation may take two forms: prohibiting or mandating specific products or product characteristics, and requiring that the product design process ensures good consumer outcomes. The first form is more commonly applied to investment products but can also be used for retail deposit and credit products and services as well where specific products or product characteristics are determined to be patently unsuitable for consumers. For example, the Central Bank of Brazil banned a specific payroll loan product linked to a debit card, deeming it inherently detrimental to consumers. A FinCoNet survey has found that only a small number of countries currently have such types of regulation.⁸⁴

The second form consists of regulatory requirements regarding the efficacy of product oversight and governance by financial service providers and covers the whole product cycle from research to post-sales, with the objective of producing fair outcomes for consumers in general—that is, not for a specific consumer. This approach could give clearer means for the supervisory authority to take action when unsuitable products are introduced in the market or offered to a particular consumer, even where there are no regulatory prohibitions on a specific practice or product.⁸⁵ For example, the European Banking Authority issued guidelines for European financial supervisors to address product design processes; the guidelines are expected to be an integral part of providers' organizational requirements and internal controls, to ensure fair outcomes for consumers.⁸⁶ Similarly, the United Kingdom's Treating Customers Fairly framework requires that products be specifically designed to be suitable for their identified target markets.

C5: CUSTOMER MOBILITY

- a. **Financial service providers should be prohibited from unduly limiting a customer's ability to cancel or transfer a product or service to another provider, on the customer's reasonable notice.**
 - b. **Financial service providers should be required to provide comprehensive information about its cancellation and portability procedures to consumers, including when products and services are delivered through agents or digital channels.**
 - c. **Financial service providers should be allowed to charge a reasonable cancellation fee or prepayment penalty only if set out in the consumer agreement, which should also contain its method of calculation.**
 - d. **Immediately following the signing of a consumer agreement, financial service providers should be required to provide the consumer with a reasonable cooling-off period for financial products or services with a medium- or long-term component or those sold via high-pressure sales or marketing.**
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Explanatory Notes

The ability to switch products and services easily and inexpensively—whether from one provider to another or within the same provider—allows consumers to benefit from offers that are best for them. The cost to the consumer for switching, if any, should be reasonable. For loans, prepayment/closing fees should be allowed only for fixed-rate loan agreements.

One type of unfair practice that should be prohibited is the imposition of noncontractual hurdles, such as burdensome procedures for consumers seeking to cancel a service or product or switch to another provider. For example, customers may be required to go to a branch to sign long forms and present an “acceptable” justification for the intent to cancel the service or close the account. With regard to loan mobility, lenders may impose obstacles such as a delay in providing the loan account statement that will be needed by the new lender, or intentionally miscalculating the loan balance to impose further delays. To address such obstacles, when a consumer in Italy requests to switch their loan to another provider, financial service providers are required to complete the procedure within a fixed timeframe. If a delay occurs, the consumer is entitled to an indemnity payment.

The Central Bank of Ireland has issued a Switching Code, which sets out procedures that must be followed by financial service providers when a customer decides to switch a current account from one provider to another.⁸⁷ Cancellation and mobility barriers are also becoming important in prepaid accounts, particularly when high levels of market concentration or near-monopoly situations exist.⁸⁸ The new General Data Protection Regulation in the European Union includes a right to “data portability,” in order to enable customers to receive their personal data in a structured, commonly used, and machine-readable format so they can transfer it more easily to another provider.⁸⁹

Customer mobility can also be enabled by requiring cooling-off periods. These are grace periods during which customers are permitted to cancel or treat the agreement as null and void without penalty of any kind. Cooling-off periods are important for certain types of products, such as those subject to high-pressure sales techniques. (See C3.) Products sold remotely without face-to-face contact, such as loans by phone or over the Internet, should also benefit from reasonable cooling-off periods, although this is not yet common practice for low-value, short-term digital credit.⁹⁰ Although no penalty should apply, the consumer may be required to pay a pre-agreed reasonable fee to cover the administrative costs incurred by the financial service provider with the early cancellation.

The length of a cooling-off period should vary according to the type of product. For example, longer periods are warranted for products with a long-term savings component. The period should also be proportional to the mechanisms offered to consumers to exercise their cooling-off rights. For instance, if the financial service provider requires consumers to sign, present, or send any formal document in order to cancel the agreement, and many consumers are located in remote areas where the postal service is unavailable or not reliable, a short cooling-off period will be ineffective. The existence of a cooling-off period and related procedures should be fully disclosed to consumers both in writing and orally. (See B3.)

Finally, the cooling-off period should not overlap with the reflection period—namely, the time allowed by a financial service provider to a potential customer to consider whether to sign an agreement based on the provider’s offer, which remains valid throughout the reflection period. A cooling-off period should start only once an agreement between the provider and consumer has been signed.

C6: PROFESSIONAL COMPETENCE

- a. **Financial service providers should be required to ensure that all relevant staff members and third parties acting on its behalf meet competency requirements, including familiarity with the products and services sold to consumers and financial consumer protection principles and rules.**
 - b. **The financial service provider’s board of directors should bear ultimate responsibility for ensuring effective implementation of training and competency requirements, and there should be an established system to ensure that the board of directors is adequately informed and able to take corrective action when needed.**
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Explanatory Notes

Staff members and third parties interacting either directly or indirectly with consumers can have an important impact on consumer protection, during the sales process as well as throughout the product lifecycle. This includes some positions that do not interact directly with consumers but whose work may affect the outcome for consumers, such as product design and compliance jobs. (See the discussion of product regulation in the explanatory notes to C4.) Staff members and third parties should meet minimum competency standards, including with respect to financial consumer protection, in order to ensure that they are appropriately qualified to interact with consumers. Personnel in charge of interacting directly with consumers, including those handling complaints, should be familiar with the products and services sold to consumers.

Regulatory requirements on qualifications, professional competencies, and training should not be too restrictive or detailed. They should be general, proportional, and flexible, so that they can be implemented by a range of financial service providers of different sizes and complexity, and in a range of different contexts. Competency requirements may also vary by type of position within the provider and related responsibilities, as well as by type of product. For example, complex products will require greater knowledge and experience.

Financial service providers should have an internal training and qualification policy in line with their own mapping of competencies. Staff and third parties working on behalf of the financial service provider should be held accountable for their actions that deviate from internal policies, laws, and regulations with respect to consumer protection and fair treatment of consumers.

C7: AGENTS

- a. Financial service providers should be legally liable for the actions and omissions of their agents.
 - b. Financial service providers should be required to perform appropriate due diligence before contracting with any agent or agent network manager.
 - c. Financial service providers should be required to continuously monitor the performance of their agents, including adherence to regulatory requirements and internal policies and procedures.
 - d. The agency relationship should be governed by a formal agency agreement between the agent and the financial service provider.
 - e. The authority should have legal or regulatory power to assess the activities of financial service providers' agents and agent network managers and to take appropriate action upon regulatory non-compliance by any agent or agent network manager.
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Explanatory Notes

This GP encompasses all persons/entities selling or facilitating products or services on behalf of financial service providers. This includes not only agents in the strict legal sense of a particular jurisdiction, but also any representatives, introducers, referrers, and retail agents—that is, third-party establishments or individuals commercializing products or services on behalf of financial service providers in exchange for a fee. This also includes agent network managers who provide agent management services for banks and nonbanks.⁹¹

In an increasing number of countries, such as Bangladesh, Brazil, Colombia, Ghana, Guatemala, Kenya, Nigeria, Philippines, Rwanda, and Tanzania, banks and nonbanks use agents to market and distribute their products, such as loans, credit cards, and savings accounts. The solicitations and transactions take place at the agent's or another third party's establishment, or at places and

events such as malls, busy streets, buses, taxis, and fairs. Agents are therefore useful in urban areas, given their convenient locations, and are also particularly relevant in rural areas—for example, to receive remittances sent by family members. In addition to using commercial establishments, financial service providers may also use other financial service providers as their agents, such as when a bank opens accounts to microfinance consumers using the MFI's branches.

Such models often provide significant advancements in financial inclusion. As agents are an essential element of many digital financial service models around the world and, in some instances, are the only points of interaction between consumers and financial service providers, particularly in remote and rural areas, the importance of ensuring consumer protection when agents are being used is essential.

In line with Principle 6 of the G20 FCP Principles and the ITU-T Focus Group Digital Financial Services,⁹² regulation should ensure that providers are legally liable for the actions and omissions of their agents, including when agent network managers are used to select and conduct onboarding of individual agents. In general, the same standards of quality, disclosure, fairness, and other aspects of consumer protection applicable to services delivered directly by the staff of a financial service provider should apply when services are delivered by its agents. Regulation should make financial service providers legally liable for the actions and omissions of its agents, so that providers have a strong interest in assessing and monitoring their agents on a continuous basis, and in providing appropriate training to their agents. However, the regulatory framework should refrain from imposing overly burdensome requirements on agents in order to allow for the emergence of different and innovative types of agents, whose activities performed on behalf of financial service providers may vary widely.

For example, the financial service provider's policies and procedures toward agents may establish the following:⁹³

- Agents are adequately trained and qualified to perform the consumer-interaction functions agreed in the agency agreement.
- Agents do not charge unauthorized fees to consumers.
- Agents do not engage in activities that could harm consumers (for example, creating fake transactions to withdraw cash from a consumers' accounts, asking for a consumer's PIN or password).
- The financial or other incentives offered to agents do not encourage behavior that goes against the principles of product suitability and fair treatment (such as encouraging consumers to acquire a product or service that generates higher fees for the agent but is not in the consumer's best interest).
- Disclosure requirements are complied with (posting of charges and fees at the agent establishment, disclosing different providers of bundled services),

- Internal dispute resolution mechanisms work reasonably well even if agents are utilized (see E1, "Internal Complaints Handling").

- Agents do not misuse customer data and information, and comply with data protection rules.

In environments where there is an increasing use of agents to serve consumers, authorities should monitor whether providers are unduly shifting their contractual responsibilities toward the consumer to agents or other third parties, such as agent network managers. For instance, a bank may refrain from reimbursing a consumer in a case of fraud perpetrated by an agent managed by an agent network manager. Such practices may be based on risk-transfer or risk-sharing clauses in the contract between the financial service provider and the agent network manager. The transfer of responsibilities away from the provider should be curbed through supervision and enforcement. Any contractual clause that shifts the provider's liability should be considered void. Another topic of interest to the authority is whether financial service providers (particularly large ones) impose exclusivity clauses on their agents in a way that limits competition and consumer choice. Finally, the authorities should ensure that agent regulations for nonbanks are either the same or very similar to those applicable to banks, as is the case in Brazil, Colombia, Ghana, and Peru, in order to ensure harmonization of consumer protection requirements.

Given the issues discussed above, supervisory authorities need to have clear power to assess and take action when necessary with regard to agents and agent network managers. This includes the power to gather data on transactions and services provided by agents, conduct inspections at agents and agent network managers, suspend certain agents from entering into new agreements with regulated financial service providers, and prohibit certain providers from contracting with new agents. For example, the ITU-T Focus Group Digital Financial Services recommends providers be required to report regularly on onboarding, trends, and sanctions of third parties working on behalf of the provider, which could allow authorities to monitor developments more closely.

C8: COMPENSATION OF STAFF AND AGENTS

- a. Financial service providers should be required to have compensation policies that ensure that their staff—including senior executives—and agents are compensated in such a way as to minimize conflicts of interest.
- b. Financial service providers should be required to have established policies and procedures to manage and resolve actual conflicts of interest with respect to compensation policies that arise in the interaction between their staff and agents and their customers and potential customers.

- c. **The financial service provider's board of directors should be held responsible for the policies referenced in clauses C8(a) and (b) and their effective implementation.**
- d. **To the extent possible, prior to the provision of advice or the sale of a product or service that will result in a commission to a staff member or an agent, the existence of the commission and its amount should be disclosed to the consumer.**

Explanatory Notes

Increasingly, authorities are turning their attention to the financial and nonfinancial incentives for proper or improper behavior by individuals working for financial service providers, whether staff members or agents. Compensation is typically a key aspect of a financial service provider's business practices to take into consideration.

As stated in Principle 6 of the G20 FCP Principles, remuneration structures should be designed to encourage responsible business conduct and avoid conflicts of interest. For example, it can be particularly problematic when staff members and agents are compensated solely on the basis of sales volume. Remuneration should be based, at least in part, on elements such as consumer well-being and satisfaction, loan-repayment performance, product retention, compliance with regulatory requirements/internal policies and COCs, fair treatment of consumers, satisfactory audit and compliance review results, and the results of complaint investigations. Compensation should have elements reflective of long-term performance, and not merely short-term sales targets. The objective is to ensure an effective alignment of compensation with prudent risk taking, while encouraging trustworthy, responsible, professional behavior and a corporate culture that works toward regulatory compliance and fair treatment of consumers.

The Remuneration Codes of the United Kingdom's FCA set the standards that banks and NBFIs must meet when setting pay and bonus awards for their staff, with the justification that "inappropriate remuneration policies

were widely identified as a contributory factor behind the Financial Crisis."⁹⁴ These Codes are intended to discourage inappropriate risk taking, and include: (i) deferral of bonuses over time; (ii) limitations on the proportion of bonuses that can be met by shares or the equivalent; (iii) limitations on guaranteed bonuses; (iv) requirements for policies on governance and risk taking and management; and (v) annual publication of remuneration policies. Likewise, other countries have instituted regulations setting standards for compensation.⁹⁵ In China, banks' compensation systems need to provide an appropriate mix of short- and long-term incentives, and the payout schedule should be aligned with the time horizon of risks of the relevant business. In the Netherlands, regulation requires that compensation be based on longer-term performance and should vary according to the type of activity performed by staff or agents. International standards relevant to the compensation policies of banks and NBFIs have also been issued by the FSB, and an assessment methodology of such standards has been published by the BCBS.⁹⁶

Inappropriate or misaligned incentives for loan officers have been behind some of the most notable failures in the microfinance sector globally. In this industry, it is particularly critical that incentives are aligned with the interests of consumers and good portfolio risk management, due to the higher level of freedom allowed to MFI loan officers compared to the more strict separation of front- and back-office functions that is normally required of banks.⁹⁷

C9: FRAUD AND MISUSE OF CUSTOMER ASSETS

- a. **Financial service providers should be liable to customers for losses due to fraud or misuse involving customer assets held, administered, or controlled by the provider, except in cases of consumer fraud or gross negligence.**
- b. **Financial service providers should be required to have and implement adequate policies and procedures that aim to protect customers' deposits and other assets against internal or external fraud or misuse.**
- c. **Financial service providers should have and implement clear policies and procedures to resolve cases of suspected fraud or misuse regarding customers' accounts.**

Explanatory Notes

Fraud and unauthorized transactions can be extremely detrimental to consumers' confidence in financial service providers, and especially deleterious for low-income consumers when such occurrences are not resolved promptly and effectively. In particular, fraud is becoming a major concern in countries where access to the formal financial sector by millions of new consumers, including consumers with limited prior experience with financial service or digital devices, is happening primarily through digital financial services and electronic channels more broadly and facilitated by retail agents.⁹⁸

Countries are strengthening their regulation and supervision to identify potential fraudulent activities and to prevent them from occurring, such as by requiring timely reporting of confirmed or suspected instances of fraud. Regulators are also assessing the quality of financial service providers' management of this type of operational risk, as well as whether their procedures to deal with actual cases (which need to be formalized in internal policies) are fair to consumers. The ITU-T Focus Group Digital Financial Services recommends that providers be made liable for the loss or harm due to fraud related to the digital financial services platform, staff, agents, and third-party service providers.⁹⁹ However, it is important that regulation be balanced, proportional, and agnostic with respect to the technology used to increase security and safety of transactions, since improperly designed regulation could otherwise inadvertently curtail healthy innovation, competition, and market development.

Numerous reference materials are useful in this area. Relevant international standards on operational risk management include the Principles for Sound Management of Operational Risk by the BCBS.¹⁰⁰ With regard to digital financial services, the GSM Association, Microsave, and the Alliance for Financial Inclusion have all published relevant documents cataloging and defining fraud risks, and the International Finance Corporation has a toolkit with recommendations on curbing fraud.^{101,101} The FCA in the United Kingdom has published a guide on financial crimes including fraud.¹⁰³ There are guidance papers for MFIs looking to manage their fraud risk as well.¹⁰⁴ **See also related discussions in C7, "Agents," and section D, "Privacy and Data Protection,"** in this chapter; and **C7, "Protection and Availability of Customer Funds," C8, "Authorization, Authentication, and Data Security," and C9, "Unauthorized and Mistaken Transactions and Liability for Loss,"** in annex A, "Retail Payment Services."

As indicated in Principle 7 of the G20 FCP Principles, financial service providers should be required to have policies, systems, and controls in place to deal effectively with

cases of reported unauthorized transactions and other situations in a timely manner. These policies should include the duty to communicate with customers throughout the process of investigating their cases and reimbursing the value of the transaction both temporarily (that is, while the investigation is ongoing) and permanently (after the investigation has concluded). For example, providers ideally should reimburse a reported victim of fraud immediately, providing a value equivalent to the unauthorized transaction while further investigation is conducted, up to a certain reasonable threshold. The reimbursement should be confirmed when the investigation is over, unless it can be proven that the unauthorized transaction resulted from the consumer's own gross negligence or fraud. The consumer must be informed of the procedures, which should not be unduly burdensome to the consumer, and the burden of proof should lie on the financial service provider.

Various types of fraud and scams abound, including those involving consumer loans. One example is of agents requesting borrowers to sign a blank loan document, which is then completed with clauses allowing agents to roll over the loan to other lenders without the consumer's prior consent, generating new fees for the agent. Financial service providers should conduct periodic audits to test the robustness of internal controls in preventing and identifying any type of fraud. Such internal evaluations, and actual fraud cases, should be used to improve operational procedures and fraud-detection systems. Providers should also have clear policies and mechanisms in place to investigate staff suspected of involvement in fraud.

In addition, fraud and scams perpetrated by illegal providers of financial services or persons pretending to provide financial services are becoming more common as a result of the greater range of institutional types and delivery channels used by financial service providers, which makes it more difficult for consumers to differentiate between legitimate providers from fraudsters. For instance, a scammer may promise a loan, usually to a person with a poor credit history and facing financial hardship, in exchange for an advance fee.¹⁰⁵ The supervisor needs to have the power to act against illegal providers. **(See A1 and A2.)** A basic step should be to publicize a list of registered and licensed financial service providers, which should be accompanied by efforts to raise consumer awareness regarding the need for consumers to check whether purported providers are in fact legitimate. For example, the BNM in Malaysia has created a mobile app, BNM My Link, which consumers can download for free. It provides a direct channel of communication to all financial service providers licensed by the BNM, allowing consumers to make inquiries or complaints.

C10: DEBT COLLECTION

- a. **Financial service providers and any third parties acting on their behalf should be prohibited from employing abusive debt-collection practices, including the use of false statements, practices akin to or constituting harassment, or the giving of false or unauthorized credit information to third parties.**
- b. **The type of debt that can be collected on behalf of a financial service provider, the person who can collect any such debt, and the manner in which such debt can be collected should be clearly stated in the credit agreement.**
- c. **There should be an adequate regulatory regime governing the activity of debt collection.**
- d. **In the event a debt collector has a statutory right to contact any third party about a borrower's debt, the debt collector should exercise such right only provided he or she informs both the third party and the debtor**
 - i. **Of the debt collector's statutory right to do so; and**
 - ii. **The type of information that the debt collector is seeking.**
- e. **Where the sale or transfer of a debt without the borrower's consent is permitted by law, the borrower should be**
 - i. **Notified of any such sale or transfer within a reasonable number of days thereafter;**
 - ii. **Informed that the borrower remains obligated on the debt;**
 - iii. **Provided with information as to where to make payment; and**
 - iv. **Provided with the purchaser's or transferee's contact information.**

Explanatory Notes

Abusive practices—for example, daily phone calls, threatening or aggressive language, harassing relatives and coworkers, publicly embarrassing borrowers, knocking at borrowers' doors, or making calls during late-night or early-morning hours—are often used by a range of financial service providers such as consumer lenders and credit card companies, particularly against low-income, elderly, and other more vulnerable consumers, and particularly when third-party debt collectors are utilized. In a number of countries, safeguards against abusive debt collection remain weak and may be coupled with weak judicial systems. There is a further risk that weak safeguards against abusive debt collection (i) strengthen the call for a more cumbersome recovery process; (ii) lead to moratoriums on collection; and (iii) earn the sympathy of courts. As a result, debt collection can become a prolonged and expensive process that increases the cost of financing in the long run, thereby harming consumers and financial inclusion.

Sound regulation on debt collection is therefore needed (which can have general application to all types of debt). The United States, for instance, has the Fair Debt Collection Practices Act.¹⁰⁶ In Australia, the Debt Collection Guideline, jointly issued by the Australian Competi-

tion and Consumer Commission and ASIC, provides guidance on the entire collection process from the first contact with the borrower to dispute resolution. For example, it prohibits the debt collector from using abusive, offensive, obscene, or discriminatory language; embarrassing or shaming the borrower; adopting an intimidating manner; using violence or physical force against the borrower; or misleading the consumer about the extent of the debt or the consequence of nonpayment. The FCA in the United Kingdom also has rules for debt collectors.¹⁰⁷ Providers should be required to have in internal documents and trainings clear guidelines and rules on what constitute appropriate and inappropriate debt-collection practices. Providers should also bear liability for the actions of debt collectors acting on their behalf.

Abusive and aggressive debt collection has been an issue in many credit markets, including the microfinance sector. For instance, some MFIs traditionally followed a no-tolerance policy toward delinquency that resulted in abusive practices toward consumers. These practices led to the specific inclusion of debt collection in the Client Protection Principles of the Smart Campaign, which advocates for fair and respectful treatment of consumers in the microfinance sector.¹⁰⁸

D: DATA PROTECTION AND PRIVACY¹⁰⁹

D1: LAWFUL COLLECTION AND USAGE OF CUSTOMER DATA

- a. Financial service providers should be allowed to collect customers' data within the limits established by law or regulation and, where applicable, with the customer's consent.
- b. The law or regulation should establish rules for the lawful collection and use of data by financial service providers, including when consumer consent is required, and clearly establishing at a minimum
 - i. How data can be lawfully collected;
 - ii. How data can be lawfully retained;
 - iii. The purposes for which data can be collected; and
 - iv. The types of data that can be collected.
- c. The law or regulation should provide the minimum period for retaining all customer records, and throughout this period, the customer should be provided ready access to such records for a reasonable cost or at no cost.
- d. For data collected and retained by financial service providers, providers should be required to comply with data privacy and confidentiality requirements that limit the use of consumer data exclusively to the purposes specified at the time the data were collected or as permitted by law, or otherwise specifically agreed with the consumer.

Explanatory Notes

Financial service providers collect many different types of personal information from and regarding their customers, including contact details, consumer agreements, transaction logs, and passwords. Given the potential for misuse of such information, it is essential that data collection be regulated to avoid the risk of harm to consumers. For example, financial service providers may otherwise collect sensitive information and use it for unfit purposes that may harm consumers. Reasons for ensuring data protection and privacy include:

- The sensitivity of the personal information held and used in financial services
- The extensive information flows that take place in financial services, such as between providers and agents and between members of a corporate group that includes one or more financial service providers
- The increasing likelihood of information being received and held electronically, with a corresponding increase in the risk of remote, unauthorized access to such data
- The fact that privacy is a fundamental human right deserving of protection, as indicated in various international declarations and conventions that have been ratified by many countries¹¹⁰

Financial service providers should be allowed to legally collect, retain, and use personal information after obtaining lawful and informed consent from the consumer or on some other legitimate basis, including when related to the provision of the specific financial product or service the consumer acquired. International guidance is clear in establishing that "the collection of personal data and any such data should be obtained by lawful and fair means and, where appropriate, with the knowledge or consent of the data subject."¹¹¹ While the policies and practices regarding what constitutes lawful collection of data differ both across jurisdictions and among international guidance and principles, lawful and informed consent represents an underlying and cross-cutting theme. What constitutes informed consent can also pose challenges, particularly where adhesion contracts are common, or in the era of digital financial services, big data, and alternative credit scoring models.

Furthermore, following the approach of treating data privacy as a human right, Convention 108 of the Council of Europe (COE Convention) establishes that data shall undergo automatic processing only for a legitimate purpose and that certain categories of sensitive data cannot be processed automatically, unless national legislation provides appropriate safeguards.¹¹²

Financial service providers may also have incentives to store personal information for longer than necessary. Therefore, the major international instruments also recom-

mend that limitations be placed on data retention.¹¹³ For example, the COE Convention states that data must be “preserved in a form which permits identification of the data subjects for no longer than is required for the purpose for which those data are stored.”¹¹⁴

The lawful collection of data is strictly connected to the purpose for which data are collected, and financial service providers should be permitted to use the data only for these purposes. For example, selling data to third parties for marketing purposes without prior authorization by the consumer should be prohibited. If law or regulation is silent on this issue, there is a risk that financial service providers may collect information for certain purposes for which customers may be willing to give consent, but then use that same information for other purposes that may be detrimental to customers’ interests and for which the customer may not otherwise have given consent. Providers should also be prohibited from disclosing consumer information to third parties for unauthorized uses—that is, without the consumer’s prior consent—such as for marketing purposes.

For purposes of credit reporting, data should also be relevant to the purpose for which it was collected and of good quality. If there are no requirements on the quality of data, there is the risk that erroneous information may be collected and processed, potentially adversely affecting consumers. **See annex B, “Credit Reporting Systems,”** for further discussion of this topic.

The use of alternative data and big data analytics presents exciting opportunities with respect to financial inclusion but has raised new issues with respect to financial consumer protection—or, rather, the application of existing principles with respect to data protection and privacy to new types of data and data analytics, in particular related to the principles of specific use of collected data, data ownership, and informed consent. The thinking around how best to address these issues is evolving rapidly. As recommended by the ITU-T Focus Group Digital Financial Services, authorities should strive to identify any gaps in the legal and regulatory framework for data protection and privacy with respect to digital financial services. **See D1 in annex A, “Retail Payment Services,”** for further discussion of this topic.

D2: CONFIDENTIALITY AND SECURITY OF CUSTOMERS’ INFORMATION

- a. **Financial service providers should be required to have and implement policies and procedures to ensure confidentiality, security, and integrity of all data stored in their databases that relate to their customers’ personal information, accounts, deposits, deposited properties, and transactions.**
 - b. **In order to ensure confidentiality, when establishing policies and procedures, financial service providers should also establish different levels of permissible access to customers’ data for employees, depending on the role they play within the organization and the different needs they may have to access such data.**
 - c. **In order to maintain the security of customers’ data, financial service providers should also be required to have and implement policies and procedures to ensure security related to networks and databases.**
 - d. **Financial service providers should be held legally liable for misuse of consumer data.**
 - e. **Financial service providers should be held legally liable for any breaches in data security that result in loss or other harm to the customer and should put in place clear procedures to deal with security breaches, including mechanisms to reimburse or compensate consumers.**
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Explanatory Notes

It is critical that the information collected by financial service providers be kept safe, unaltered, and confidential. Security should be in place to protect against unauthorized access to a consumer’s information and any threats or hazards to data security or integrity. Financial service providers should be required to have policies and procedures in place to ensure the privacy and protection of consumer data, and their boards of directors should be held responsible for the effective implementation of such policies. Financial service providers’ staff and agents should be continually and adequately trained in such policies and

procedures. For example, in some developing countries with fast-growing markets for digital financial services, retail agents have been found to be given PINs or passwords by customers in order to facilitate conducting transactions, practices that pose obvious risks to data security. **(See C6 in annex A, “Retail Payment Services.”)**

With regard to data security, many countries, including Colombia, Mexico, and Singapore, have regulations requiring financial service providers to have adequate policies, procedures, and systems in place to ensure the security of their electronic data, including client data. Relevant topics covered include entry of data, alterations,

access, deletion, secure transfers, secure archiving, and back-up systems. Although such rules should be similar for banks and NBFIs, they should be general enough to allow flexibility in implementation by smaller providers as compared to larger ones. Security mechanisms should

cover both electronic and paper-based data. This GP can be regarded as outlining the minimum requirements for banks and other large financial service providers; many countries require more.¹¹⁵

D3: SHARING CUSTOMER INFORMATION

- a. The law should provide rules for the release to and use of customer information by certain third parties such as government authorities, credit registries or credit bureaus, and collection agencies.
- b. Whenever a financial service provider is legally required to share a customer's information with a third party, the provider should be required to inform the customer in writing (including in an electronic form) in a timely manner of
 - i. The third party's precise request;
 - ii. The specific information of the consumer that has been or will be provided; and
 - iii. How and when that information has been or will be provided and how it will be used.
- c. Subject to the exceptions noted in clauses D3(a) and (b), above, without a consumer's prior written consent as to the form and purpose for which their data will be shared, the law should prevent a financial service provider from selling or sharing any of a consumer's information with any third party for any purpose, including telemarketing or direct mailing, unless such third party is acting on behalf of the provider and the information is being used for a purpose that is consistent with the purpose for which that information was originally obtained.
- d. Before any such sharing for the first time, the financial service provider should be required to inform the consumer in writing of his or her data privacy rights in this respect.
- e. Financial service providers should be required to allow consumers to stop or opt out of any sharing by the financial service provider of information regarding the consumers that they previously authorized (unless such sharing is mandated by law).
- f. In the case of tied products, the consumer should be informed if a third party will have access to the consumer's information.
- g. Unless it is a credit bureau or a credit registry, the third party should be prohibited from disclosing the shared information regarding a consumer.

Explanatory Notes

Financial service providers may share customer data with a range of third parties as required by law or for business purposes, including credit registries; a range of government authorities, such as financial sector supervisors, tax authorities, courts, and financial intelligence units; collection agencies; affiliated entities; and marketing companies. The legal and regulatory framework for data privacy applicable to financial service providers should strike a balance between protecting privacy of individual consumers with the need to share such data for outsourcing arrangements and services that require a minimum of data sharing between several parties participating in service delivery, including domestic and cross-border data sharing.

Increasingly, financial services, particularly when targeting low-income consumers, involve a range of entities that may be inside or outside the corporate group of the financial service provider directly responsible for the service. In many instances, several actors will need to access consumer information—for instance, to produce a credit scoring model, design customized communications with a particular consumer, or conduct other types of data analytics. For example, the increasing use of open application programming interfaces (APIs) has the potential to expand the availability of targeted financial products and services offered to consumers by third parties. As the types of entities in the financial services value chain grow, and the types of consumer information sources expand, it

becomes more challenging and complicated to regulate consumer data protection and privacy effectively while balancing potential benefits to financial inclusion. In Mexico, the law protects personal data from third-party sharing, but this has not prevented financial regulators from allowing agency arrangements in which regulated providers hire mobile network operators to manage low-value customer accounts, provided that minimum privacy and security mechanisms are put in place. Considering the increasing adoption of partnerships and outsourcing arrangements in digital financial services, it is important that the regulation keeps financial services providers liable for protecting client data regardless of the number and types of third parties involved in the design, sale, and delivery of services.

Consumer waivers on privacy rights should be designed so that they do not take advantage of consumer behavioral biases, effectively give consumers the choice to share or not share their data, and ensure that consumers understand the consequences of their action. The staff or agent of the financial service provider should explain such a waiver orally to the consumer whenever

possible as required by the consumer. For example, electronic consumer agreements may come with a waiver marked by default that allows the sharing of consumer data with third parties for marketing purposes. Unless the consumer rejects the default waiver, the information will be shared. This type of practice should not be allowed; rather, active consent by the consumer should be required to be obtained. Waivers should also be for specific and limited purposes.

In the event that consumer data need to be shared with government authorities such as the police, prosecutors, tax authorities, or financial sector regulators, specific rules and procedures should be laid out in the law or regulation, including:

- Rules on what the government authority may and may not do with such records
- The exceptions, if any, that apply to these rules and procedures, such as for national security
- The penalties for the financial service provider and any government authority for any breach of these rules and procedures

E: DISPUTE RESOLUTION MECHANISMS

E1: INTERNAL COMPLAINTS HANDLING

- a. Every financial service provider should be required to have an adequate structure in place as well as written policies regarding their complaints handling procedures and systems—that is, a complaints handling function or unit, with a designated member of senior management responsible for this area, to resolve complaints registered by consumers against the provider effectively, promptly, and justly.
- b. Financial service providers should be required to comply with minimum standards with respect to their complaints handling function and procedures. These include the following:
 - i. Resolve a complaint within a maximum number of days, which should not be longer than the maximum period applicable to a third-party external dispute resolution mechanism. (See E2.)
 - ii. Make available a range of channels—telephone, fax, email, web—for submitting consumer complaints appropriate to the type of consumers served and their physical location, including offering a toll-free telephone number to the extent possible, depending on the size and complexity of the financial service provider’s operations.
 - iii. Widely publicize clear information on how a consumer may submit a complaint and the channels made available for that purpose, including on providers’ websites, marketing and sales materials, KFSs, standard agreements, and locations where their products and services are sold, such as branches, agents, and alternative distribution channels. (See B1, “Format and Manner of Disclosure.”)
 - iv. Publicize and inform consumers throughout the complaints handling process, and particularly in the final response to the consumer, regarding the availability of any existing ADR schemes. (See E2.)
 - v. Adequately train staff and agents who handle consumer complaints.
 - vi. Keep the complaints handling function independent from business units such as marketing, sales, and product design, to ensure fair and unbiased handling of the complaints, to the extent possible, depending on the size and complexity of the provider.

- vii. **Within a short period following the date the provider receives a complaint, acknowledge receipt of the complaint in a durable medium—that is, in writing or in another form or manner that the consumer can store—and inform the consumer about the maximum period within which the provider will give a final response and by what means.**
 - viii. **Within the maximum number of days, inform the consumer in a durable medium of the provider’s decision with respect to the complaint and, where applicable, explain the terms of any settlement being offered to the consumer.**
 - ix. **Keep written records of all complaints, while not requiring that the complaint itself be submitted in writing—that is, allow for oral submission.**
- c. **Financial service providers should be required to maintain and make available to the supervisory authority up-to-date and detailed records of all individual complaints.**
 - d. **The financial service provider’s complaints handling and database system should allow the provider to report complaints statistics to the supervisory authority.**
 - e. **Financial service providers should be encouraged to use analysis of complaints information to continuously improve their policies, procedures, and products.**

Explanatory Notes

Financial service providers should be required to have written policies and effective mechanisms and systems for the proper handling and resolution of consumer complaints. The provider should have someone responsible for the operations of the complaints handling function, but the ultimate responsibility for effective implementation of complaints handling policies should fall on its board of directors. Financial service providers, particularly those serving low-income or remotely located consumers, should offer adequate channels (including with respect to working hours) for consumers to register their complaints without undue access and transportation costs or waiting times. Specially tailored channels may also be needed for illiterate consumers, consumers who speak only local dialects, and the speech- or hearing-impaired.

While it is common for providers of digital financial services such as digital credit to operate within the organizational structure of a parent company, such as a mobile network operator, they should be required to assign dedicated and specialized staff and procedures (such as scripts) to handle complaints regarding financial services. The provider should also be able to prioritize phone calls of the two companies separately—that is, digital credit consumers should not be placed on the same waiting list as mobile phone consumers—such as by having a dedicated hotline.¹¹⁶

As providers increasingly leverage alternative distribution channels for product and service delivery, the role of such channels in internal complaints handling should be considered. For example, when financial service providers serve consumers primarily through agents that are closer in physical proximity to the consumer, agents should be properly trained to receive and resolve simple complaints

or to forward the complaint to the financial service providers’ complaints handling unit.

With respect to MFIs, microfinance customers may interact exclusively with a loan officer or agent who collects loan payments and insurance premiums. Since the loan officer is also a salesperson who therefore has influence over the borrower’s ability to obtain future loans, consumers may be reluctant to present complaints to the loan officer or agent. Therefore, providers should ideally offer other channels for complaints, such as via phone, text message, email, website complaint forms, or via staff in branch offices, so that consumers can register complaints, including against agents, branch employees, and loan officers.

As noted in Principle 9 of the G20 FCP Principles, there should be minimum regulatory requirements regarding the internal procedures for handling complaints and the dissemination of related information, and the requirements should be similar across regulated entities offering similar services, such as banks and nonbanks. However, the requirements should be flexible enough or not too burdensome, so smaller providers with less complex operations can also comply with them without incurring disproportionate costs. An example is the requirement for the complaints handling function to be independent—that is, not linked to the business units. This may not be possible in small providers due to limited resources. In such cases, the provider should ensure that complaints are still handled properly, such as through impartial analysis of the case, which in turn requires clear policies and procedures and adequate board support.

The responsibility for resolving complaints in the first instance should rest with the financial service provider. (See A3.) To encourage consumers to place trust in and

seek the provider's internal dispute resolution mechanism first, instead of external channels such as the authority, certain measures may need to be utilized. For example, where feasible, the various agencies receiving consumer complaints could coordinate to create a hierarchical process in which complaints that have not been presented to the financial service provider first cannot be accepted by external channels. For example, the financial supervisor and the consumer protection agency in Peru have coordinated with financial service providers to use a common case file number that is generated by the provider when a customer files a complaint. This number then needs to be presented to the external channel should the customer be unsatisfied with the solution offered by the provider's complaints handling process. Alternatively, if the authority and/or other third parties receive complaints in the first instance, there should be a mechanism through which these complaints are forwarded to financial service providers' complaints handling function.

Providers' complaints handling function should be required to maintain up-to-date records of all complaints, with full information on each complaint, including a record/reference number of the case, the contact details of the complainant, a description of the complaint, its classification within an internal classification system, the investigations carried out by the provider's business units, the communications with the customer, the action taken by the financial service provider, the response to the consumer, copies of other relevant correspondence or records, and whether resolution was achieved and, if so, on what basis. Most providers should be able to acquire a complaints handling and database system, but regulation should be flexible enough to accommodate smaller providers. The information extracted from complaints statistics can, and should be encouraged to, be fed into internal processes to improve the provider's products, services, practices, and documentation, as part of the provider's broader efforts to treat customers fairly.

E2: OUT-OF-COURT FORMAL DISPUTE RESOLUTION MECHANISMS

- a. **If consumers are unsatisfied with the decision resulting from the internal complaints handling at the financial service provider, they should be given the right to appeal, within a reasonable timeframe (for example, 90–180 days), to an out-of-court ADR mechanism that**
 - i. **Has powers to issue decisions on each case that are binding on the financial service provider (but not binding on the consumer);**
 - ii. **Is independent of both parties and discharges its functions impartially;**
 - iii. **Is staffed by professionals trained in the subject(s) they deal with;**
 - iv. **Has an adequate oversight structure that ensures efficient operations;**
 - v. **Is financed adequately and on a sustainable basis;**
 - vi. **Is free of charge to the consumer; and**
 - vii. **Is accessible to consumers.**
- b. **The existence of the ADR mechanism, its contact details, and basic information relating to its procedures should be made known to consumers through a wide range of means, including when a complaint is finalized at the provider level.**
- c. **If the ADR mechanism has a member-based structure, all financial service providers should be required to be members.**

Explanatory Notes

Having out-of-court ADR mechanisms for consumers to seek redress when they are not satisfied with the result of financial service providers' internal complaints handling is very important, as clearly stated in Principle 9 of the G20 FCP Principles. This is particularly the case in the many countries where the judicial system does not work properly for retail consumers, due to being too burdensome, expensive, unreliable, intimidating, or not timely. ADR mechanisms should be in place and follow clear minimum

standards as provided by law or regulation, including those listed above. Such ADR mechanisms should also be monitored—for example, by an independent body such as a board of directors that is accountable to a regulatory or other governmental authority.

When establishing an ADR mechanism for resolving consumers' disputes with financial service providers, policy makers should consider a range of possible models. For instance, ADR mechanisms can be established by industry associations or consumer associations, or be a govern-

ment agency created by law. In many jurisdictions, industry schemes are created under a general legal framework that establishes minimum standards, such as in Australia and Belgium. Industry schemes can play an important role particularly in NBFIs sectors that are unregulated or where regulation and supervision is minimal. There are examples of microfinance SROs or industry associations creating their own industry schemes with support from organizations like the SMART Campaign (for example, MFIN and Sa-Dhan in India, ALAFIA in Benin,¹¹⁷ AMFIU in Uganda¹¹⁸).

As an ADR mechanism becomes more fully operational, formalized, and trusted in a given jurisdiction, it is important that the decisions of the ADR mechanism become binding on financial service providers. Allowing providers to appeal decisions would defeat the purpose of having ADR schemes, as financial service providers could bring consumers through costly and lengthy processes in the court system, where consumers will be highly disadvantaged.

There are also different options for ADR processes and dispute resolution methods. The ADR process may be designed as adversarial, where a final decision depends on the disputing parties' deposition,¹¹⁹ or inquisitorial, where the decision maker plays a more active role in investigating the facts of the case.¹²⁰ Similarly, the process may follow either a facilitative approach, employing conciliation, or an evaluative approach, via arbitration.

The principle of independence is particularly important to ensure that consumers and financial services providers have confidence in ADR mechanisms. The International Network of Financial Services Ombudsman Schemes' *Effective Approaches to Fundamental Principles* states not only that ADR mechanisms need to be independent, but also that the decision-making process should be impartial. While different ADR mechanisms have different governance structures, independence is generally guaranteed by the fact that the public sector (via the regulatory authority or Ministry of Finance), the industry, and consumers are equally represented in the governing body of the relevant ADR mechanism. This should be the case for both statutory schemes, as in Senegal, South Africa, and the United Kingdom, and industry-based schemes, as in Australia, Belgium, and Botswana. Beyond the principles of independence, the EU Directive on ADR for Consumer Disputes (2013/11/EU) contains a useful set of standards applicable to ADR bodies in all sectors. The *Effective Approaches to Fundamental Principles* illustrates approaches that have worked in financial ADR mechanisms around the world, including in developing economies such as Armenia, Botswana, and South Africa, to deliver the principles of independence (to ensure impartiality), clarity of scope and powers accessibility, effectiveness, fairness, transparency, and accountability.

There are also multiple options for funding ADR mechanisms. Funding may be provided from public sources, private sources, or a combination of the two. In the case of public funding, funds may be allocated by the central government—that is, out of taxation, as in Lithuania—or from the budget of a specific government authority, such as the central bank or other financial regulators—that is, out of their budgets, as in Spain and Poland. In the case of private funding, an ADR scheme may be funded by an industry association, its members, or the members of the ADR scheme itself, as in Armenia, Australia, Canada, the Channel Islands, Finland, France, Germany, Ireland, the Netherlands, New Zealand, Slovakia, Trinidad and Tobago, and the United Kingdom. However, funding should not come from the fees of consumers. Beyond trivial and minimal fees, which in rare instances are charged to consumers, it is important that consumers are not charged a fee to use the ADR mechanism, as one of the fundamental objectives of ADR mechanisms is that they should be accessible to low-income consumers.

Whatever funding arrangement is chosen, it should be sufficient to ensure that the ADR mechanism can meet its goals and efficiently and effectively exercise its mandate. In practice, this means that it is essential that the ADR mechanism has the offices, physical inventory (such as office furniture, computers, and a file registry), and the information and communications technology that it requires to be successful. The ADR mechanism should also have sufficient resources to be able to select, employ, and retain experienced and independent staff and to provide them with ongoing training. The ADR mechanism will also need to develop strategies to ensure accessibility to consumers, such as by providing for online dispute resolution, multiple channels to file complaints, and multiple languages for communications.

The option to appeal to an ADR mechanism should be clearly communicated to consumers during the first instance, when consumers are dealing with the complaints handling function at the provider level, so that they are aware that they do not need to accept any offer from a provider that is considered unsatisfactory out of ignorance of the availability of the ADR mechanism's services.

Arbitration mechanisms may also be in place that could be used by consumers. However, the compulsory use of arbitration should ideally be prohibited. Consumers should not be obliged to use such mechanisms and forgo their right to go to court. The CFPB in the United States recently issued a comprehensive study that found that arbitration clauses in consumer agreements limit consumer redress choices, as most consumers do not seek to go to arbitration or court.¹²¹ The study also found that consumers did not realize that arbitration clauses limited their right to go to court.

F: GUARANTEE SCHEMES AND INSOLVENCY

F1: DEPOSITOR PROTECTION

- a. The law should ensure that the financial safety net—that is, a deposit insurance system, if existing, the regulator or supervisor, and the resolution authority, if existing—can take necessary measures to protect depositors when a deposit-taking financial service provider is unable to meet its obligations, including the return of deposits.
- b. If there is a law on deposit insurance, it should clearly state
 - i. the mandate and powers of the deposit insurer(s);
 - ii. the scope of depositors who are insured (for example, natural persons, legal persons);
 - iii. the types of financial instruments that are insured;
 - iv. the deposit insurance coverage level limits;
 - v. the mandatory membership of all deposit-taking financial service providers;¹²²
 - vi. the creation of an ex ante financed fund for payout purposes;
 - vii. the contributing institutions to this fund and clear back-up financing arrangements;
 - viii. the events that will trigger a payout from this fund to insured depositors; and
 - ix. the mechanisms and the timeframe to ensure timely payout to insured depositors.
- c. Directly and through insured institutions, the deposit insurer(s) should promote public awareness of the deposit insurance system on an ongoing basis.
- d. The public should be informed of the scope of depositors and types of financial instruments that are insured (and those that are not), the institutions that are members of the deposit insurer(s) and how they can be identified, the coverage level, the mandate of the deposit insurer(s), the reimbursement process, and the benefits and limitations of the deposit insurance system.
- e. In the event of a failure of a member institution, the deposit insurer(s) must notify depositors where, how, and when insured depositors will be provided with access to their funds.
- f. The deposit insurer(s) should work closely with member institutions and other safety-net participants to ensure consistency and accuracy in the information provided to depositors and consumers and to maximize public awareness on an ongoing basis. Law or regulation should require member institutions to provide information about deposit insurance in a format and language prescribed by the deposit insurer(s).
- g. The deposit insurer(s) should have in place a comprehensive communication program and conduct a regular evaluation of the effectiveness of its public awareness program or activities.

Explanatory Notes

Policy makers have choices regarding how to protect depositors and contribute to financial system stability. Explicit, limited-coverage deposit insurance (a deposit insurance system), which is prefunded by member institutions, has become the preferred choice compared to reliance on implicit protection. A deposit insurance system clarifies the authority's obligations to depositors, contributes to financial stability, can promote public confidence, helps to contain the costs of resolving failed institutions, and can, depending on its design, provide an orderly process for dealing with the failures of deposit-taking financial institutions.

The introduction or the reform of a deposit insurance system can be more successful when a country's financial system is healthy and its institutional environment is sound. In order to be credible, a deposit insurance system needs to be part of a well-constructed financial system safety net, properly designed, and well implemented. It also needs to be supported by strong prudential regulation and supervision, the enforcement of effective laws, including a special bank resolution framework, and sound accounting and disclosure regimes.

To be effective, the deposit insurance system needs a clearly defined mandate and the powers necessary to fulfill its roles and responsibilities, such as assessing and col-

lecting premiums as well as using a range of tools to reimburse depositors. A deposit insurance system should be able to reimburse depositors' insured funds promptly, which means within seven working days. If the deposit insurer(s) cannot currently meet this target, a credible plan to do so should be in place. A high level of public awareness about deposit insurance, its benefits, and its limitations is essential to protect depositors and contribute to financial stability. The deposit insurer(s) should be responsible for promoting public awareness of the deposit insurance system on an ongoing basis and as part of a comprehensive communication program.

A deposit insurance system should be able to deal with a limited number of simultaneous failures of deposit-taking financial institutions, but the resolution of a systemic banking crisis requires that all financial system safety-net participants work together effectively. Funding for the deposit insurance system should be provided on an ex ante basis, before any failure of a deposit-taking financial institution, and the responsibility of funding the deposit insurance system should be primarily with its member institutions. Emergency funding arrangements such as prearranged and assured sources of liquidity funding should be set out explicitly in law or regulation.

Deposit insurers should make efforts to stay abreast of technological innovations occurring in their jurisdictions, particularly those regarding digital stored-value products. Considering the multitude of new types of deposit or deposit-like products managed by nonbank providers, or new types of accounts managed by banks that are classi-

fied differently from traditional deposit accounts, it is important to ensure that consumers are made aware of the coverage (or lack of thereof) and the terms of deposit insurance or other protection. Where customers are able to transfer their uninsured values promptly to insured accounts, they should also be clearly informed about the differences between both products.¹²³ **See also C7, "Protection and Availability of Customer Funds"** in Annex A, "Retail Payment Services."

Policy makers should consider different approaches to deposit insurance treatment of such products, including (i) an exclusion approach, whereby such products are explicitly excluded from deposit insurance coverage, although other measures to protect customers' stored value may be adopted; (ii) a direct approach, whereby such products are directly insured by a deposit insurer and their providers must become members of the deposit insurance system; or (iii) a pass-through approach, whereby deposit insurance coverage passes through a custodial account at an institution that is a deposit insurance member and holds funds from digital stored-value products to the benefit of each individual customer of the provider of the products, although this provider is not a deposit insurance member.¹²⁴

The Core Principles for Effective Deposit Insurance Systems issued by the International Association of Deposit Insurers in November 2014, the EU Directive on Deposit Guarantee Schemes 2014/49/EU, and the FSB Thematic Review on Deposit Insurance Systems provide guidance for this GP.¹²⁵

F2: BANKRUPTCY OF INDIVIDUALS

- a. **A financial service provider should inform its individual customers in a timely manner and in writing on what basis the provider will seek to render a customer bankrupt, the steps it will take in this respect, and the consequences of any individual's bankruptcy.**
- b. **Every individual customer should be given adequate notice and information by the financial service provider to enable the customer to avoid bankruptcy.**
- c. **Either directly or through industry associations, financial service providers should be encouraged to make counseling services available to customers who are bankrupt or likely to become bankrupt.**
- d. **The law should enable individuals to**
 - i. **Declare their intention to present a debtor's petition for a declaration of bankruptcy;**
 - ii. **Propose a debt agreement;**
 - iii. **Propose a personal bankruptcy agreement;**
 - iv. **Enter into voluntary bankruptcy;**
 - v. **Exclude certain assets from the bankruptcy process if they are required to provide for the basic needs of the individual;**
 - vi. **Be discharged from bankruptcy and its associated debts (subject to reasonable exclusions) after a reasonable period of time; and**
 - vii. **Protect the individual from unreasonable or criminal sanctions (absent fraud) for declaring bankruptcy.**

- e. **Any institution acting as the bankruptcy office or trustee responsible for the administration and regulation of the personal bankruptcy system should provide adequate information to consumers on their options to deal with their own debt and rehabilitation process in the event of bankruptcy.**

Explanatory Notes

Bankruptcy carries serious implications for an individual and can have a significant negative impact on a person's social and economic standing. In many countries, being declared bankrupt also entails travel restrictions and a prohibition on being named to official positions and participating in certain economic activities.

In some countries, customers of financial service providers who default on their loans have little knowledge of the likelihood of being declared bankrupt and its consequences to their lives. In general, it is good practice to have personal bankruptcy laws/regimes in places. In many countries, the process lacks transparency; consumers may not even know that they have been declared bankrupt until their subsequent application for a credit has been turned down. By making counseling available to those

who are likely to become bankrupt, consumers may be able to avoid bankruptcy or at least manage the process better. For example, in Portugal, the legal framework establishes specific requirements to deal with pre-arrears and arrears situations, including requiring that providers develop a pre-arrears action plan in order to track pre-arrears indicators and assist customers in dealing with difficulties in repayment. In many countries, debtors either are unable to shield assets needed for their basic needs from bankruptcy or are unable to be discharged of their debts, leaving them indebted in perpetuity. The law also ought to provide for a rehabilitation process for bankrupt persons, if possible.¹²⁶

The World Bank's Report on the Treatment of Insolvency of Natural Persons and Best Practices in the Insolvency of Natural Persons provide guidance for this GP.¹²⁷

F3: INSOLVENCY OF FINANCIAL INSTITUTIONS

- a. **Depositors should enjoy higher priority than other unsecured creditors in the liquidation process of a financial service provider.**
- b. **The law dealing with the insolvency of financial service providers should provide for expeditious, cost-effective, and equitable provisions to enable the maximum timely refund of deposits to depositors.**

Explanatory Notes

The BIS Supervisory Guidance on Dealing with Weak Banks, the EU Directive on Deposit Guarantee Schemes (1994/19/EC), and the key conclusions of the Asia-Pacific Economic Cooperation Policy Dialogue on Deposit Insurance in 2005 provide guidance and background for this GP.

NOTES

1. See “FinTech Credit: Market Structure, Business Models and Financial Stability Implications,” a report prepared by a working group established by the Committee on the Global Financial System and the Financial Stability Board (FSB, 2017). See also “The Proliferation of Digital Credit Deployments” (CGAP, 2016), <http://www.cgap.org/publications/proliferation-digital-credit-deployments>.
2. See, for example, *Best Practices and Recommendations for Financial Consumer Protection* (Association of Supervisors of Banks of the Americas, 2012), 17, available at <http://www.asbasupervision.com/en/bibl/publications-of-asba/working-groups/303-if17/file>.
3. Some countries may use such a specialized law to create a regulatory agency dedicated to financial consumer protection (for example, Canada, Mexico, South Africa, and the United States) or to clarify or expand powers of an existing financial authority that also has other mandates, such as prudential supervision (for example, Belgium, Colombia, Netherlands, Peru, South Africa, and the United Kingdom). Note that South Africa is mentioned as having a dedicated agency for financial consumer protection, although the agency, the National Credit Regulator, covers only retail credit markets. South Africa is currently undergoing a major institutional reform to implement a “twin peaks” approach to financial sector supervision, under which the prudential supervisor will be separate from the market conduct supervisor. A dedicated financial conduct authority will be created and become responsible for market conduct in relation to most financial products, except credit, which will remain under the National Credit Regulator. For details, see *Twin Peaks in South Africa: Response and Explanatory Document Accompanying the Second Draft of the Financial Sector Regulation Bill* (National Treasury of the Republic of South Africa, 2014), available at <http://www.treasury.gov.za/public%20comments/FSR2014/2014%2012%2012%20Response%20document.pdf>.
4. G20 High-Level Principles on Financial Consumer Protection (OECD, 2011).
5. In Canada, the Financial Consumer Agency of Canada covers federally regulated financial institutions. Other providers may or may not be covered by provincial laws and supervisors, including insurance supervisors. See “Our Mandate” (Financial Consumer Agency of Canada) available at <http://www.fcac-acfc.gc.ca/Eng/about/Pages/OurManda-Notreman.aspx>. In Colombia, the Financial Consumer Protection Regime (which comprises Title I of Law 1328 of 2009) covers institutions regulated and supervised by the Financial Superintendence. In Mexico, the Financial Consumer Protection Law covers any entity providing financial services if it is required to obtain authorization to operate from the Ministry of Finance or any other financial regulatory authority. In Peru, the Financial Consumer Protection Law covers institutions that are regulated and supervised by the Superintendence of Banks, Insurance and Pension Funds. In Mexico, the Financial Consumer Protection Law covers providers of financial services that are required to obtain authorization to operate from the Ministry of Finance or any financial regulatory authority.
6. The meaning of the term *license* varies widely across countries, but it is used in this chapter to refer to permission to operate given by a financial sector authority based on the evaluation of an application presented by the financial service provider. Without a license, the financial service provider cannot operate. The provider also cannot cease operations without prior approval by the authority. Licensed providers are included in a register maintained by the authority.
7. The meaning of the term *registration* also varies across countries. The term is used in this chapter to refer to the notification (which may be required by law or regulation) by a financial service provider to a financial sector authority informing the authority that the provider is operating. The information to be provided, and whether registration entails any type of regular reporting, varies across countries. Providers that are only registered (as opposed to licensed) can usually cease operations without prior approval of the authority, though they may be required to notify the authority within a specified timeframe.
8. In fact, many central banks require some type of registration and collect data at least from large nonbank credit providers as part of their macro-prudential oversight (shadow banking monitoring) or for other reasons. Registration is also common in the retail payments industry and for agents of regulated financial institutions, such as insurance, investment, and pension agents.
9. See, for instance, requirements for financial service providers seeking a license to operate from the Australian Securities and Investment Commission, available at <http://download.asic.gov.au/media/3278613/rg2-published-1-july-2015.pdf>.
10. See the BCBS’s discussion on a graduated approach to licensing to accommodate market developments, in “Guidance on the Application of the Core Principles for Effective Banking Supervision to the Regulation and Supervision of Institutions Relevant to Financial Inclusion” (BCBS, 2016), 9–10.
11. In this context, regulatory arbitrage would be a situation where NBFIs keep their operations just under the threshold that would require them to be supervised.
12. Such as the “Model Law for Financial Consumer Protection” (Microfinance CEO Working Group, 2015), based on the Smart Campaign’s Client Protection Principles, which were developed for the microfinance sector.
13. One approach is the so-called twin peaks model, where one authority deals with prudential regulation and supervision pertaining to banks (and possibly other financial institutions) and a separate authority is responsible for the regulation and supervision of the business conduct of banks (and possibly other financial institutions and even nonfinancial firms providing certain financial products and services). This model—with variations regarding the mandate and remit of the market conduct authority—is employed by Australia, Belgium, France, the Netherlands, and the United Kingdom and is anticipated in South Africa.
14. “Financial Services and Markets Act 2000: Memorandum of Understanding between the Financial Conduct Authority and the Bank of England, including the Prudential Regulation Authority” (March 2015), available at <http://www.fca.org.uk/your-fca/documents/mou/mou-between-the-fca-and-the-pracoordination>.

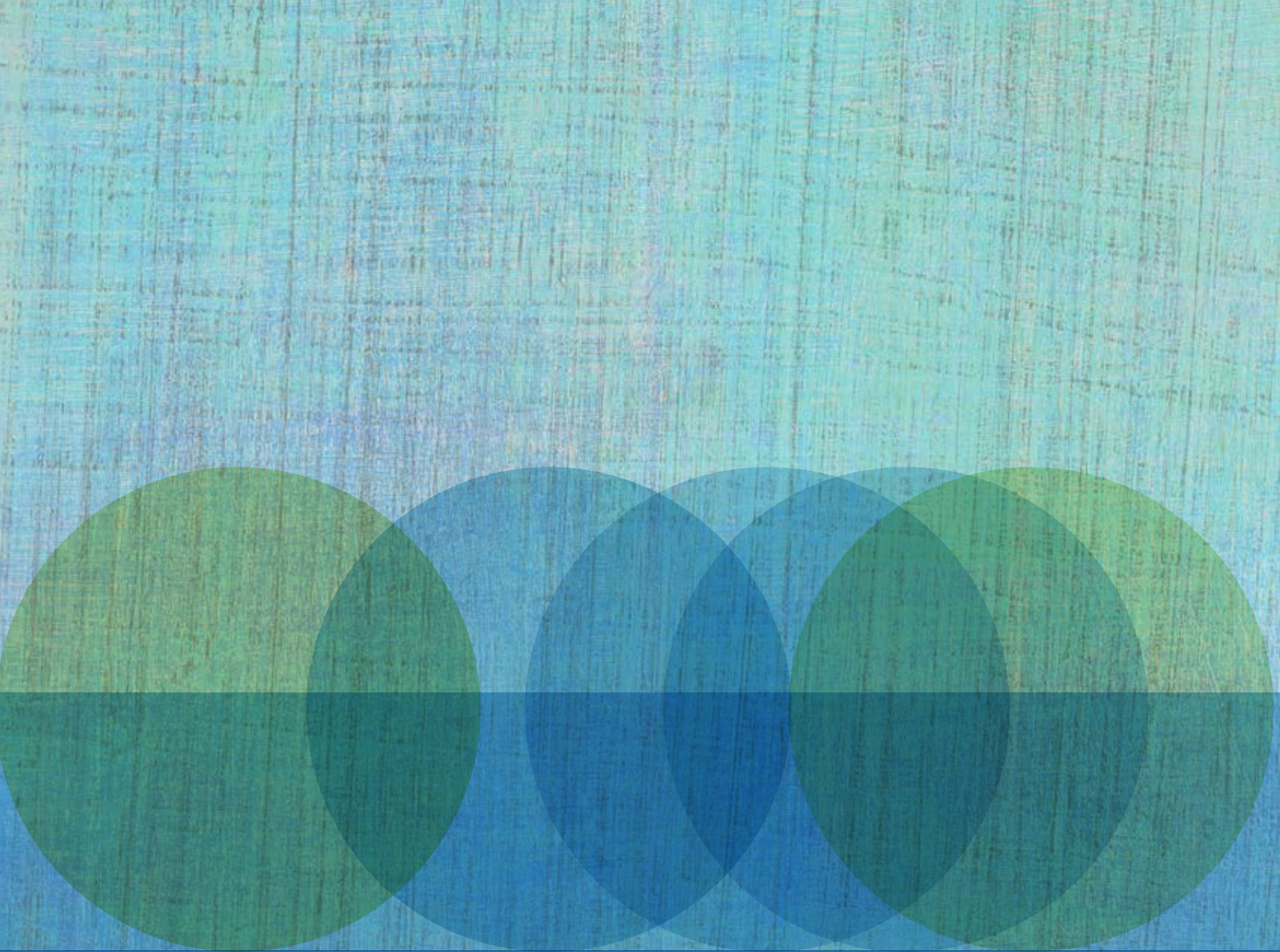
15. <http://www.apra.gov.au/AboutAPRA/Documents/ASIC-MoU.pdf>.
16. Australian Competition and Consumer Commission, <https://www.accc.gov.au>.
17. Administrative Council for Economic Defense, <http://www.cade.gov.br>.
18. Competition Superintendence of El Salvador, <http://www.sc.gob.sv/home>.
19. Competition Commission of Singapore, <https://www.ccs.gov.sg>.
20. One of the recommendations of the Consumer Experience and Protection Working Group of the ITU-T Focus Group Digital Financial Services is for regulators to work in collaboration to harmonize coverage of different providers of digital financial services. This is in line with the G20 High-Level Principles for Financial Consumer Protection, which also calls for cooperation between regulators of the financial and nonfinancial sectors. See ITU-T Focus Group Digital Financial Services, *Consumer Experience and Protection* (ITU, 2017).
21. See, generally, "International Consumer Organisations," http://ec.europa.eu/consumers/eu_consumer_policy/consumer_consultative_group/international_consumer_organisations/index_en.htm.
22. See, for example, the European Commission's Financial Services User Group, http://ec.europa.eu/finance/finservices-retail/users/index_en.htm.
23. This is specifically advocated by the ITU-T Focus Group Digital Financial Services in *Consumer Experience and Protection* (ITU, 2017).
24. See also Jeanne M. Hogarth and Ellen A. Merry, "Designing Disclosures to Inform Consumer Financial Decisionmaking: Lessons Learned from Consumer Testing," *Federal Reserve Bulletin* 97, no. 3 (August 2011). <http://www.federalreserve.gov/pubs/bulletin/2011/pdf/designingdisclosures2011.pdf>.
25. See, for example, FCA, "FCA Publishes Occasional Papers on Behavioural Economics Exploring How People Make Financial Decisions," press release, April 10, 2013, <http://www.fca.org.uk/news/fca-publishes-occasional-papers-on-behavioural-economics>.
26. ITU-T Focus Group Digital Financial Services, *Consumer Experience and Protection* (ITU, 2017).
27. "Treating customers fairly" is a regulatory and supervisory approach that aims to raise the standards in the way providers carry out their business centered around fair outcomes for consumers, which are then used as the basis around which providers design operations that lead to such outcomes.
28. The ITU-T Focus Group Digital Financial Services gives specific recommendations for supervision of digital financial services with respect to consumer protection and experience, such as taking a harmonized approach to agents of banks and NBFIs. See *Consumer Experience and Protection* (ITU, 2017).
29. The weaknesses in banks' risk data aggregation and reporting were largely revealed in the wake of the recent global financial crisis, as pointed out in Basel Committee on Bank Supervision, "Principles for Effective Risk Data Aggregation and Risk Reporting" (BCBS, 2013), available at <http://www.bis.org/publ/bcbs239.pdf>. Although the principles are designed for internationally active banks, some of them could be useful for any type and size of regulated financial service provider, to ensure quality regulatory reporting to the supervisory authority.
30. See Denise Dias, *Implementing Consumer Protection in Emerging Markets and Developing Economies: A Technical Guide for Bank Supervisors* (Washington, DC: CGAP, 2013). Available online at <http://www.cgap.org/publications/implementing-consumer-protection>.
31. Mystery shopping involves sending individuals posing as normal consumers to provider outlets to simulate a typical consumer/provider interaction to assess the behavior of provider staff. See Rafe Mazer, Xavier Gine, and Cristina Martinez, *Mystery Shopping for Financial Services: What Do Providers Tell, and Not Tell, Customers about Financial Products?* (Washington, DC: CGAP, 2015). Available online at <http://www.cgap.org/sites/default/files/Technical-Guide-Mystery-Shopping-for-Financial-services-Oct-2015.pdf>.
32. <http://www.hkma.gov.hk/eng/key-information/press-releases/2011/20110524-4.shtml>.
33. In order to deal with a significant increase in the number of regulated entities, the FCA recently reformed its previous tiered approach to conduct supervision. As of February 2016, regulated entities are divided into two groups: "fixed portfolio firms," which have dedicated supervisory teams, and "variable portfolio firms," which do not have supervisory teams assigned to them. Entities in the variable portfolio are subject only to reactive—that is, event-driven—supervision and thematic, cross-sector analyses.
34. The United Kingdom's FCA approach to enforcement is described in two documents: *Decision Procedure and Penalties Manual* and *The Enforcement Guide* (FCA 2016). Both are available online at <http://www.fca.org.uk/firms/being-regulated/enforcement/how-we-enforce-the-law>. The approach adopted by the Central Bank of Ireland is found online at <http://www.centralbank.ie/regulation/processes/Enfl/Pages/Introduction.aspx>. ASIC's approach is found online at <http://asic.gov.au/about-asic/asic-investigations-and-enforcement/asic-s-approach-to-enforcement/>.
35. See "Code of Banking Practice," issued by the Hong Kong Association of Banks and the DTC Association and endorsed by the Hong Kong Monetary Authority (DTC Association, February 2015), at http://www.hkma.gov.hk/media/eng/doc/code_eng.pdf.
36. See "Banking Code for Consumer Protection," prepared by the Bankers Association of the Philippines in conjunction with four other relevant associations and the Chamber of Thrift Banks (January 2011).
37. See "The Code of Banking Practice" in effect as of January 1, 2012 (Banking Association of South Africa).
38. *Best Practices and Recommendations for Financial Consumer Protection* (Association of Supervisors of Banks of the Americas, 2012), 17. https://wbg.app.box.com/files#/files/0/f/2420840753/1/f_20723074807?&_suid=1428332743974018286119713275228.
39. Not only is the Single Banking Circular a compilation of regulations, it can also be used as a substitute text, as it abrogates what is not relevant, reorders, and reclassifies the content from different regulations.
40. See compilation of consumer credit policy and regulations compiled by the United Kingdom's FCA at www.fca.org.uk/firms/firm-types/consumer-credit.

41. <http://asic.gov.au/online-services/search-asics-registers/>.
42. <https://www.bportugal.pt/en-US/Supervisao/Pages/Instituicoesautorizadas.aspx>.
43. http://www.ncr.org.za/register_of_registrants/registered_cp.php.
44. <http://clientebancario.bportugal.pt/pt-PT/Publicacoes/RAI/Paginas/RAI.aspx>.
45. See <http://www.consumerfinance.gov/complaintdatabase/>.
46. See <http://www.bcb.gov.br/?ranking> (in Portuguese).
47. <http://www.centralbank.ie/regulation/processes/Enfl/Pages/Introduction.aspx>.
48. <http://www.mas.gov.sg/news%20and%20publications/enforcement%20actions.aspx>.
49. <http://www.fca.org.uk/firms/being-regulated/enforcement/outcomes-notices>.
50. <http://www.consumerfinance.gov/newsroom/consumer-financial-protection-bureau-takes-action-against-payday-lender-for-robo-signing/>.
51. <http://www.afm.nl/en/consumer.aspx>.
52. <http://www.sbs.gob.pe/usuarios>.
53. <http://mymoneybox.mfsa.com.mt/>.
54. <http://clientebancario.bportugal.pt/pt-PT/Paginas/inicio.aspx>.
55. <https://www.abcfinance.am/finhelper/>.
56. G20/OECD Task Force on Financial Consumer Protection, "Update Report on the Work to Support the Implementation of the G20 High-Level Principles on Financial Consumer Protection, Principles 4, 6 and 9" (OECD, 2013).
57. Section 64 of South Africa's National Credit Act 34 of 2005, which covers credit products.
58. This price comparison tool is available on the regulator's website at <http://www.sbs.gob.pe/app/retasas/paginas/retasasInicio.aspx#>.
59. In 2006, the Bank of Italy developed seven different user profiles (such as young user, family with low usage, and retiree with median usage), with a specified pattern of account usage for each user profile. Financial service providers are required to identify in advance the profiles that an account product is most suitable for and to display related comprehensive cost indicators in KFSs to potential customers.
60. See ITU-T Focus Group Digital Financial Services, *Consumer Experience and Protection* (ITU, 2017).
61. Directive 2008/48/EC of the European Parliament and of the Council on April 23, 2008, on credit agreements for consumers.
62. A useful reference on electronic delivery of disclosure documents and the shift to electronic disclosure as the default format of disclosure in Australia can be found at "Facilitating Electronic Financial Services Disclosures," Consultation Paper 224 (Australian Securities and Investment Commission, November 2014).
63. ITU-T Focus Group Digital Financial Services, *Consumer Experience and Protection* (ITU, 2017).
64. See Jeanne M. Hogarth and Ellen A. Merry, "Designing Disclosures to Inform Consumer Financial Decisionmaking: Lessons from Consumer Testing," *Federal Reserve Bulletin* 97, no. 3 (August 2011).
65. See, for example, Rafe Mazer, Katharine McKee, and Alexandra Fiorillo, "Applying Behavioral Insights in Consumer Protection Policy," *Focus Note 95* (CGAP, June 2014). See also, generally, Marianne Bertrand, Sendhil Mullainathan, and Eldar Shafir, "A Behavioral Economics View of Poverty," *American Economic Review* 94, no. 1 (2004), 419–423, and Saugato Datta and Sendhil Mullainathan, "Behavioral Design: A New Approach to Development Policy," Policy Paper 016 (Washington, DC: Center for Global Development, 2012). See further Michael Barr, Sendhil Mullainathan, and Eldar Shafir, "Behaviorally Informed Financial Services Regulation," Asset Building Program Policy Paper (New America Foundation, 2008), and Daryl Collins, Nicola Jentzsch, and Rafael Mazer, "Incorporating Consumer Research into Consumer Protection Policy Making," *Focus Note 74* (CGAP, November 2011).
66. See Notice 10/2008, Banco de Portugal.
67. The CFPB developed the rules over a two-year period that included external consultations and consumer research. As the new rules also had a significant impact on providers who needed to adapt their systems and retrain their staff, the rules were programmed to be effective two years after their issuance. See analysis in "CFPB Mortgage Disclosure Rules: An Analysis of the Consumer Financial Protection Bureau's 'Know Before Your Owe' Disclosure Forms" (PwC, 2014), available at www.pwc.com/consumerfinance. See also "Final Rule on Simplified and Improved Mortgage Disclosures: Detailed Summary of the Rule" (Consumer Financial Protection Bureau, 2013), available at http://files.consumerfinance.gov/f/201311_cfpb_tila-respa_detailed-summary.pdf.
68. See "On the Approval of Resolution 8/05 on 'Procedure, Terms, Forms and the Minimum Requirements for Communication Between Bank and Depositor, Creditor and Consumer'" (Central Bank of the Republic of Armenia, 2009), available at https://www.cba.am/EN/laregulations/Regulation%208_05_eng.pdf.
69. Standardized statements are available for banking accounts, deposits, loans, and credit lines at https://www.cba.am/EN/laregulations/Regulation%208_05_eng.pdf.0.
70. For example, this protects NBFIs credit providers from arbitrary political interference on interest-rate levels or even abuse by consumers who seek to void loan contracts, alleging that the price was too high. However, the courts in some EU countries such as Poland and Spain have nullified contract termination fees that were considered abusive, having no real relationship to expenses.
71. Act Concerning the Regulation of the Law of Standard Business Terms.
72. The Unfair Contract Terms Act (1977), which was substituted by the Unfair Terms in Consumer Contracts Regulations (1994 and 1999), after adoption of the EU Unfair Terms in Consumer Contracts Directive.
73. See ITU-T Focus Group Digital Financial Services, *Consumer Experience and Protection* (ITU, 2017).
74. See the Credit Card Act of 2009 and Regulation Z (Truth in Lending).
75. "Tying of two products (or services) occurs when a seller sells one good (tying good) on the condition that the buyer buys the other good (tied good) from that seller or imposes on the buyer the requirement that s/he will not purchase the other good from another seller. Bundling is a general

- term describing selling collections of goods as a package. In pure bundling, the individual goods are not sold separately but only in combination, so it is essentially equivalent to tying. In mixed bundling, the individual goods, as well as the package, are available." See the *Palgrave Encyclopedia of Strategic Management*, available at http://www.stern.nyu.edu/networks/Economides_Bundling_and_Tying.pdf.
76. For these reasons, product tying by one or more financial institutions in a particular EU member state may constitute an exclusionary abuse of dominance under Article 102 of the Treaty establishing the European Community (EC Treaty), where such institutions have a dominant position.
 77. See ITU-T Focus Group Digital Financial Services, *Consumer Experience and Protection* (ITU, 2017).
 78. See, for instance, Australia's ASIC's guide for financial consumers to avoid high-pressure sales tactics at <https://www.moneySMART.gov.au/borrowing-and-credit/borrowing-basics/avoiding-sales-pressure>, and further sales practices exploiting consumer vulnerabilities that should be specifically avoided in G20/OECD Task Force on Financial Consumer Protection, "Update Report on the Work to Support the Implementation of the G20 High-Level Principles on Financial Consumer Protection, Principles 4, 6, and 9" (OECD, 2013).
 79. "FinCoNet Report on Responsible Lending: Review of Supervisory Tools for Suitable Consumer Lending Practices" (FinCoNet, July 2014).
 80. For instance, see "Credit Licensing: Responsible Lending Conduct," Regulatory Guide 209 (ASIC, 2009).
 81. See "Basel Core Principles for Effective Banking Supervision and Microfinance Activities" (BCBS, 2010), available online at <http://www.bis.org/bcbps/publ/d351.htm>.
 82. For instance, in several countries, financial service providers extend credit over mobile phones, the Internet, or in person based on new credit scoring models that use alternative data (for example, social media, bill-payment history, mobile airtime consumption history, e-commerce data, psychometric data). Although such practices may not conform with current requirements regarding minimum information to be gathered to assess suitability for prospective customers, they may still result in good consumer outcomes. This area will likely require ongoing monitoring and analyses by policy makers to determine what appropriate policy responses may be needed.
 83. In addition, some countries have stepped up their monitoring of household indebtedness levels. For example, in Peru, financial regulators have engaged with the National Institute of Statistics to improve data on this topic.
 84. "FinCoNet Report on Responsible Lending: Review of Supervisory Tools for Suitable Consumer Lending Practices" (FinCoNet, July 2014).
 85. As with consumer agreements, some supervisors impose an approval process before each new product is launched in the market. Although this may help supervisors to identify inadequate product features, it may impose an obstacle to market development and financial inclusion while also entailing a significant burden on supervisory resources.
 86. The guidelines are based on EU Regulation 1093/2010 and become applicable from January 2017. See European Banking Authority, "Guidelines on Product Oversight and Governance Arrangements for Retail Banking Products" (EBA, 2016), available online at <https://www.eba.europa.eu/documents/10180/1141044/EBA-GL-2015-18+Guidelines+on+product+oversight+and+governance.pdf>.
 87. See "Code of Conduct on the Switching of Current Accounts with Credit Institutions" (Central Bank of Ireland, 2010, as updated in 2016), available online at <http://www.centralbank.ie/regulation/processes/consumer-protection-code/Pages/codes-of-conduct.aspx>. See also EU Directive on Basic Accounts.
 88. See, for instance, Lebogang Nleya and Genna Robb, "Mobile Money Monopolies in Kenya and Zimbabwe: Where Should the Balance with Rivals Be?" *Mail and Guardian Africa*, November 20, 2014, <http://mgafrika.com/article/2014-11-19-mobile-money-monopolies-in-kenya-and-zimbabwe>, and "Competition and Financial Markets: Key Findings" (OECD, 2009), available online at <http://www.oecd.org/daf/competition/43067294.pdf>.
 89. Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the Protection of Natural Persons with Regard to the Processing of Personal Data and on the Free Movement of Such Data, and Repealing Directive 95/46/EC (General Data Protection Regulation), to become effective May 25, 2018.
 90. See further discussion in ITU-T Focus Group Digital Financial Services, *Consumer Experience and Protection*, (ITU, 2017).
 91. Note that some countries consider these entities "agents," while others regard them as another third-party service provider. In both cases, the role of regulation is important to keep the financial institution liable for the actions of these entities, regardless of the number of intermediaries that exist between the institution and the consumer.
 92. ITU-T Focus Group Digital Financial Services, *Consumer Experience and Protection* (ITU, 2017).
 93. Other examples of problems that can arise from the use of agents are found in Katharine McKee, Michelle Kaffenberger, and Jamie M. Zimmerman, "Doing Digital Finance Right: The Case for Stronger Mitigation of Customer Risks," *Focus Note 103* (CGAP, June 2015).
 94. FCA's Remuneration Codes are available online at www.fca.org.uk/firms/being-regulated/remuneration-codes.
 95. See a list of country examples in http://www.financialstabilityboard.org/wp-content/uploads/r_120709.pdf.
 96. See "FSB Principles for Sound Compensation Practices" (FSP, 2009) at <http://www.financialstabilityboard.org/what-we-do/policy-development/building-resilience-of-financial-institutions/compensation/> and BCBS, "Compensation Principles and Standards Assessment Methodology" (Bank for International Settlements, 2009), at <http://www.bis.org/publ/bcbps166.pdf>.
 97. See *A Guide to Regulation and Supervision of Microfinance: Consensus Guidelines* (CGAP, 2012), available at <http://www.cgap.org/publications/guide-regulation-and-supervision-microfinance>; Michael W. Krell and Micol Pistelli, "An Examination of Field Staff Compensation and Incentive Structure at Indian MFIs Intended to Shed Light on Allegations Regarding Loan Payment Collection Practices in India" (Microfinance Information Exchange, 2010); and "Corporate Governance in Financial Institutions and Remuneration Policies," green paper (European

- Commission, 2010), available online at <http://www.microfinancegateway.org/library/corporate-governance-financial-institutions-and-remuneration-policies>.
98. See Katharine McKee, Michelle Kaffenberger, and Jamie M. Zimmerman, "Doing Digital Finance Right," *Focus Note* 103 (CGAP, June 2015), available at <http://www.cgap.org/publications/doing-digital-finance-right>.
 99. ITU-T Focus Group Digital Financial Services, *Consumer Experience and Protection* (ITU, 2017). The ITU also asks for digital financial services providers to have a robust security and fraud-detection management, and mitigation measures and procedures, that should be assessed by the supervisor at the time of licensing and on an ongoing basis.
 100. <http://www.bis.org/publ/bcbs292.pdf>.
 101. See Lara Gilman and Michael Joyce, *Managing the Risk of Fraud in Mobile Money* (Mobile Money for the Unbanked, 2012), available online at www.gsma.com/mobilefordevelopment/wp-content/uploads/2012/10/2012_MMU_Managing-the-risk-of-fraud-in-mobile-money.pdf; *Fraud in Mobile Money* (MicroSave), available at <http://www.gsma.com/mobilefordevelopment/a-closer-look-at-the-risk-of-fraud-in-mobile-financial-services>; and *Mobile Financial Services Working Group, Mobile Financial Services: Consumer Protection in Mobile Financial Services* (Alliance for Financial Inclusion, 2014), available at <http://asbaweb.org/E-News/enews-37/inclin/06inclin.pdf>.
 102. The toolkit can be found online at http://www.ifc.org/wps/wcm/connect/industry_ext_content/ifc_external_corporate_site/industries/financial+markets/publications/toolkits/mobilemoney_toolkit1.
 103. "Fraud," chapter 4 in *Financial Crime: A Guide for Firms. Part 1: A Firm's Guide to Preventing Financial Crime* (Financial Conduct Authority, 2014), available at http://media.fshandbook.info/Handbook/FC1_Full_20140401.pdf.
 104. See Anita Campion, "Improving Internal Control: A Practical Guide for Microfinance Institutions" (Washington, DC: Microfinance Network and GTZ, 2000); Akwasi A. Boateng, Gilbert O. Boateng, and Hannah Acquah, "A Literature Review of Fraud Risk Management in Micro Finance Institutions in Ghana," *Research Journal of Finance and Accounting* 5, no. 11 (2014), available at www.iiste.org/Journals/index.php/RJFA/article/view/13527; "Corruption and Financial Crime: An Issue in Microfinance?" (responsibility, 2008), available at <http://www.responsibility.com/funding/data/docs/en/1564/Discussion-Paper-Corruption-and-financial-crime.pdf>; and Beatriz Marulanda et al., "Failures in Microfinance: Lessons Learned" (Calmeadow, 2010).
 105. See <http://www.consumer.ftc.gov/articles/0078-advance-fee-loans>.
 106. <https://www.ftc.gov/enforcement/rules/rulemaking-regulatory-reform-proceedings/fair-debt-collection-practices-act-text>.
 107. For a global overview of practices related to debt collections, see "Global Practices in Responsible and Ethical Collections," working paper, (IFC, August 2009).
 108. http://www.smartcampaign.org/storage/documents/20110916_SC_Principles_Guidance_Draft_Final.pdf.
 109. Financial service providers gather vast amounts of data, including personal information, in order to conduct their daily tasks. This information is sensitive to misuse or breaches, which have the potential to cause harm to consumers. This section refers only to a few select issues regarding data protection and privacy that are of greatest relevance to financial consumer protection.
 110. See, for example, (a) Universal Declaration of Human Rights, Article 12 (United Nations, 1948), (b) Convention for the Protection of Human Rights and Fundamental Freedoms, Article 8 (European Court of Human Rights, 1950), available at <http://www.coe.fr/eng/legaltxt/5e.htm>, (c) Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data, ETS No. 108 (Council of Europe, 1981), available at <http://www.coe.fr/eng/legaltxt/108e.htm>, (d) International Covenant on Civil and Political Rights (United Nations, 1966), available at <http://www.hrweb.org/legal/cpr.html>, and (e) Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the Protection of Natural Persons with Regard to the Processing of Personal Data and on the Free Movement of Such Data, and Repealing Directive 95/46/EC (General Data Protection Regulation), to become effective May 25, 2018.
 111. Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data, section 7 (OECD, 2013).
 112. Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data (Council of Europe, 1981).
 113. See, for example, the Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data, Principle 10 (OECD, 2013); the UN Guidelines, Article 3; APEC Privacy Framework, Principle III, "Collection Limitation" (Asia-Pacific Economic Cooperation, 2005); and the COE Convention.
 114. Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data (Council of Europe, 1981).
 115. See "Record Keeping and Client Identification for Financial Entities," Guideline 6G (Financial Transactions and Reports Analysis Centre of Canada, February 2014), available at www.fintrac-canafe.gc.ca.
 116. Additional guidance specific to digital financial services is found in Rafe Mazer and Nitin Garg, "Recourse in Digital Financial Services: Opportunities for Innovation," *CGAP Brief* (December 2015).
 117. http://newsite.alafianetwork.org/index.php?option=com_content&view=article&id=91&Itemid=435.
 118. <http://www.amfiu.org.ug/what-amfiu-does/complaint-handling.html>.
 119. See, for example, <http://dictionary.findlaw.com/definition/adversary-process.html>.
 120. See, for example, <http://legal-dictionary.thefreedictionary.com/Inquisitorial+System>.
 121. The study was mandated by the Dodd-Frank Act. See <http://www.consumerfinance.gov/newsroom/cfpb-study-finds-that-arbitration-agreements-limit-relief-for-consumers/>.
 122. Deposit-taking financial institutions can be banks, credit unions, financial cooperatives (urban or rural), housing or

- building societies, MFIs, and so forth, which should be subject to sound prudential regulation and supervision on a regular basis.
123. The ITU recommends that in the absence of deposit insurance coverage, other mechanisms should be put in place. It also recommends that authorities engage in public awareness initiatives related to the coverage (or not) of deposit insurance to digital financial services. ITU-T Focus Group Digital Financial Services, *Consumer Experience and Protection* (ITU, 2017).
124. See Juan Carlos Izaguirre, Timothy Lyman, Claire McGuire, and Dave Grace, "Deposit Insurance and Digital Financial Inclusion," *CGAP Brief* (October 2016).
125. See <http://www.iadi.org/docs/cprevised2014nov.pdf>.
126. See http://www.apec.org/apec/documents_reports/finance_ministers_process/2004.html.
127. See Insolvency and Creditor/Debtor Regimes Task Force, "Report on the Treatment of Insolvency of Natural Persons" (World Bank, 2014), available at http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2013/05/02/000333037_20130502131241/Rendered/PDF/771700WP0WB0In00Box377289B00PUBLIC0.pdf, and Susan Block-Lieb, "Best Practices in the Insolvency of Natural Persons: The World Bank Insolvency and Creditor/Debtor Regimes Task Force Meetings, Rapporteur's Synopsis, January 11, 2011," available at http://siteresources.worldbank.org/EXTGILD/Resources/WB_TF_2011_Consumer_Insolvency.pdf.



INSURANCE

Effective consumer protection practices play an important role not only in helping individual consumers but also in developing insurance markets and in ensuring their long-term growth and stability. Insurance is a service unlike most others. It is a business where the insurer, in exchange for a regular ongoing payment, promises to indemnify or protect the consumer against the small probability of a large loss. This “business of promises” depends on consumer confidence and trust in the underlying industry to function well. Not only do consumers need to know that insurers have the ability to meet their obligations, but they need to know that they will be treated fairly during the course of their business activities. Otherwise, they will pursue other less effective means of managing personal risks.

Similarly, if the insurance industry is to grow and develop, it needs to be able to rely on the accuracy and good faith of consumers providing information to insurers for underwriting purposes. Where legal and regulatory protections regarding the information provided by consumers to the insurance industry are inadequate, serious fraud problems can develop, affecting the solvency of insurers and the cost of insurance products provided to other consumers.

In both developed and developing countries, there are many instances where good practices have failed to develop, and the consequences have been severe for consumers and market development. As a result of weak regulation, the insurance sector has sometimes been manipulated by desperate, unscrupulous, or misdirected operators using inappropriate market conduct practices, such as recent payment protection insurance

issues.¹ In response, such events usually lead to the introduction of specific insurance consumer protection laws and systems intended to remedy the problems, but only after confidence in the sector has eroded and the potential of sector growth has been severely impacted.

Many developed countries with common law legal systems have a large and dynamic inventory of case law that addresses consumer protection issues. Similarly, many countries with older industries and established civil code systems have a lengthy history of regulation. Nevertheless, conduct of business² regulation, which is concerned with fair treatment of consumers, has tended to lag behind prudential regulation until recently. As a result of initiatives like the G20 High-Level Principles on Financial Consumer Protection and a renewed focus by the International Association of Insurance Supervisors (IAIS) on fair treatment of consumers in supervisory standards and by intermediaries in the insurance industry, this is beginning to change. In addition, the strong linkages between prudential regulation and conduct of business regulation are increasingly being recognized globally.

Higher standards are reflected in recent regulatory and supervisory changes in countries like Australia, Singapore, and the United Kingdom. The European Union (EU) has also recently become more engaged in this area since the passage of Directive 2008/52/EC on certain aspects of mediation in civil and commercial matters and an ongoing dialogue on the broader consumer protection agenda. The European Insurance and Occupational Pensions Authority (EIOPA) has also taken a significant step forward in the issuance of Guidelines on Complaint Handling (2012) for insurers and for intermediaries.

In the developing world, several countries, such as South Africa and Colombia, have improved regulatory standards and consumer practices. These countries are enjoying rapidly growing retail insurance markets, due to stronger regulation as well as rising real income levels and the introduction of compulsory motor and health insurance and links with credit provision.

Developing country markets often present additional challenges in the form of financial inclusion and financial capability issues. These challenges can accentuate the fundamental asymmetric information imbalance between insurance service providers and consumers and reinforce the need for strong consumer protection standards. They can also, however, challenge the applicability of regulatory models used in developed countries and require an approach tailored to the special nature, scale, and complexity of the local market.

Microinsurance and inclusive insurance are two different but related manifestations of financial inclusion. The term *inclusive insurance* is generally used in the context of overcoming barriers that have prevented large populations in many countries from using formal financial services such as insurance. *Microinsurance* also seeks to overcome exclusions but with a particular focus on low-income households and micro, small, and medium enterprises. The most salient feature of emerging customers is their lower purchasing power, which usually requires thorough reengineering of all aspects of insurance. The two most notable differences with conventional insurance are the principle of outsourcing every task to a party that can achieve it at the lowest possible cost, and simplification. Both differences aim to reduce the cost of insurance, and both can raise potential challenges to consumer protection. Outsourcing is most notable with respect to distribution (insurers using the infrastructure, trust, and brand awareness of other entities), and can lead to complex value chains that distance the insurer from the client. Simplification reduces consumer choice and can preclude in-depth advice, individual underwriting, and thorough claims assessment.

“Mobile insurance” illustrates the differences between conventional and inclusive insurance. Insurance distributed by mobile network operators (MNOs) not only benefits from the geographical omnipresence of MNOs but also allows for a low-cost communication channel with customers and, increasingly, for payment of premiums and claims via bankless payment systems. This new distribution model has allowed for significant reductions in cost and increases in scale and is fueling innovation in insurance. The IAIS proposes that “technology can be required and should be permitted in regulation and supervision to overcome barriers to access.”³ But the innovative partner-

ships that often characterize mobile insurance can potentially threaten consumer protection, as the case of EcoLife in Zimbabwe shows.⁴ Coordination among various regulators will be necessary, at a minimum, to address such concerns. In addition, due to the complexity of insurance products, insurance supervisors may be required to regulate new parties that in the past have not been involved in insurance distribution networks.

Regulators will need to strike an appropriate balance between the consumer protection needs of unsophisticated customers, on the one hand, and burdensome requirements that may deter insurers from serving this segment, on the other. A strong business case for inclusive insurance/microinsurance has not emerged for any but the most elementary products, so insurers are often hesitant to invest in this market. Insurers may be deterred from engaging in microinsurance if they have to follow the same documentation requirements for a six-month personal accident insurance as for a 20-year unit-linked life insurance. On the other hand, the degree of financial literacy of typical emerging customers is significantly lower than that of conventional insurance clients, suggesting a different approach may be required for communication, disclosure, and dispute resolution. The IAIS suggests that “requirements and rules should be based on the principle of proportionality, considering each jurisdiction’s context and national strategic objectives, with adaptations made to ensure that the needs of inclusive insurance customers can be most appropriately addressed and their interests adequately protected.”⁵ This recommendation should be applied to the good practices proposed throughout this chapter.

Good consumer practices, drawn from the work of international standard setters and best practice experience in leading countries, can, however, provide lessons for all insurance markets and help them avoid a number of common consumer protection problems. Some of these include the sale of inappropriate products by authorized or unauthorized insurers and intermediaries; unfair claims-settlement practices; products that are not suited to clients’ needs; unrealistic benefit illustrations; poor disclosure of the real costs of products; misleading advertisements; and misaligned agency and salesperson sales incentives that result in inappropriate intermediary conduct and advice. The following sections attempt to capture major elements of these good practices for the insurance sector to assist in the conducting of country-level diagnostics.

Table 1 presents a list of key readings related to consumer protection for the insurance sector to support this work.

TABLE 1: Selected Key Readings on Consumer Protection for the Insurance Sector

"Insurance Core Principles" (IAIS, 2011)
"Application Paper on Approaches to Conduct of Business Supervision" (IAIS, 2014)
"Application Paper on Approaches to Supervising the Conduct of Intermediaries" (IAIS, 2016)
"Issues Paper on Conduct of Business in Inclusive Insurance" (IAIS, 2015)
"Application Paper on Regulation and Supervision Supporting Inclusive Insurance Markets" (IAIS, 2012)
"Final Report on Public Consultation on Preparatory Guidelines on Product Oversight and Governance Arrangements by Insurance Undertakings and Insurance Distributors" (EIOPA, April 2016)
Alberto Monti, "The Law of Insurance Contracts in the People's Republic of China: A Comparative Analysis of Policyholders' Rights," <i>Global Jurist Topics</i> 1, no. 3 (2001)
Parliamentary and Health Services Ombudsman, <i>Equitable Life: A Decade of Regulatory Failure</i> , HC 815-I (London: Stationery Office, 2008)
"Insurance Contract Law: A Joint Scoping Paper" (English Law Commission and Scottish Law Commission, 2005), available at https://www.scotlawcom.gov.uk/files/2512/7981/5440/cp_insurance.pdf
Australian Law Reform Commission, <i>Submissions to the Department of Treasury Review of the Insurance Contracts Act 1984</i> (Cth), 2003 and 2004
A. A. Tarr, "Insurance Law and the Consumer," <i>Bond Law Review</i> 1, no. 1 (1989)

A: LEGAL AND SUPERVISORY FRAMEWORK

A1: CONSUMER PROTECTION LEGAL FRAMEWORK

- a. There should be a clear legal framework for the protection and fair treatment of retail insurance consumers, whether in a general insurance law, financial consumer protection law, contracts law, or insurance contracts law.
- b. The legal framework should include specific provisions for insurance contracts, which should set out the following:
 - i. Minimum information exchange and disclosure requirements for the insurance contract
 - ii. Basic rights and responsibilities of insurer and policyholders under the contract
 - iii. Basic protections against asymmetries of negotiating power or access to information in negotiating the insurance contract
- c. In addition to specifying the minimum content of and major exclusions to an insurance contract (ideally differentiated by the type of coverage, e.g. general, life, accident, and sickness), good statutory provisions on insurance contracts should also outline the following:
 - i. When the contract comes into force
 - ii. How disputes over the wording of contracts will be resolved
 - iii. Minimum requirements regarding use of plain language, typeface, and so forth
 - iv. The consequences of material and nonmaterial nondisclosure
 - v. How a payout against a claim will be made where the sum insured is less than the loss
 - vi. Notification requirements when an insurer wishes to cancel or alter a contract
 - vii. Treatment of subrogation of claims and renewals for retail and small business coverage as well as how a payout against a claim will be made where such a policy undervalues the sum insured
 - viii. What clauses may not be included in the contract— for example, warranty clauses, compulsory arbitration on the insurer's terms, and so on
 - ix. Conditions for renewal

- d. The legal framework should include specific provisions enabling or establishing requirements concerning who may conduct insurance business and how insurance business should be conducted by industry participants to ensure that customers are protected and treated fairly.
- e. The legal framework should include a clear definition of insurance business.
- f. Insurers should be licensed to participate in insurance markets, and entities that undertake insurance business without a relevant license should be subject to both criminal and civil sanctions.
- g. The licensing process should, at a minimum, require the following:
 - i. The applicant's beneficial owners, board members, senior management, and people in control functions demonstrate integrity and competence.
 - ii. Appropriate governance and internal control systems are in place, including specific controls to mitigate conduct of business risk.
 - iii. The insurer has adequate capital and financial resources to engage in insurance business.
 - iv. The insurer has sound business and financial plans.
- h. Insurance intermediaries, such as insurance agents and brokers, should be licensed. At a minimum, there should be requirements that individuals conducting intermediary activity
 - i. Be suitable and competent to engage in those activities—that is, they are of good character and have experience and appropriate training to engage in insurance business);
 - ii. Engage in ongoing professional training; and
 - iii. Are subject to ongoing supervision and discipline if they fail to conduct insurance business consistent with regulatory requirements.
- i. The legal framework should include provisions establishing or enabling (for example, through subordinate regulation) specific requirements for the fair treatment of consumers throughout the insurance product lifecycle, from the marketing of insurance products through to the extinguishment of contractual obligations. (See A3, below.)
- j. The legal framework should include provisions establishing an effective supervisory authority (or authorities) and enabling the use of a range of supervisory tools to evaluate the conduct of business by insurers and intermediaries and enforce compliance with legislation and supervisory requirements by industry participants.

Explanatory Notes

Insurance contract provisions

Special insurance contract provisions are required because of the complex nature of insurance contracts and the asymmetric relationship that exists between industry participants and consumers. Insurance markets are inherently biased in favor of industry participants rather than consumers because insurers and intermediaries usually have greater product knowledge and experience than consumers. Moreover, most consumers do not enter into contracts frequently, and consumers generally pay premiums for insurance services long before the insurer is required to honor potential claims obligations under the contract. Most noncommercial insurance contracts are also offered on a take-it-or-leave-it basis, without affording consumers any realistic opportunity to bargain.

Given that the very nature of most retail insurance contracts is to compensate for unusual or catastrophic loss, the failure to obtain proper coverage, or to appreciate its limitations, can be disastrous. Insurance contract law can establish considerable protection for consumers by establishing clear expectations, minimum levels of protection and standard terms, coverages procedures, and conditions. Such provisions can be established in the general insurance law, in a contracts law, or in a separate insurance contracts law. The final arbitrator of disputes regarding contractual provisions should be the court system if disputes cannot be resolved in some other way, such as through an insurer complaints handling system, mediation, or a financial consumer ombudsman.

Insurers should generally not be able to deny renewal unless there has been a material change in a risk or the authority has so directed or approved. In addition, there should be a period (typically 30 days) after the renewal

date when a policy can be renewed under the terms offered in the material sent well before the renewal date.

Provisions to establish or enable regulation of conduct of business

Insurance is a business of trust, and it is important that legislation establish requirements to ensure that inappropriate individuals and entities that may abuse that trust are prevented from entering the market. This requires that legislative provisions define insurance business and who may engage in it, establish a strong prohibition against unauthorized insurance business, and establish or enable (through subsidiary legislation) a licensing system (including appropriate exemptions) to control who may engage in it. Insurance activities should be allowed to be conducted only by authorized insurers and intermediaries.

In addition, the insurance legislation must establish or enable (through subordinate regulation) requirements regulating how authorized individuals carry out their activities. These are necessary to ensure that consumers

are treated fairly throughout the product lifecycle. (See [A3, below.](#))

Provisions to establish an effective authority and supervisory system

The legal framework should ensure that oversight of insurance markets is effective and that regulatory action is taken to address potential harm. In countries where large groups of the population are not served by formal supervised insurance but use informal risk-transfer arrangements—for example, prepaid funeral plans, credit life insurance “underwritten” by microfinance institutions, or mutual self-help associations—efforts are justified to bring these schemes into formality and under insurance supervision for consumer rights to be protected effectively. However, proportionality should be applied, such as with respect to appropriate capital and solvency requirements, reporting and auditing requirements, and the need for investment policies and qualified actuaries.

A2: INSTITUTIONAL ARRANGEMENTS AND MANDATES

- a. Legal provisions should clearly define an authority responsible for conduct of business supervision (the “authority”), provide a clear supervisory mandate and clear objectives for conduct of business supervision, and establish the independence, accountability, and transparency of the authority (or authorities).
 - b. The authority in charge of supervising conduct of business should be adequately resourced.
 - c. Appropriate legal protection should be established to protect the authority and supervisory staff from personal litigation in the good-faith exercise of their supervisory duties.
 - d. Where more than one authority is responsible for supervision, their responsibilities should be clearly demarcated to ensure there is no unnecessary duplication and overlap, and provisions should enable them to share information necessary for the exercise of their individual responsibilities.
 - e. The provisions establishing an effective supervisory system should include strong investigative powers, including the power to obtain any relevant information from industry participants with respect to matters within its mandate.
 - f. The provisions establishing an effective supervisory system should include the power to undertake timely preventative and corrective action against both unlicensed activity and industry participants, and the power to undertake enforcement action in a timely manner with a range of enforcement tools that can be tailored to the seriousness of the contravention.
 - g. The legal framework should clearly define the role of the authority relative to other authorities and should provide for coordination mechanisms (such as memorandums of understanding between various authorities).
 - h. Authorities should work with industry associations, consumer groups, and the media to ensure that they play an active role in promoting financial consumer protection.
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Explanatory Notes

Provisions to establish an effective authority are necessary to ensure that there is effective oversight of the insurance markets and that regulatory action is taken to address potential harm. Regardless of whether the supervisory system includes a single independent insurance regulator, a financial services regulator dealing with multiple financial sectors, or a “twin peaks” model, the authority responsible for conduct of business in insurance must have a clear supervisory mandate and objectives, operational independence, accountability and transparency, and appropriate legal protection to carry out its mandate. Legislation should establish or enable (through subordinate regulation) a proactive and risk-based supervisory system to help ensure effective oversight of the insurance market and the fair treatment of consumers.

Where more than one authority is responsible for conduct of business, their mandates should be clearly established and complementary, rather than overlapping and conflicting. Ideally, these mandates should be clearly defined in legislation. If they are not, a memorandum of understanding between regulators can be used to avoid conflict. Legislation should also clearly define the role of the authority relative to other authorities and any ombudsmen that may exist, and that of the court system—for example, in regard to contractual disputes and the appeal of supervisory decisions. In addition, provisions for the

sharing of information between authorities need to be established where there is a legitimate supervisory or administrative purpose, and where protection of confidential information can be maintained.

Beyond avoiding overlapping and conflicting mandates, it is also important that there is coordination between the authority responsible for conduct of business of the insurance sector and other authorities, such as the competition authority or the payments authority. Competition is closely related to consumer protection and to financial inclusion, so it is important that authorities coordinate to monitor competition issues in the retail insurance market.

Given the convergence of telecommunication and information technologies and the financial sector, particularly in the supply of innovative retail insurance and micro-insurance products using new channels or providers, there may also be a need to coordinate with regulators outside of the financial sector, such as the telecommunications regulator. As more insurance products in developing markets are being sold via mobile phone, as in Ghana and Haiti, need is increasing for coordination between relevant authorities (financial and nonfinancial sector regulators) to ensure adequate oversight and avoid potential conflicts between the insurance provider and MNOs that could lead to potential detrimental consequences for consumers, as in the case of EcoLife in Zimbabwe.

A3: REGULATORY FRAMEWORK

- a. **There should be a comprehensive regulatory framework to support the fair treatment of consumers by insurers and intermediaries. These requirements should be focused on supporting fair treatment of consumers throughout the insurance product life cycle.**
- b. **At a minimum, these requirements should require that insurers and intermediaries**
 - i. **Act with due skill, care, and diligence when dealing with customers;**
 - ii. **Embed fair treatment of customers into their business culture in dealing with consumers;**
 - iii. **Take into account the needs and interests of different types of customers when developing and marketing insurance products;**
 - iv. **Promote products and services in a manner that is clear, fair, and not misleading;**
 - v. **Set requirements for insurers and intermediaries with regard to the timing, delivery, and content of information provided to customers at point of sale;**
 - vi. **Ensure that, where customers receive advice before concluding an insurance contract, such advice is appropriate, taking into account the customer’s disclosed circumstances;**
 - vii. **Ensure that potential conflicts of interest are properly managed;**
 - viii. **Service policies properly through to the point at which all obligations under the policy have been satisfied;**
 - ix. **Disclose to the policyholder information on any contractual changes during the life of the contract; and**
 - x. **Have policies and processes in place to handle claims and complaints in a timely and fair manner.**

- c. Regulatory requirements can be established in regulations or in rules issued by the relevant authority or authorities but must be legally enforceable.
- d. Regulatory requirements should be tailored to the nature, scale, and complexity of the insurance market and the conduct of business risks facing retail consumers in those markets, including proportionate adaptation of requirements to avoid potential barriers to access.
- e. Regulatory requirements may include prescriptive rules for the conduct of insurers or intermediaries; more indirect, principles-based approaches that use oversight of the insurer or intermediary's governance and internal control structure to achieve the above-noted standards; or a combination of these two approaches.
- f. Regulatory requirements should be developed in consultation with the industry association and other internal and external stakeholder groups (including consumer representatives) to help ensure that they are effective. The regulatory framework should also be regularly reviewed with stakeholders to ensure that it remains relevant to conduct of business risks in the insurance market.
- g. To the extent possible, regulation should benefit from research regarding the regulatory practices of other countries, as well as from consumer research and behavioral economics.

Explanatory Notes

Most jurisdictions use a combination of rules-based and principles-based approaches to try and achieve the fair treatment outcome. Balancing rules-based and principles-based supervisory approaches can be difficult and depends to a large degree on the jurisdiction's legal system (such as civil code or common law), cultural factors, and history, as well as the need to protect its most vulnerable consumers.

Prescriptive rules-based approaches support regulatory certainty and predictability but can also result in authorities being more concerned with whether industry participants are meeting (sometimes outdated) requirements than whether consumers are being protected from harm. They can also stifle product innovation and financial inclusion.

Principles-based approaches allow greater flexibility for authorities to tailor their supervisory approach to a range of business models and to adapt to the changing nature of conduct of business risks. They can also offer greater flexibility to insurers to design products and business processes. On the other hand, principles-based provisions may raise concerns that the authority's expectations and actions are unclear, arbitrary, or even capricious. As a result, they can also be legally more difficult to enforce, particularly in countries with civil code legal systems.

Regardless of the approach, insurers and intermediaries in all markets need to meet certain international regulatory standards for fair treatment. These are described in Principle 19 of the IAIS Insurance Core Principles.⁶

Some of the specific regulatory tools that can be used to achieve fair treatment standards by industry participants include:

- Codes of conduct (COCs), either voluntary or established in law, that help provide a higher-level board-endorsed commitment to fair treatment of consumers (principles-based)
- Legal requirements (and supervisory guidance) for board-approved policies and board reporting on measures to mitigate conduct of business risks (for example, EIOPA guidelines on complaints handling policy requirements), to hold the board accountable for conduct of business risks (principles-based)
- Regulations requiring fairness, clarity, and quality in product promotions and against deceptive or misleading advertising (rules-based or principles-based)
- Product review or approval requirements by the authority (including beyond actuarial and product design aspects), particularly for compulsory products and retail products in markets with low financial literacy (rules-based)
- Regulations or rules respecting the information provided at point of sale (for example, key information requirements)
- Regulations or rules (placed either on insurers or through intermediary licensing processes) requiring the following:
 - The people selling products are suitable, competent and properly trained about the major features of the product and its target market (rules-based).
 - They collect information about the client and assess the appropriateness of the product for the client's needs before recommending the product.

- They provide an explanation of the major features of the products, including exclusions, preconditions, and deductibles (rules-based or principles-based).
- They document the advice they provide, including the client’s understanding of key terms and conditions.
- They appropriately handle and remit client funds.

Regulatory requirements can also be proportionately adapted for (well-defined) microinsurance and other forms of (well-defined) inclusive insurance so as not to present undue supply-side barriers. Proportionately lower requirements include, for example, intermediary licensing and qualifications, (funeral) benefits in kind, flexible premium payments, streamlined (digital) enrollment procedures to allow for the digital delivery of insurance products and services, or supportive rules for pilot testing. Appropriately higher requirements may also be

required to address particular vulnerabilities of consumers at higher risk, such as those from emerging markets—for example, with respect to policy conditions and exclusions, expeditious claims settlement, and consumer information and protection mechanisms specific to previously excluded populations.

Industry associations, consumer groups, and the media can play an important role in the development and maintenance of the regulatory framework and should be consulted regularly on regulatory issues. In the case of industry associations, they can provide information to help make the regulatory requirements more effective and less costly. They can help in the development of best practices and guidelines for their members, and they can act as a focal point for clarification of industry positions on regulatory issues. Consumer groups and the media can also alert regulators to weaknesses in regulatory requirements and the emergence of new conduct of business issues that may not be addressed in the regulatory framework.

A4: SUPERVISORY ACTIVITIES

- a. The authority should undertake a risk-based and proactive approach to supervision of conduct of business risks in the insurance market to help ensure fair treatment of consumers.
 - b. On an ongoing basis, through regulatory returns and third-party information sources, the authority should collect and monitor basic data on insurance operations, products, and services in the insurance market, including standardized complaint information and statistics on premiums, claims, and costs (for example, claims ratios).
 - c. A supervisory plan for conduct of business supervision should be developed annually within a documented framework that sets out clear priorities, reporting, and accountability criteria.
 - d. Supervisory procedures should be documented.
 - e. The authority should use a variety of tools to ensure robust conduct of business supervision. Depending on the nature, scale, and complexity of the market, these may include
 - i. Market analysis;
 - ii. Policy review;
 - iii. Off-site supervision;
 - iv. On-site supervision;
 - v. Thematic review; and
 - vi. Complaint handling.
 - f. The authority should evaluate its supervisory approach, tools, and techniques, as well as supporting information systems, on a regular basis, to enable its staff to assess institution-specific and market-wide risks effectively.
 - g. Supervisory staff should meet high professional standards and have sufficient insurance knowledge and appropriate backgrounds and training to carry out conduct of business supervision—for example, insurance knowledge, legal training, or audit training.
 - h. The authority should report to the public regularly on insurance markets and about its own role and the performance of its duties. (See A6.) It should also share relevant information with other supervisory authorities where there is a legitimate regulatory need and where confidentiality can be maintained.
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Explanatory Notes

In the past, supervisory frameworks for conduct of business often consisted of investigation of contraventions of a few rules-based regulatory requirements and investigation of complaints made to the authority. International standards require that modern conduct of business supervisory frameworks be more risk-based, proactive, and flexible. They should utilize a mix of supervisory tools that are appropriate to the nature, scale, and complexity of the insurance market. They need to be effective and mindful of the burden they place on the regulated industry.

Good practice in leading jurisdictions requires that this be accomplished by designing an annual supervisory plan within a documented framework that sets out clear priorities, reporting, and accountability criteria, and includes a mix of supervisory tools to achieve the plan priorities. It also requires that the authority report regularly to the public on the conduct of its activities.

Frameworks that meet international best practices often include the following tools described below.

Market analysis

A starting point for the development of an effective and risk-based supervisory plan is a systematic analysis of conduct of business risk in the market. General economic conditions; the size, structure, and product mix of the insurance sector; distribution models (including electronic channels and digitally enabled distribution); and the rate of growth, among other factors, can all affect the nature, scale, and complexity of conduct of business risks.

Market analysis should be used to help set supervisory priorities and direct the use of other supervisory tools. Market analysis attempts to identify underlying trends within the insurance sector and provides direction to the supervisory plan. Depending on the market, it can employ sophisticated methodologies such as risk categorization tools, risk scorecard approaches, rotation models, and sampling methodologies, as in the United Kingdom, or simple approaches, as in Colombia.

Where prudential supervision is carried out by another supervisory authority, it may also involve an exchange of information and discussions between authorities, as prudential issues often have symptoms in market conduct problems, and market conduct issues sometimes have symptoms in prudential problems.

Market analysis should occur regularly (for example, twice per year) because markets change. It should be consistent in its approach and utilize a variety of information from a variety of sources, including data on the general economy, market participants, business mix, and forecast issues and trends, as well as information from consumer agencies, ombudsmen, the media, and other external sources. A key component of this work is a detailed analysis of consumer complaints against insurers and interme-

diaries and their resolution for the preceding time period. This should include not only those complaints received by the insurance authority, but also those received by the insurers and industry ombudsmen as well.

Implementation of a systematic market analysis program often requires that authorities develop and implement new reporting requirements on insurers regarding the handling of complaints that the insurers receive. Issues in this area include the definition of complaint, complaint categories (such as line of business and type of complaint), and categorizing how the complaint was resolved. To facilitate reporting and analysis by the authority, information received should be in electronic form, and the development of an appropriate database is often required.

In countries where large parts of the population use informal risk-transfer schemes instead of supervised insurance, the authority's market intelligence may consider also including such schemes to the extent possible. Even though they are not currently subject to insurance supervision (or reporting), the insurance supervisory authority is often best positioned to warn consumers regarding unfair practices and unreliable promises. Also, knowledge of the informal risk-transfer markets will help regulators to bring these schemes into some form of supervised formality for proper consumer protection.

Policy review/product approvals

Product review and/or approval processes include the review of such specific documents as policies, applications, and advertising materials with respect to legal compliance and conduct of business risks (for example, misrepresentation or fit with consumer needs). The regulatory requirements for such reviews are typically established in legislation. Internationally, three approaches are commonly used: (1) preapproval processes, (2) file-and-use processes, and (3) selective product review processes. The intention of such requirements is to ensure that inappropriate products—that is, those that present high levels of conduct risks—either are not introduced to the market or, if introduced, are removed as quickly as possible.

Higher levels of conduct risk are likely to be found in products that have been designed with high margins and low expected claims payouts, and in products bundled with other services whose premium is so low that it can pass unnoticed, especially if marketed to emerging market customers (for example, some mobile/digital microinsurance products). As a general rule, it can help to look at how the conflicts of interest inherent to insurance are addressed in product and process design—that is, the conflicts between the interests of insurance shareholders, insurance intermediaries, insurance-related service providers (such as health care providers or fund managers),

and insurance customers. For example, long-term life insurance policies with substantial savings components positively affect the insurer's income statement and provide considerable, and mostly up-front, commissions to intermediaries, usually leading to high penalties to customers if they regret the decision and rescind from the policy in the years following the purchase.

From a supervisory perspective, product review processes can proactively avoid market conduct problems. They can be particularly important for ensuring that retail products are packaged in plain language. However, the following issues can arise in establishing such reviews:

- The type of process, its objectives, and the criteria for the review must be clear, both to the supervisory staff conducting the review and to the industry participants. A common problem with such processes is that unless objectives and criteria are clearly articulated, the conduct of the review can become subjective and inconsistent over time. Attention should also be paid to ensuring that the reviews do not become so compliance-oriented that they stifle product innovation.
- A product review may be interpreted by the industry for purposes that are much broader than what was originally intended. For example, approval of the policy may be viewed as absolution from any problems that develop after introduction, including decisions of the courts with respect to policy interpretation.
- Supervisory staff conducting the review must have sufficient knowledge and experience to carry out the work. Usually, this work requires a mix of industry knowledge, law, and consumer protection experience. For innovative products aimed at previously excluded populations, particular understanding of microinsurance, poor households' risks, coping mechanisms, and income streams, among others, may need to be developed while these markets grow.

Several authorities in the United States use extensive product review processes. Many other countries rely on file-and-use systems or preapproval processes (for example, for compulsory insurance products). For product review or preapproval processes, it can be helpful to ensure that authorities have statutory protection, as noted in A2, to address any concerns with potential liability.

Another approach used in some countries is to specify standard wording for the largest voluntary consumer classes of insurance, such as comprehensive motor insurance, motor casualty and collision insurance, and mortgage protection insurance, and then require that insurers be required to provide a prominent derogation statement if they deviate from the standard.

Entity-specific supervision

Entity-specific supervision involves regular review of the supervised entities' culture, as well as their conduct of business policies, procedures, and practices in a manner similar to prudential supervision. The latter might include systematic assessment of compliance with insurer and intermediary COCs; conduct of business rules; strategic plans, policies, and procedures; and internal controls with respect to conduct risks. The authority should also assess the role and practices of the most relevant third parties involved in service design and delivery, or consumer interactions, such as agents and sales consultants. This can be carried out through a combination of on-site and off-site activities and has three general goals:

- To assess whether insurers have the required policies and procedures
- To ascertain whether they are being complied with and are engrained in the culture of the organization
- To determine whether such policies and procedures are effective and sufficient

Like prudential supervision, the approach taken to this work should be risk-based and proactively focused. It can be conducted as part of other on-site and off-site activities (for example, prudential activities) or separately, depending on the nature of the market and the structure of the jurisdiction's regulatory system.

Thematic reviews and investigations

Thematic reviews and investigations are special examinations intended to address emerging or particularly complicated market conduct risks. They can involve on-site or off-site supervisory activity and target specific types of insurers, insurance business, or business functions. Examples might include the examination of the sale of certain types of insurance products, such as credit insurance or travel-insurance products; particular distribution models, such as insurance sold through banks; or particular activities—for example, a review of loss-adjusting activity related to motor insurance. Well-chosen thematic reviews can strengthen supervisory knowledge and make market conduct supervision more proactive.

A new supervisory practice used in some jurisdictions to gather information on insurers and the market is called mystery shopping. This practice involves supervisory staff or their appointed representatives, such as contracted market research firms, acting as retail consumers to assess various point-of-sale practices of insurers. By recording what an insurer says in discussions with a mystery shopper, an authority can establish or confirm an insurer's normal practices in a way that might not be possible by any other means.

Consumer complaints

While many consumer complaints are dealt with by insurers or by dispute resolution systems, consumer complaints to the regulator are part of the regular day-to-day business that an authority must deal with. Complaints are a litmus test for broader conduct of business and solvency problems. Complaint investigations and the individual issue reviews that they generate can identify broader problems and trends with insurer risk-mitigation activities or changes to conduct risk. They are also a measure of the overall effectiveness of a conduct of business framework.

Complaints are also part of any normally functioning insurance market. A conduct of business framework under which there are many unresolved complaints or complaints that take a long time to resolve can be a symptom of ineffectiveness. Conversely, a conduct of business framework under which there are no complaints may be a sign of an overly burdensome framework or one that simply fails to identify and mitigate conduct of business risks.

It is important that the authority's complaints and enquiry functions have a clear mandate and clear procedures. Many authorities, for example, will address a complaint only if the complainant has exhausted the insurer's complaints handling process or if there is a specific allegation of a regulatory breach. It is also important that complaints handling be well documented and that consumers are informed and made aware of these procedures.

With regard to mandate, it is important that the role of the authority not be confused with other venues, such as the court system. Many supervisory systems address this issue by giving the insurance authority a mandate to address systemic and regulatory problems, while alternative dispute resolution (ADR) systems, such as a financial services ombudsman or, as a last recourse, the courts, deal with individual contractual complaints that cannot be resolved by insurers. For this approach to work, however, ADR systems and court systems must be credible vehicles for resolution of complaint issues.

A5: ENFORCEMENT

- a. The authority's enforcement powers and tools, and the actions taken against insurance providers by the financial consumer protection authority, should create a credible threat of enforcement in case of lack of compliance with the legal and regulatory framework, in order to punish and deter wrongdoing.
 - b. The authority should also have the power to take enforcement action against unlicensed insurance activity as well as against licensed industry participants who contravene regulatory requirements for fair treatment of consumers.
 - c. Supervisory powers should include the ability to take timely preemptive action to protect the interests of insureds prior to the occurrence of violations.
 - d. The authority should have a range of enforcement tools to address contraventions, including but not limited to
 - i. The power to issue binding directions;
 - ii. The power to suspend, restrict, or attach conditions to business activities;
 - iii. The power to suspend, restrict, or attach conditions or revoke licenses;
 - iv. The power to remove individuals or bar them from acting in particular capacities—for example, senior officers, directors, or people heading control functions;
 - v. The ability to apply administrative penalties for minor contraventions; and
 - vi. The ability to seek fines and other offence penalties commensurate with seriousness of the contravention.
 - e. The authority should have the ability and the authority to escalate enforcement action and should do so in order to prevent the continuance or reoccurrence of regulatory contraventions.
 - f. The authority should have the ability to identify and refer potential criminal activity to appropriate authorities for investigation in a timely manner.
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Explanatory Notes

Effective supervision and regulation of conduct of business in insurance depend on the ability of the authority to take enforcement action when necessary. This includes the ability to take action against authorized as well as unauthorized industry participants.

To be effective, the authority should have a range of preemptive and enforcement powers and be able to

increase the level of intervention depending on the nature, scope, and seriousness of regulatory contraventions. Preemptive actions may consist of informal regulatory communications leveraging upon moral suasion. As criminal breaches are often discovered through supervisory investigations, the ability to refer criminal investigations to appropriate authorities is also important.

A6: CODES OF CONDUCT AND OTHER SELF-REGULATION

- a. **The legal and regulatory framework should allow for the emergence of self-regulatory organizations, including industry associations.**
- b. **Industry participants should have a COC, either established by law or on a voluntary basis, illustrating their commitment to the fair treatment of consumers.**
- c. **COCs and other self-regulation must be written in plain language and without industry jargon, to ensure that insurance consumers and industry participants can understand them easily.**
- d. **COCs and other self-regulation should be publicized and disseminated, so that they are known to consumers.**
- e. **To the extent possible, the authority should take actions to encourage or check compliance by industry participants with self-regulation and should use self-regulation when evaluating an insurer's or intermediary's conduct.**

Explanatory Notes

Many jurisdictions are establishing industry COCs as part of the regulatory system. Industry COCs are important because they provide an overarching benchmark for evaluating insurer or intermediary conduct and the effectiveness of insurer internal controls under the supervisory framework. COCs should be considered an addition to, rather than a substitute for, a sound regulatory system. The codes can be established in law or on a voluntary basis by industry participants. When the COC is endorsed by an insurer's board, it can help to establish a culture of fair treatment within the insurer organization.

Sometimes COCs are prescriptive, such as the Monetary Authority of Singapore's Guidelines on Standards of Conduct for Financial Advisers and Representatives.⁷ Other times, they establish very high-level principles, such as the Canadian Life and Health Insurance Association's Code of Ethics.⁸ Regardless of the approach, they must be written in plain language and without industry jargon, to ensure

that insurance consumers and industry participants can understand them easily, and they should be publicized and disseminated, so that they are known to consumers.

Principles-based COCs are sometimes criticized as being legally unenforceable. This perspective neglects to recognize that the true value of such codes is to confirm the insurer or the intermediary's commitment to fair treatment of consumers. Once a code is in place, it provides the authority with a benchmark by which it can assess the entity's internal controls, policies, and procedures with regard to conduct of business risks.

One method of strengthening the likelihood of enforcement of voluntary COCs is to require by law that all insurers and intermediaries be members of the relevant industry association, and then make membership in the association contingent on abiding by the voluntary COC. The association should be able to enforce compliance with the code, and there should be consequences for violations.

TABLE 2: Selected Codes of Conduct for the Insurance Sector

COUNTRY	INSTITUTION	CODE OF CONDUCT
Australia	National Insurance Brokers' Association	General Insurance Brokers' Code of Practice
	Insurance Council of Australia	General Insurance Code of Practice
	Financial Planning Association	Financial Planners' Code of Ethics and Rules of Professional Conduct
India	Life Insurance Council of India	Code of Best Practice for Indian Life Insurers
Malaysia	Life Insurance Association of Malaysia	Code of Ethics and Conduct (approved by Bank Negara)
Russia	Russian Association of Motor Insurers	Various codes, including developing a register of insurance agents and insurance brokers against whom complaints have been made; rules of professional conduct entitled "Improving the Level of Service in the MTPL Market"; rules covering the review of claims made by victims and the payment of compensation
South Africa	Life Offices' Association of South Africa	Code of Conduct (24 chapters covering a range of products and activities)
United Kingdom	Association of British Insurers	Various codes and guidance notes, including Statement of Best Practice for Long-term Care Insurance, Code of Practice for Endowment Policy Reviews, Statement of Best Practice for Critical Illness Insurance, Best Practice Guide on With-Profit Bonds.
Singapore	Monetary Authority of Singapore	Guidelines on Standards of Conduct for Insurance Brokers

Source: World Bank Research and Financial Sector Assessment Program

A7: DISSEMINATION OF INFORMATION BY AUTHORITIES

- a. The authority should make readily available to the general public, at no cost, minimum relevant information on the insurance sector and about its own role and how it performs its duties to help achieve its statutory goals and increase its transparency. Generally, this information should include
 - i. A clear description of its regulatory and supervisory mandate and remit, and the role of other authorities, if applicable;
 - ii. A report, at least annually and in a timely manner, on its supervisory program, describing its performance in pursuing its supervisory objectives;
 - iii. Information and analysis about the insurance market and the conduct of business in the insurance sector, such as aggregated information about insurer complaints;
 - iv. Information about problem or failed insurers, including information on supervisory actions taken, subject to confidentiality considerations and in so far as it does not jeopardize confidentiality requirements and other supervisory objectives;
 - v. Its audited annual financial statements;
 - vi. A list (or access to a database) of all licensed insurance providers and intermediaries and their regulatory status; and
 - vii. Laws and a compilation of all regulations on financial consumer protection relevant to the insurance sector.
- b. To the extent possible, the authority should coordinate with a variety of stakeholders—such as industry and consumer associations, the media, and other government agencies—to increase the reach of the information it disseminates.

Explanatory Notes

The two main objectives of the authority in disseminating information to the public are

- To help ensure its own accountability; and
- To make consumers aware of conduct of business risks and the means of addressing them.

With regard to ensuring accountability, dissemination of information by authorities should be linked to the fundamental mandate of the authority and to the risks that insurance supervision is intended to reduce. Information should be outcome-oriented, rather than output-oriented, and focused on the performance of the supervisory system.

Supervisory information can also make consumers more aware of emerging or ongoing conduct of business

risks and can include information on common market-place scams, illegal activities, and specific enforcement actions taken to address real and potential harm.

In the United States, for example, several jurisdictions (at the state level) are disclosing greater information on consumer complaints, including the publication of a consumer complaint ratio for each insurer in each business class, such as in Colorado, Michigan, North Carolina, Texas, and Virginia. This ratio is a statistic that shows the number of closed complaints for every US\$1 million of premium the company sold in the jurisdiction during that calendar year. Aggregated complaints data can be disclosed in order to avoid confidentiality concerns.

Furthermore, many jurisdictions now routinely publish on the authority's website or in annual reports information on enforcement actions taken against industry participants for major breaches of regulatory provisions.

B: DISCLOSURE AND TRANSPARENCY

B1: FORMAT AND MANNER OF DISCLOSURE

- a. To ensure that information is properly understood, insurers and intermediaries should use plain language in all documents (including those in electronic formats) and oral communications with retail insurance clients.
- b. Plain language requirements should apply to the following, across all manners of communication:
 - i. Advertising and sales materials
 - ii. All point-of-sale documents
 - iii. Applications and policy documents
 - iv. Ongoing reports and correspondence
 - v. Oral communications with policyholders
- c. There should be minimum requirements regarding typefaces for written materials and readability (for example, Flesch-Kincaid⁹ readability tests and minimum font size), including for materials in electronic format.
- d. Illustrations must not mislead consumers as to the features of the product and should facilitate product comparison.
- e. Information on key product features and other key communications should be provided in written form (including electronic format) that can be kept or saved by the consumer and in an appropriate medium that lasts for a reasonable amount of time.
- f. Where feasible, key features should also be communicated to the consumer orally during the precontractual stage and at the point of sale.
- g. Wherever possible, communications should be in the client's preferred language.

Explanatory Notes

The format and manner of disclosure are as important as requirements on what to disclose, as disclosure may be rendered completely ineffective by factors such as a small font, convoluted language, excessively fast visual and oral communication, or excessive information.

Improving the readability of products through plain language requirements can help build consumer trust in insurance markets. Plain language communication is particularly important in underserved markets and markets characterized by low levels of financial literacy. Ideally, when developing materials, insurers should provide for independent review, such as through focus group testing, to ensure that materials meet consumer needs. Compliance with plain language requirements should be assessed through policy review processes or in off-site or on-site review of the insurer's or intermediary's operations.

Consumers may be put in a weak position when key disclosures are made in a format that cannot be saved or is not durable enough to be used later, whether electronic or paper-based. Disclosures and communications should give prominence to key features and risks of products and services, to induce the consumer to pay extra attention to such features and, if needed, seek further clarification with the insurer's or intermediary's staff or agents. With regard

to visual and spoken disclosure, flexibility is required. When there is no adaptation to specific channels, disclosure becomes excessive and meaningless. For example, visual or oral prerecorded communications should be required to provide information at a reasonable speed or for a reasonable period of time, to allow a consumer to listen to or read it.

Given that insurance products and services are increasingly being sold through electronic channels, the regulatory requirements on format, including for sales and marketing materials, should also be flexible enough to be adapted to different delivery channels. Disclosure requirements should be adapted for electronic channels while not forming barriers for ethical and healthy innovation in service delivery and information disclosure. For instance, SMS (short message service) messages are often used as receipts for payment of premiums when insurance is sold bundled with airtime. Although they are usually more difficult to read and understand than a paper-based receipt, this fact provides insufficient reason to consider them invalid. Complementary regulatory requirements could also be considered regarding recordkeeping for digital transactions, to ensure that records are available for supervisors and can also be provided upon request to customers and used to support disputes.

B2: ADVERTISING AND SALES MATERIALS

- a. In addition to the general requirements described in B1, insurers and intermediaries should be required to ensure that their advertising and sales materials and procedures do not mislead customers or omit key information (such as the identity of the insurer).
 - b. Insurers should be legally responsible for all statements made in marketing and sales materials that they produce related to their products.
 - c. Advertising materials by insurers and intermediaries should disclose that they are regulated, and the name of the regulatory authority.
 - d. Insurers should be responsible for providing information that is accurate, clear, and not misleading to intermediaries who may rely on this information in providing advice to customers.
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Explanatory Notes

International standards require that insurers and intermediaries promote products and services in a manner that is clear, fair, and not misleading. Before an insurer or intermediary promotes an insurance product, it should take reasonable steps to ensure that the information provided is accurate and clear and will not mislead consumers. This includes not only information related to the features of the product but also the identity of the insurance provider or providers.

If an insurer or intermediary subsequently becomes aware that the information provided is not accurate and clear or is misleading, it should withdraw the information from the market and notify any person known to be relying on the information as soon as reasonably practicable.

The information provided, at a minimum, should

- Be easily understandable;
- Include results for the product that are consistent with the results that can be reasonably expected to be achieved by the majority of customers of that product;

- State prominently the basis for any claimed benefits and any significant limitations; and
- Not hide, diminish, or obscure important statements or warnings.

Most jurisdictions currently have regulatory provisions that allow the authority to prohibit the use of product advertisements for insurance that are obviously unfair, misleading, or deceptive. Recently, often in response to improved standards, leading jurisdictions have extended requirements into the fairness, clarity, and quality of product promotions. The increasing complexity of products has sometimes made this necessary. In some cases—in markets with low levels of financial literacy, for example—it has also become necessary because applications or policies are difficult to understand and, as a result, some consumers are relying on the promotional material they receive, rather than the product documentation.

For example, in the state of Kansas in the United States, regulation of complex life insurance products has been extended from prohibiting obviously incorrect or misleading statements to requiring the disclosure of certain specific types of information, such as regulatory limits placed on investment returns used in life insurance value projections. This is generally more important for life insur-

ance products than non-life products. In general, the level of detail required by a jurisdiction depends on the nature, scale, and complexity of the market, with markets characterized by simple products requiring less onerous regulatory provisions.

The treatment of insurance sales material and contracts is most developed in common law countries, where case law has supported the introduction of such concepts as plain meaning interpretations (*consensus ad idem*), violation of good faith and fair dealing (*mala gestio*), and bans on warranty clauses that could otherwise enable insurers to avoid claims. Common law countries have considerable scope to deal with the enormous range of potential transaction types that can arise under property, liability (tort), and credit-related insurance arrangements. Civil law countries tend to rely on specific sections of their civil codes or separate contracts laws (for example, the law of obligations) and sometimes on strict regulatory/supervisory oversight of transaction and sales material.

Several directives in Europe hold financial institutions responsible for the content of their public announcements. These include Directive 2002/65/EC, concerning the distance marketing of financial services, and Directive 1997/55/EEC, on comparative advertising.

B3: DISCLOSURE OF TERMS AND CONDITIONS

- a. **The insurer or intermediary, as relevant, should take reasonable steps to ensure that a customer is given appropriate information at point of sale about the key terms and conditions of a product, so that the customer can make an informed decision about the arrangements proposed before entering into an insurance contract.**
- b. **While the level of product information required may vary, it should include information on key features, such as the following:**
 - i. **The name of the insurer, its legal form, and, where relevant, the group to which it belongs**
 - ii. **The type of insurance contract on offer, including the policy benefits**
 - iii. **The level of the premium, the due date, and the period for which the premium is payable, as well as the consequences of late or nonpayment**
 - iv. **Where a policy is bought in connection with other goods or services (a bundled product), premiums for each benefit (both main benefits and supplementary benefits) should be disclosed separately from any other prices.**
 - v. **Whether buying the policy is compulsory**
 - vi. **The type and level of charges to be deducted from or added to the quoted premium, and any charges to be paid directly by the customer**
 - vii. **When the insurance cover begins and ends, including any cooling-off period associated with the sale of the product**
 - viii. **A description of the risk insured by the contract and of the excluded risks**
 - ix. **Prominent and clear information on significant or unusual exclusions or limitations**

- c. Insurer salespeople and intermediaries should be required to disclose major rights and obligations under the insurance contract, including the consequences of nondisclosure and inaccuracies in information provided by the prospective policyholder, the right to cancel, and the right to complain, among others. The process for dispute resolution and contact information for internal and external third-party complaints handling mechanisms should also be disclosed.
- d. Disclosure requirements should focus on the quality of product disclosure rather than the quantity of disclosure, as when disclosure becomes too voluminous, the customer may be less likely to read or comprehend the information.
- e. Disclosure of key terms and conditions should occur in good time, before the signing of an insurance contract.
- f. Wherever possible, a printed or electronic copy of the insurance contract, containing at minimum the information listed in clause B3(b), should be provided to the consumer at signing.
- g. Each term and condition of an insurance contract should be set out in full either in the policy or in writing securely attached to it when it is issued.
- h. The regulatory framework providing for clauses B3(a)–(g), above, should be applicable to consumer agreements signed electronically—for example, via mobile phones, over the Internet, and by phone recordings.

Explanatory Notes

The information provided to consumers should enable them to understand the characteristics of the product they are buying and help them understand whether and why it meets their needs, before entering into an insurance contract.

The level of information required will tend to vary according to matters such as:

- The knowledge and experience of a typical customer for the policy in question
- The policy terms and conditions, including its main benefits, exclusions, limitations, conditions, and duration
- The policy's overall complexity and whether the policy is bought in connection with other goods and services
- Whether the same information has been provided to the customer previously and, if so, when

In regards to major rights and obligations, disclosed information should generally include the following:

- The law under which the contract is made
- The obligation to disclose material facts—including prominent and clear information on the obligation on the customer to disclose material facts truthfully
- Obligations to be complied with when a contract is concluded and during its lifetime, as well as the legal consequences of noncompliance

- The obligation to monitor cover—including a statement, where relevant, that the customer may need to review and update the cover periodically to ensure it remains adequate
- The right to cancel, including the existence, duration, and conditions relating to the right to cancel. If there are any charges related to the early cancellation or switching of a policy, this should be prominently disclosed
- The right to claim benefits, including conditions under which the policyholder can claim, and the contact details to notify a claim
- The right to complain, including how to make a complaint, the insurer's internal dispute resolution mechanism, and the existence of any alternative dispute resolution mechanism.

International standards are generally met through principle-based requirements on insurers and intermediaries. Many jurisdictions, such as the Canadian provinces, have legally enforceable intermediary COCs setting out major obligations. These are sometimes supplemented with specific rules and training requirements on intermediaries and sales staff. Requirements for compulsory products and some investment products tend to be more prescriptive than other products. Key facts statements (KFSs) can be useful tools to help meet the requirements for this standard. (See B4, below.)

Annex III of the EU Life Assurance Directive, in particular, requires that life insurance consumers be advised of recourse mechanisms at the time of sale.

China has made consumer protection a core element of its recently updated insurance regulatory model and is pioneering cutting-edge requirements for distribution (including certain types of agents, such as bank branches) and policy type combinations (including investment-linked and participating contracts where benefit illustrations are provided). Innovations include requiring new policyholders to write in their own hand that they understand the terms of the contract they are entering into, and requiring life insurers to follow up by phone after a short period to confirm necessary information.

Group insurance, while relevant in mature markets—for example, in the form of employer-sponsored life insurance—also plays an important role in microinsurance and may require an adapted approach with respect to disclosure of terms and conditions, particularly with respect to clause B3(g), above. Some jurisdictions, such as Pakistan and South Africa, impute a contractual relationship between the insurer and the insured group members, while in other countries, the contractual relationship is only between the insurer and the group's master policyholder. In the latter cases, the information provided to the master policyholder may differ from the information provided to the group members. In India, for example, the master policyholder receives the policy contract, while each of the individuals covered under the group receives a certificate evidencing proof of insurance and containing key details (rather than full terms and conditions), such as period of cover and the

addresses of the underwriting (and the servicing) office. In Mozambique, the master policyholder has the obligation to inform the insured persons about the coverage, including rights and obligations, and the insured persons can request from the insurance company all the information necessary to ensure the effective understanding of the contract.

Whether individuals insured under group schemes are aware of their insured status is often a greater concern to regulators in developing microinsurance markets than whether they are aware of the policy terms and conditions details. Requesting that insurers provide and promote a helpline where insureds can clarify any doubts (and make complaints) is often more conducive than requiring that extensive information be provided to the consumer at the time of sale.

Remote contracting, where insurance offers are made without the physical presence of an intermediary and accepted by the insurer with the receipt of the premium, are increasingly used to serve populations that are otherwise difficult to reach sustainably, including via mobile phones and over the Internet. Such approaches require flexible and proportionate requirements to address information needs (and other acceptance procedures) appropriately, balancing practical operational needs with potential risks to consumers. The regulatory framework should seek to balance achieving sufficient disclosure and transparency for electronic channels, particularly when targeted at and used by low-literacy consumers who may not be familiar with insurance products, without impeding innovations in service delivery, particularly where beneficial for financial inclusion.

B4: KEY FACTS STATEMENTS

- a. **KFSs that disclose key product terms and conditions should generally be provided to consumers of common retail insurance products before the insurance contract is entered into.**
 - b. **KFSs should be concise, effectively designed, and written in plain, easy-to-understand language, summarizing in a page or two the key terms and conditions and major risks and obligations of the specific product and allowing the comparison of similar products offered by different providers.**
 - c. **For common retail insurance products, KFSs should cover key product features such as coverage levels, deductibles, fees and charges, risks, information on cancellation, claims handling, and complaints processes, and other major rights and obligations under the contract.**
 - d. **KFSs should indicate that they do not substitute for plain language insurance policies and forms.**
 - e. **Insurance providers should be required to provide KFSs through a convenient channel, including at least the channels through which the insurance products are sold.**
 - f. **KFSs should be retained by the provider and be available for inspection for a reasonable number of years.**
 - g. **In developing KFSs requirements, the authority should work with the insurance industry and consumer groups to develop standardized templates.**
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Explanatory Notes

In many instances, and for a variety of reasons—including suggestions given by a salesperson—a consumer may not read the contractual terms and conditions of an agreement at all. Even when consumers want to read the terms and conditions, they may not understand them, or often the length of contracts might put them off or intimidate them, particularly in the case of less sophisticated or illiterate or low-literacy consumers, or in the case of products being delivered electronically.

A KFS is a short, plain language document that gives a prospective customer a concise summary of the key features and risks of that insurance product. The KFS is intended to reduce consumer confusion regarding what is and is not included in an insurance contract and provide consumers with a mechanism to easily compare the key aspects of different insurers' products. KFSs are consistent with Principle 4, "Disclosure and Transparency," of the G20 High-Level Principles on Financial Consumer Protection.

KFSs are particularly important for investment products. A KFS for a typical investment product should include the following information:

- Name and type of product
- Name of issuer and company information
- Simple description of the product
- Description of key risks and level of risk
- Fees and charges
- Intermediaries remuneration
- Cooling-off period
- Whether the product provides any financial guarantees

Where KFSs include descriptions about the past performance of an investment product, such descriptions should be required to be fair and honest and to accurately reflect overall performance. KFSs should also indicate that past performance is not a guarantee for future performance.

KFS requirements are usually established in regulation. In developing KFS requirements, the authority should work with the insurance industry and consumer groups to develop standardized templates for major types of retail insurance products, as comparability across providers is one of the main functions of a KFS. KFSs should be concise, so as not to increase the burden of documents that consumers need to review, and do not substitute for the need to simplify policy documents for retail insurance products. Consumer behavioral research and consumer testing of KFSs can be used to test whether a standardized template is effective, particularly with different population segments. If digital channels are being used and documentation is primarily electronic, providers should still ensure that the KFS is prominently displayed. The authority and the industry should also work together to identify any particular circumstances and situations in which it may be impractical to provide the consumer with a KFS prior to purchase—for example, telephone purchases of low-risk products that the consumer has purchased previously.

Many jurisdictions effectively use KFSs. They include Australia, Canada, the European Union, Hong Kong (for investment-linked assurance scheme products), the United Kingdom, and the United States.

B5: STATEMENTS AND ONGOING POST-SALE COMMUNICATIONS

- a. Once a policy has been accepted, insurers should provide confirmation of cover and policy documentation.
 - b. Policy documents must be consistent with the insured's application or an authorized amended application for insurance.
 - c. At a minimum, customers should receive periodic statements of the value of their policy in the case of insurance savings and investment contracts. For traditional savings contracts, this should be provided at least yearly; however, more frequent statements should be produced for investment-linked contracts. For multiyear insurance products, annual statements should be provided to confirm continuation of policy coverage.
 - d. Customers should be provided with renewal notices a reasonable number of days before the renewal date for non-life policies. If an insurer does not wish to renew a contract, it should also provide a reasonable notice period to allow the consumer to find replacement coverage (for example, six months, unless there are extenuating circumstances).
 - e. Ongoing post-sale communications should be required to be provided using at least the channel through which the policy was sold—that is, aligned to the manner in which the policy was signed—to avoid confusion or undue burden on the consumer.
 - f. The same obligations listed herein apply to intermediaries where they participate in policy-servicing tasks.
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Explanatory Notes

After an insurance policy is approved, it is important that the insured receive full policy documentation outlining their obligations and entitlements. In addition, during the life of the policy, the insured should receive periodic statements outlining basic information about the coverage.

In regards to life insurance policies and annuities, the following information should be required to be included at a minimum:

- Participation rights in surplus funds
- The basis of calculation and state of bonuses
- The current cash surrender value
- Premiums paid to date
- For unit-linked life insurance, a report from the investment firm (including performance of underlying funds, changes of investments, investment strategy, number and value of the units and movements during the past year, administration fees, taxes, charges and current status of the account of the contract)

For customers receiving periodic statements on the value of their policy, there should be a means to question the accuracy of the transactions recorded in the statement within a stipulated period. (See section E, “Dispute Resolution Mechanisms.”)

In practice, minimum regulatory requirements regarding the provision of information are set out in insurance contracts legislation, and requirements should be estab-

lished in the policy documents themselves. Most authorities assess adherence with these requirements through policy review, investigation of complaints, and on-site review of the insurer’s policies, procedures, and internal controls related to servicing business. Insurance law rarely deals with customer account handling in any detail, partly reflecting the large variation in requirements needed for different products.

When establishing such requirements in less developed markets and low- to middle-income economies, regulators should consider the costs to the consumer and the provider. With the increased use of computers and mobile phones as channels to access and manage insurance policies, some consumers may wish to receive, access, or download statements or other types of ongoing disclosures more or less frequently. Whenever possible, choices on frequency, channels, and formats should be left to consumers. For example, insurance providers should not be prohibited from using opt-out clauses (that is, making electronic statements the default option) for certain insurance policies that are sold entirely electronically (for example, mobile microinsurance). When establishing requirements on statements or other types of ongoing disclosures, regulators should also be cognizant of constraints relating to the efficiency of the postal service or to consumers not having a formal fixed address. In such cases, insurance providers may be required to make statements available for collection by consumers in branches or outlets, or substitute paper-based statements for electronic versions.

B6: NOTIFICATION OF CHANGES IN RATES, TERMS, AND CONDITIONS

- a. The insurer should notify policyholders of their rights and obligations regarding any changes in terms and conditions provided for in the policy at point of sale.
- b. If the insurer wishes to change a policy rate, term, or condition, and the change is not expressly provided for in the insurance contract, the insurer should be required to notify and seek the consent (including in electronic form, if feasible) of the policyholder to amend the contract.
- c. The insurer should also notify the policyholder of major changes permitted by the contract that could affect the policyholder’s willingness to continue the policy, such as changes in insurer ownership.

Explanatory Notes

From time to time, insurers may wish to change the terms or conditions of insurance contracts affecting the interests of policyholders. In such circumstances, it is important that legislation governing the terms of insurance contracts define how those changes should be

dealt with. In addition, policyholders should be made aware of significant changes in the operations of the insurer that could affect the policyholder’s willingness to continue the policy. Good public disclosure of insurer information can help in this regard. (See B7, “Public Disclosure of Insurer Information.”)

B7: PUBLIC DISCLOSURE OF INSURER INFORMATION

- a. Insurers should be required to disclose relevant, comprehensive, and adequate information to consumers on a timely basis, in order to give consumers and market participants a clear view of the insurers' business activities, performance, and financial position.
 - b. At a minimum, information should be disclosed on the following:
 - i. Company profile (nature of business, products, external environment, business strategy and objectives, corporate structure, corporate governance framework)
 - ii. Enterprise risk management and internal controls
 - iii. Technical provisions (valuation method and assumptions)
 - iv. Capital adequacy (capital management policy, regulatory capital resources, regulatory capital requirements, and internal model, if used)
 - v. Investments (investment policy, valuation method and assumptions, sensitivity to market variables)
 - vi. Financial performance (earnings, claims, pricing, investment returns)
 - c. Disclosed information should be provided in a manner that is useful for determining an insurer's fair treatment of consumers—for example, it should be timely, current, meaningful, and comparable between insurers operating in the same market.
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Explanatory Notes

Public disclosure of information on the business practices of insurers can be a powerful tool, influencing purchasers of insurance products and helping to ensure their fair treatment. Detailed financial and operational information are most useful to advisors and members of the specialist media, who can act as information intermediaries for the benefit of consumers. Simple metrics such as solvency ratios, complaint ratios, and financial strength ratings are more appropriate for the general consumer.

In the past, most jurisdictions have required insurers to disclose basic financial statement information, but the new Insurance Core Principles require that a much broader range of information be disclosed, including information that may be useful to the public in considering fair treat-

ment of consumers and conduct of business risk. The core principles also require that such information be useful in decision making, timely and up to date, and comprehensive and meaningful, among other requirements.

The new standard requires regulators to reconsider disclosure requirements placed on insurers and to broaden the information that insurers must provide to the public, including aggregate information on fair treatment, such as insurer complaint handling statistics. Usually, insurers are required to provide this information on websites and in annual reports.

Internationally, this is still an area that is in transition. Leading jurisdictions on these new approaches include the United States and the United Kingdom.

C: FAIR TREATMENT AND BUSINESS CONDUCT

C1: UNFAIR TERMS AND CONDITIONS

- a. There should be legislated requirements to prevent unfair terms and conditions from being established in insurance contracts or in sales practices—for example, warranty clauses, compulsory arbitration on the insurer's terms, and so forth. In addition, the authority should have the power to prohibit unfair, deceptive, or misleading forms of contracts.
- b. Claims should not be deniable or adjustable if nondisclosure of information on the part of the insured is discovered at the time of the claim but is immaterial to the proximate cause of the claim.

- c. Contracts should not include unreasonably short timeframes for providing proof of loss—that is, there should be reasonable interpretation of requirements that the insured notify the insurer of the loss immediately and deliver to the insurer a proof of loss as soon as practicable.
- d. Contracts should not allow unreasonable delays in loss payment after proof of loss has been provided (for example, more than 60 days in most instances).
- e. Contracts should not include unfair and unreasonable provisions limiting the timeframe for commencing a court action or proceeding against an insurer in relation to the contract, be it before an external dispute resolution mechanism (see E2) or before a court of law (for example, less than two years after the date on which the cause of action against the insured arose).
- f. Whenever an insurer contracts with a merchant or credit grantor (including banks and leasing companies) as a distribution channel, coercive bundling or tied selling of products should be prohibited.

Explanatory Notes

The asymmetric nature of insurance transactions has, in the past, resulted in a number of unfair practices being used in insurance contracts or in sales practices.

Unfair contractual provisions are usually dealt with through specific provisions in the law dealing with insurance contracts. This is often supplemented by providing the authority with discretionary powers to prohibit unfair, misleading, or deceptive forms of contract.

Coercive tied selling can be defined as undue pressure imposed on a consumer to obtain a product or service from a bank or its affiliates as a condition for obtaining another product or service from the bank. This means that as a banking consumer, one cannot be put in a position of undue pressure to purchase a particular insurance product from a specific insurer in exchange for being granted approval for another product or service.

C2: SALES PRACTICES AND CONFLICTS OF INTEREST

- a. Regulatory requirements should ensure that high-pressure sales tactics or misrepresentations during the sales process are not permitted.
- b. Insurer salespeople and intermediaries and their salespeople should be held accountable for altering customer forms or asking customers to sign blank or incomplete forms.
- c. Insurer salespeople and intermediaries should be held accountable for verbal misrepresentations or half-truths or omissions in the sale of insurance products.
- d. Insurer salespeople and intermediaries should be held accountable for downplaying or dismissing warnings or cautionary statements in written sales materials.
- e. Insurer salespeople and intermediaries should be held accountable for proper handling and remittance of client funds to the insurer.
- f. Insurers and intermediaries should be required to disclose any potential conflicts of interest where they cannot be avoided, particularly when customers receive advice from a licensed financial adviser before concluding an insurance contract.

Explanatory Notes

Inappropriate sales practices

High-pressure sales tactics and other inappropriate sales practices sometimes found in multilevel selling should be prohibited through regulatory rules or a code of practice applying to salespeople and intermediaries. Estab-

lishment of such requirements should be accompanied by a system to investigate perceived contraventions and penalize those who have been found to violate the requirements.

The main sources of guidance on insurance sales practices in the European Union are the EU Insurance Distribution Directive, the consolidated Life Assurance Directive

(chapter 4 and annex III), the numerous directives covering non-life insurance and motor insurance, and the Mediation Directive. Some EU members, such as the United Kingdom, have disclosure and sales practices that are substantially stronger than those of the Life Assurance Directive and the Mediation Directive, including requiring that full records (sometimes including recordings) of sales transactions are maintained.

In addition, regulation should ensure that providers of digital finance keep records of consumer transactions, marketing materials, and other forms of disclosure; have such records available for the supervisor; and provide copies to consumers upon request.

This approach imposes operational costs that may be difficult to recover through margins for policies with very low premiums and could constitute a potential obstacle to microinsurance. In such cases, authorities may want to pay particular attention up front to sales materials and procedures instead. For products with low premiums or short policy durations (hence frequent renewals) that are often characterized by nontraditional distribution and a bundled nature, policy makers may wish to consider requirements for sales practices that are proportionate and should motivate insurers—who retain ultimate responsibility—to develop suitable approaches, such as intermediary COCs. Standardized microinsurance products whose features are disseminated via mass media, and standardized KFSs customized to microinsurance products and customers, are other alternatives to regulating sales transactions.

Other important directives include Directive 2002/65/EC of the European Parliament and Council concerning the distance marketing of consumer financial services; Directive 97/55/EC on comparative advertising; and Directive 2005/29/EC on unfair commercial practices, which sets out misleading practices (Articles 6 and 7) with 23 examples in the annex, and aggressive practices (Articles 8 and 9) with 8 examples. In Article 10, it is explicitly stated that unfair commercial practices may be controlled through COCs. Further, there can be recourse to out-of-court settlement, but the latter is not equivalent to judicial or administrative recourse.

Managing potential conflicts of interest

Conflicts of interest can take many forms, but perhaps the most common results from inducements paid to salespeople and intermediaries.¹⁰ An inducement can be defined as a benefit offered to an insurer or intermediary, or any person acting on its behalf, with a view to that firm/person adopting a particular course of action. This can include but is not limited to cash, cash equivalents, commission,

goods, and hospitality. Conflicts of interest can arise when intermediaries or salespeople who represent the interests of customers receive inducements from insurers affecting the independence of advice given to the customer.

To ensure that insurers and insurance intermediaries act in the best interests of customers, it is important that the authority require that all reasonable steps be taken to identify and manage conflicts of interest through appropriate policies and procedures. This is primarily an issue for the life insurance industry and the sale of investment products.

Conflicts of interest may be managed in different ways. Appropriate disclosure and informed consent from customers is the most common approach. Many jurisdictions require that consumers be informed whether the intermediary selling them an insurance contract is acting for them or for the insurer, and whether the intermediary will receive a commission for the sale of the product. Sometimes jurisdictions will also require disclosure of the amount of the commission for major investment products. Conflicts of interest may also be managed through rules on compensation arrangements, as further addressed in C7, “Compensation of Staff, Agents, and Intermediaries.” Policy makers in emerging markets should also consider how best to adapt disclosure practices for mature clients in mature markets for first-time insurance clients in emerging markets, particularly to balance policy interests in increasing outreach/inclusion with consumer protection.

Managing conflicts becomes particularly important when an intermediary is a licensed financial adviser. It has been recognized that different remuneration structures, including kickbacks and commissions, have created adverse incentives for advisers, sometimes leading to aggressive sales practices being mislabeled as “independent advice.” This has become an issue particularly in the area of complex and long-term products such as life insurance policies. In order to address this challenge and regulatory gap, some countries have adopted rules specifically governing the provision of financial advice intended to address these potential conflicts of interests. Australia imposes an obligation on financial advisers to provide fee-disclosure statements and an opt-in obligation that requires advisers to renew their clients’ agreement to ongoing fees every two years. In Singapore, where the Financial Adviser Act applies to licensed financial advisers who provide advice on investment and life insurance products, financial advisers must disclose, in writing, all remuneration, including any commission, fee, and other benefit, for making any recommendation. If remuneration is not quantifiable, the financial adviser should give its client a description of how it will be remunerated.

C3: PRODUCT SUITABILITY

- a. Insurers should take into account the needs and interests of different types of customers when developing and marketing insurance products, to ensure that products are not mis-sold.
 - b. Before concluding a contract or giving advice regarding an insurance product, insurance salespeople and intermediaries should obtain, record, and retain sufficient information from their customers to assess the customer's insurance needs—for example, the customer's financial knowledge and experience, needs, priorities, circumstances, ability to afford the product, and risk profile.
 - c. Insurers and intermediaries should ensure that, where consumers receive advice before concluding an insurance contract, such advice is appropriate to the consumer's disclosed needs and circumstances. They should also retain a record of the advice provided.
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Explanatory Notes

Product development and suitability

Requirements to take into account the interests of different types of consumers generally take two forms. In some jurisdictions, a product approval approach is required, whereby the authority reviews insurance products to ensure that they are appropriate for a target market and are unlikely to be mis-sold. In other jurisdictions, a principles-based approach is followed, which places the onus on the insurer's board and senior management to ensure that the products it develops are marketed in a responsible manner. Many jurisdictions in the United States follow the first approach, while the United Kingdom follows the latter.

In countries where the insurance sector is in an early stage of development, consideration should be given to the extent to which product suitability rules can be practically applied without substantially overburdening insurers and intermediaries and impairing the healthy growth of the insurance sector. In countries where the provision of insurance products via digital channels is evolving fast, such as via mobile phones and the Internet, suitability requirements may need to be adapted for new, innovative business models. For example, data analytics based on big data and alternative data may not be appropriate in all

circumstances as a complete substitute for individual assessments of product suitability.

Providing advice

Provision of advice goes beyond providing basic product information and relates specifically to the provision of a recommendation on the appropriateness of a product to the disclosed needs of the customer. Insurers and intermediaries should seek information from their customers that is appropriate for assessing their insurance needs before giving advice or concluding a contract. They should also document the information they receive. This information may differ depending on the type of product and may, for example, include information on the customer's

- Financial knowledge and experience;
- Needs, priorities, and circumstances;
- Ability to afford the product; and
- Risk profile.

In cases where advice would normally be expected and the customer chooses not to receive advice, it is advisable that the customer be required to sign an acknowledgment to this effect. The authority may also wish to specify particular types of policies or customers for which advice is not expected to be given, such as for very simple products.

C4: CUSTOMER MOBILITY AND COOLING-OFF PERIODS

- a. When an insured cancels a general insurance contract to which no cooling-off period applies, the insurer should provide, at a minimum, a refund of unearned premium less a short-rate cancellation penalty (for example, 10 percent of unearned premium), unless an alternative provision is specified in the contract.
 - b. There should be a reasonable cooling-off period associated with the sale of any traditional investment or long-term life savings contract, to deal with possible high-pressure selling and mis-selling.
 - c. A cooling-off period is also appropriate for distance marketing sales of insurance products.
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Explanatory Notes

Cancellation of insurance contracts

Legislation covering general insurance contracts should establish standards for the refund of unearned premiums when an insured decides to terminate the contract and there is no specific provision in the policy. Typically, such provisions require the insurer to refund unearned premiums less a reasonable fee for administrative cost.

In some circumstances, however, due to the special nature of the product (such as hard-to-place insurance coverage or index-based insurance, where the insured can predict the likelihood of claims payment before the end of the insurance duration), alternative provisions in the case of cancellation may be specified in the insurance contract. In such cases, consumers should be made aware of such provisions when the features of the contract are explained to them.

Cooling-off periods

These provisions are intended to address situations where a consumer should have the opportunity to step back and cancel a contract within a reasonable period after it has been signed. Cooling-off periods are typical for financial products or services with a long-term savings component (such as life insurance), complex financial products (such as life insurance), costly long-term financial products (such as regular investments), or products that are subject to high-pressure or unconventional sales tactics (such as life insurance, consumer credit, and some types of investments). Typically, cooling-off periods have been adopted for life insurance products due to their specific features: (i) highly abstract products and risks, (ii) long-term timelines, (iii) frequent investment components, (iv) difficulty verifying the quality of products in advance, (v) sales through agent and broker networks, and (vi) associations with aggressive sales techniques and mis-selling. For instance, consumers may be exposed to pressurizing sales tactics exaggerating concerns about the family after the breadwinner's death. Another area typical for cooling-off periods would be non-life insurance policies with characteristics similar to those noted above. Cooling-off periods have also been traditionally adopted for door-to-door sales.

Cooling-off periods should also be considered for insurance products sold remotely without human contact, such as by phone or over the Internet, given that the consumer may not fully understand the product and that a salesperson will have less chance to comprehend whether the consumer has understood the key features and risks of the product given the more limited in-person interaction. In France, a cooling-off period applies to all insurance products sold via distance marketing channels.

Not all insurance products require a cooling-off period, however. Typically, cooling-off periods are not appropriate

for products and services determined for immediate consumption or susceptible to fast alteration, such as short-term investments.

Cooling-off periods are an important safeguard that enables an individual to withdraw from an arrangement with impunity. A consumer is granted a time period of a reasonable number of days (at least three to five business days) immediately following the signing of any agreement between the financial institution and the consumer, during which the consumer may cancel the contract without providing any specific reason. Specifically, the consumer should be permitted to cancel or treat the agreement as null and void without penalty of any kind (unless the cooling-off period is explicitly waived in advance by a consumer in writing). When justified, necessary and reasonable expenses incurred by the financial institution due to cancellation of the contract (for example, an administration fee) may not be returned to the customer, thus presenting the only burden born by the customer in relation to exercise of the cooling-off period right.¹¹

Policy makers should take into account multiple issues when considering a cooling-off period. Specifically and prominently, policy makers should assess whether consumers are likely to be susceptible or subjected to (i) emotional decisions, (ii) shopping without comparison, (iii) sales pressure, (iv) information asymmetry, and (v) mis-selling. In such situations, cooling-off periods may provide an additional time for reflection, information research, and comparison shopping.

The right of withdrawal is enshrined in the Article 6 of the EU directive on distance marketing of consumer financial services. According to its provisions, the consumer has the right to withdraw from a contract without penalty and without giving any reasons. The periods vary by product and are longer for insurance contracts. The period of withdrawal typically begins with the conclusion of the contract and typically is in the range of two weeks (14 calendar days, as stated in the aforementioned directive). The EU Life Assurance Directive specifies a cooling-off period of between 14 and 30 days after the "contract has been concluded."

Cooling-off periods are common for long-term insurance products such as life insurance in developed countries, such as Singapore, and in some emerging markets. They cover a relatively wide range of insurance products in other countries, such as Australia.¹² Typically, cooling-off periods for long-term insurance products are longer than cooling-off periods for securities (including investment-linked life contracts) because of the onerous early-termination penalties that apply to many traditional life insurance savings contracts. In other countries, such as Japan, certain products such as variable annuities have cooling-off periods incorporated into their design.

C5: PROFESSIONAL COMPETENCE

- a. Key insurer staff, including directors, senior management, and people in charge of control functions, should be suitable to fulfill their roles. The regulatory framework should require that key officers and directors be able to demonstrate competence and integrity to the authority.
 - b. Indicators of integrity can include the absence of a criminal record; the absence of financial misconduct, personal bankruptcy, or serious regulatory breach; and the absence of disputes with previous employers concerning incorrect fulfillment of responsibilities. Indicators of competence include professional education, training, and experience directly related to the requirements of the position.
 - c. Insurer salespeople and insurance intermediaries engaged in the activity of soliciting, negotiating, or selling insurance contracts should possess high levels of integrity and competence.
 - d. For intermediaries, professional competence should be assessed through ongoing licensing, disciplinary, and professional development requirements. For insurer sales staff, this can be assessed through examination of internal training and control systems of the insurer.
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Explanatory Notes

As insurance is a business of trust, it is important that key insurer staff, insurer sales staff, and intermediaries be fit and proper. For key insurer staff, professional knowledge, experience, and training requirements usually depend on the specific business the insurer is engaged in and the person's position in the organization. For sales staff and intermediaries, competence relates to how individuals perform their responsibilities at point of sale.

In practice, regulation and supervision of these requirements is conducted through a combination of licensing

and ongoing supervision activities. Complex products require greater knowledge and experience than simple ones, and licensing systems usually require a higher licensing standard for those who engage in their sale. Many jurisdictions have established separate graduated licensing programs for general and life insurance, requiring completion of a defined curriculum and examinations for each level of licensing. Leading jurisdictions in this area include Australia, Canada, Singapore, South Africa, and the United Kingdom.

C6: AGENTS AND INTERMEDIARIES

- a. Regulations should clearly specify agent and intermediary licensing requirements.
 - b. Licensing regimes should include requirements for suitability, competency, professional conduct, and discipline of intermediaries.
 - c. As part of their licensing requirements, agents and brokers should be required to hold professional errors-and-omissions insurance relating to the conduct of their business.
 - d. Licensing requirements should not relieve insurers from responsibility for appropriate oversight and control of their in-house sales staff and their agency distribution channels.
-

Explanatory Notes

As discussed above, insurance agents and intermediaries should be licensed. Licensing helps ensure that interactions with consumers at point of sale, which generally result in a large portion of insurance consumer complaints, are conducted in a professional manner. The licensing function should extend beyond simple registration and include clear requirements for suitability, compe-

tenency, professional conduct, and discipline. Professional indemnity insurance should also be required for error and omissions by intermediaries in the conduct of insurance business.

Establishment of a licensing system should not be viewed as relieving insurers of their responsibility to oversee and control their product distribution network, nor should it be interpreted as excluding the insurer's liability

for agent or broker misconduct. Insurers should closely monitor agents and intermediaries on an ongoing basis. Monitoring should include the following:

- Establishment of clear policies, procedures, and controls to address conduct of business risks in agency agreements
- Training and testing activities
- Observing interviews with clients
- Audit of client files
- Complaints handling investigations

In countries where inclusive insurance is developing with the use of alternative distribution channels that are able to overcome previous barriers to delivery, regulators should consider crafting tailored requirements so that they support innovative distribution channels while addressing the particular consumer protection challenges raised by such channels. One way of doing this is to define and regulate microinsurance, and to allow special distribution channels for it, while also requiring special consumer protection measures—for example, with respect to product simplicity, financial literacy levels of target consumers, and service levels.

C7: COMPENSATION OF STAFF, AGENTS, AND INTERMEDIARIES

- a. **Insurers and intermediaries should be required to have a compensation policy that does not induce excessive and inappropriate risk taking and is in line with ensuring the fair treatment of consumers.**
 - b. **Such policies should require that the use of heavy front-end loaded commission schemes that induce unnecessary churning of insurance policies is prohibited.**
 - c. **To the extent possible, remuneration practices should not result in conflicts of interest on the part of insurer sales staff and intermediaries. If they do, the insurer should ensure that conflicts are properly managed.**
 - d. **To the extent possible, prior to the sale of most products or services that will result in a commission to a staff member or an agent, the fact of the commission and its amount should be disclosed to the consumer.**
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Explanatory Notes

As noted in C2, “Sales Practices and Conflicts of Interest,” conflicts of interest with respect to staff and agent compensation may be managed in different ways. In cases where the authority may have concerns about the ability of disclosure to deal adequately with conflicts of interest, the authority may consider requiring other options with respect to the structure of compensation models for staff and agents in order for insurers and intermediaries to manage such conflicts.

Examples from some jurisdictions in place or under consideration include:

- Requiring the insurer or the intermediary to decline the transaction
- Prohibitions on certain types of financial interest, such as contingent commissions to intermediaries based on volume of insurance business or profitability of business
- Structural changes to the retail distribution model, such as by prohibiting the payment or receipt of commission

for transactions of investment products in favor of an approach based on flat fees, as is currently proposed in South Africa

In the most advanced jurisdictions, strong mechanisms to protect consumers from conflicts of interest have evolved over a long time while insurance markets matured.¹³ In most countries, that is not yet the case. Often, a more immediate policy priority is how to include more people in formal insurance markets. In such circumstances, the conflicts of interest that are inevitable in insurance should be approached accordingly. For example, a particular distribution channel may reach large numbers of consumers that would not otherwise be served by insurers in a cost-effective and sustainable manner, but the channel may demand a (proportionately) high commission. The fact that consumers buy and renew such insurance may be taken as evidence that the utility of such products outweighs the possible drawbacks from conflicting interests and imbalanced bargaining power.

D: DATA PROTECTION AND PRIVACY¹⁴

D1: LAWFUL COLLECTION AND USAGE OF CUSTOMER DATA

- a. Insurers and intermediaries should be allowed to collect customers' data within the limits established by law or regulation and, where applicable, with the customer's consent.
- b. The law or regulation should establish rules for the lawful collection and use of data by insurers and intermediaries, including when consumer consent is required, and clearly establishing at a minimum
 - i. How data can be lawfully collected;
 - ii. How data can be lawfully retained;
 - iii. The purposes for which purposes data can be collected; and
 - iv. The types of data that can be collected.
- c. The law or regulation should provide the minimum period for retaining all customer records, and throughout this period, the customer should be provided ready access to such records for a reasonable cost or at no cost.
- d. For data collected and retained by insurers and intermediaries, insurers and intermediaries should be required to comply with data privacy and confidentiality requirements that limit the use of consumer data exclusively to the purposes specified at the time the data were collected or as permitted by law, or otherwise specifically agreed with the consumer.
- e. Legislation should provide a means by which individuals can correct what they believe to be erroneous personal information.
- f. If individuals have concerns or complaints regarding the handling of their personal information, the insurer should have an officer to handle enquiries and complaints regarding personal information.

Explanatory Notes

Insurers and intermediaries collect many different types of information from and regarding their customers, including personal information, contact details, consumer agreements, and so forth. Given the potential for abuse and misuse of such information, it is essential that this type of collection is regulated to avoid the risk of potential harm to consumers. For example, insurers and intermediaries may otherwise collect sensitive data and use the information for unfit purposes that may harm consumers—for example, to sell them products at higher prices. The various reasons for ensuring privacy and data protection include:

- The sensitivity of the personal information held and used in insurance products
- The extensive information flows that take place, such as between insurers and intermediaries and between members of a corporate group that includes one or more financial service providers
- The ever-increasing likelihood of information being received and held electronically, with a corresponding increase in the risk of remote, unauthorized access

- The fact that privacy is a fundamental human right deserving of protection, as indicated in various international instruments to which many countries are signatories¹⁵

Insurers and intermediaries should be allowed to legally collect, retain, and use personal information after obtaining lawful and informed consent from the consumer or on some other legitimate basis, including when related to the provision of the specific insurance product or service the consumer acquired. International guidance is clear in establishing that “the collection of personal data and any such data should be obtained by lawful and fair means and, where appropriate, with the knowledge or consent of the data subject.”¹⁶ While the concept of lawful collection of data differs substantially both among jurisdictions and among international guidance and principles, lawful and informed consent represents an underlying and cross-cutting theme. What constitutes informed consent can also pose challenges, particularly where adhesion contracts are common, or with respect to mobile or internet insurance.

Further, following the approach of treating data privacy as a human right, Convention 108 of the Council of

Europe (COE Convention)¹⁷ establishes that data shall undergo automatic processing only for a legitimate purpose, and that certain categories of sensitive data cannot be processed automatically, unless national legislation provides appropriate safeguards.¹⁸

Insurers and intermediaries may also have incentives to store personal information for longer than necessary. Therefore, the major international instruments also require limitations be placed on data retention.¹⁹ For example, the COE Convention states that data must be “preserved in a form which permits identification of the data subjects for no longer than is required for the purpose for which those data are stored.”²⁰

Overall, a guiding principle for legislative requirements in this area is that an insurer, an intermediary, or a related service provider should ensure that personal information in its custody or under its control is used only for the purpose for which that information was obtained or compiled, or for a use consistent with that purpose—for example, the use has a reasonable and direct connec-

tion to that purpose and is necessary for the insurer, intermediary, or service provider to fulfill its obligations to the client. Information should be considered legally used only if it is processed for the purpose it was collected. If this issue is not regulated by law or regulation, there is a risk that insurers and intermediaries may collect information for certain purposes for which customers may be willing to give consent, but then use that same information for other purposes that may be detrimental to customers’ interests and for which the customer may not otherwise have given consent. In addition, personal information should be obtained directly from the individual who applies for a policy. If information is required from any other source, the individual concerned should be notified, and the person’s written authorization should be obtained whenever possible.

The use of medical and genetic (biometric) information for the acceptance/decline and rating of life-related risks is currently an area of debate but is not within the scope of these Good Practices.

D2: CONFIDENTIALITY AND SECURITY OF CUSTOMERS’ INFORMATION

- a. **Insurers and intermediaries should be required to have and implement policies and procedures to ensure confidentiality, security, and integrity of all data stored in their databases that relate to their customers’ personal information, accounts, and transactions.**
 - b. **In order to ensure confidentiality, when establishing policies and procedures, insurers and intermediaries should also establish different level of permissible access to customers’ data for employees, depending on the role they play within the organization and the different needs they may have to access such data.**
 - c. **In order to maintain the security of customers’ data, insurers and intermediaries should also be required to have and implement policies and procedures to ensure security related to networks and databases.**
 - d. **Insurers and intermediaries should be held legally liable for misuse of consumer data.**
 - e. **Insurers and intermediaries should be held legally liable for any breaches in data security that result in loss or other harm to the customer and should put in place clear procedures to deal with security breaches, including mechanisms to reimburse or compensate consumers.**
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Explanatory Notes

In the insurance business, information confidentiality and security is obviously important since the collection, storage, and processing of information can involve a significant amount of financial, medical, and personal information. Safeguarding personal and financial data is one of the key responsibilities of the financial services industry and particularly insurance intermediaries.

Although consumer protection and privacy regulations vary from jurisdiction to jurisdiction, insurers and intermediaries have a clear responsibility to provide their customers with a level of comfort regarding information

confidentiality and the security of personal information. Information that a consumer expects to be confidential should be treated as such. Customers should be informed about which information might be disclosed and to whom. In addition, treatment of personal information should not depend on the medium through which the information is received—that is, written, electronic, and so forth. While legislative requirements are often established in general laws or regulations, the conduct of insurers and intermediaries with regard to compliance with these requirements should be part of the ongoing supervision and assessment work of the authority.

The confidentiality of personally identifiable information—that is, any information about an identified or identifiable individual—is protected under several international agreements, such as the Organisation for Economic Co-operation and Development’s (OECD) Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data (Article 2, “Scope of Guidelines”) and the United Nations’ Guidelines for the Regulation of Computerized Personal Data Files, adopted by the General Assembly on December 14, 1990 (section A, “Principles Concerning the Minimum Guarantees That Should Be Provided in National Legislation”). Further, important statutes are the EU Directive 1995/46/EC, on the protection of individuals with regard to the processing of per-

sonal data (chapter 1, articles 1–3), the COE Convention (chapter 1, “General Provisions”), and the APEC Privacy Framework (part ii, “Scope”).

Technical security is also demanded under the above guidelines and directives. A more detailed guideline on such security has been provided by the OECD Guidelines for the Security of Information Systems and Networks.

In the United States, the Federal Trade Commission has established guidelines in the form of Standards for Safeguarding Customer Information, which obligates financial institutions to hold customer information secure and confidential.²¹ In Canada, insurers are bound by personal information and privacy law requirements.

D3: SHARING CUSTOMER INFORMATION

- a. **The law should provide for rules for the release to and use of customer information by certain third parties such as government authorities, credit registries or credit bureaus, and collection agencies.**
- b. **Whenever an insurance provider is required to share a customer’s information with third parties by law, the provider should be required to inform the customer in writing in a timely manner of**
 - i. **The third party’s precise request**
 - ii. **The specific information about the consumer that has been or will be provided**
 - iii. **How and when that information has been or will be provided and how it will be used**
- c. **Subject to the exceptions noted in clauses D3(a) and (b), above, the sharing of a customer’s personal information with third parties should require the customer’s prior written consent as to the form and purposes for which the information is shared, unless the third party is a reinsurer, an agent of the insurer, or the intermediary, and the information is being used for a purpose that is consistent with the purpose for which that information was originally obtained.**
- d. **Before any such sharing for the first time, the insurance provider should be required to first inform the consumer in writing of his or her data privacy rights in this respect.**
- e. **Insurance providers should be required to allow consumers to stop or opt out of the authorized sharing of information regarding the consumer by the financial service provider (unless such sharing is mandated by law).**
- f. **In the case of tied products, the consumer should be informed if a third party will have access to the consumer’s information.**
- g. **Unless it is a credit bureau or credit registry, the law should prohibit the disclosure of the personal information by a third party with whom the client’s information is shared.**

Explanatory Notes

Customers should be aware of how information can be shared with third parties, including within the various units or subsidiaries of a financial institution. Insurers and intermediaries should be prohibited from disclosing consumer information to third parties for unauthorized—that is, without the consumer’s prior consent—uses, such as for marketing purposes.

Many of these shared uses can be beneficial for a customer, but the customer has the right to affirmatively state

that consent is given to such information sharing, even though it may be limited only to the specific uses to which the customer consents. Protection of personal information should extend to third parties with whom an insurer or intermediary may wish to deal. If the information is to be used for a purpose other than originally intended, the individual should be notified and their consent should be sought. A customer should also be able to opt out of sharing non-policy related information if the customer does not find such information sharing to be useful or beneficial to him or her.

Governmental regulatory authorities have the need to obtain customer information for regulatory purposes and law enforcement purposes, such as to monitor suspicious transactions for the purposes of anti-money laundering/

combatting the financing of terrorism (AML/CFT). The instances where this is permitted, as well as procedures for notification or situations where notification is not required, should be stated clearly in the law.

E: DISPUTE RESOLUTION MECHANISMS

E1: INTERNAL COMPLAINTS HANDLING

- a. Insurers and intermediaries should be required to have an adequate structure in place as well as written policies regarding their complaints handling procedures and systems – that is, a complaints handling function or unit, with a designated member of senior management responsible for this area, to resolve complaints registered by consumers against the insurer or intermediary effectively, promptly and justly.
 - b. Insurers and intermediaries should be required to comply with minimum standards with respect to their complaints handling function and procedures. These include the following:
 - i. Resolve a complaint within a maximum number of days, which should not be longer than the maximum period applicable to a third-party external dispute resolution mechanism. (See E2.)
 - ii. Make available a range of channels, such as telephone, fax, email, web, and so forth, for submitting consumer complaints appropriate to the type of consumers served and their physical location, including offering a toll-free telephone number to the extent possible, depending on the size and complexity of the insurance provider's operations.
 - iii. Widely publicize clear information on how a consumer may submit a complaint and the channels made available for that purpose, including on insurers' and intermediaries' websites, marketing and sales materials, KFSs, standard agreements, and locations where their products and services are sold, such as branches, agents, and alternative distribution channels. (See B1, "Format and Manner of Disclosure.")
 - iv. Publicize and inform consumers throughout the complaints handling process, and particularly in the final response to the consumer, regarding the availability of any existing ADR schemes. (See E2.)
 - v. Adequately train staff and agents who handle consumer complaints.
 - vi. Keep the complaints handling function independent from business units such as marketing, sales, and product design, to ensure fair and unbiased handling of the complaints, to the extent possible, depending on the size and complexity of the insurer or intermediary.
 - vii. Within a short period following the date the insurer or intermediary receives a complaint, acknowledge receipt of the complaint in a durable medium—that is, in writing or in another form or manner that the consumer can store—and inform the consumer about the maximum period within which the insurer or intermediary will give a final response and by what means.
 - viii. Within the maximum number of days, inform the consumer in a durable medium of the insurer's or intermediary's decision with respect to the complaint and, where applicable, explain the terms of any settlement being offered to the consumer.
 - ix. Keep written records of all complaints, while not requiring that the complaint itself be submitted in writing—that is, allow for oral submission.
 - c. Insurers and intermediaries should be required to maintain and make available to the supervisory authority up-to-date and detailed records of all individual complaints.
 - d. The insurer's or intermediary's complaints handling and database system should allow the insurer or intermediary to report complaints statistics to the supervisory authority.
 - e. Insurers and intermediaries should be encouraged to use analysis of complaints information to continuously improve their policies, procedures, and products.
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Explanatory Notes

Complaints handling policies should be in a form that is satisfactory to the authority and should also be approved by the insurer's board. A complaint can be defined as an expression of dissatisfaction about the service provided by an insurer or intermediary. A complaint may involve a claim for a financial loss but does not include a pure request for information. Knowledge of and access to complaints and redress mechanisms among emerging customers with low financial literacy deserve particular attention.

As an accumulation of complaints against insurers or intermediaries can indicate possible conduct of business (or solvency) problems, an ongoing analysis of policyholders' complaints is a key tool for conduct of business supervision in most insurance markets. Another key tool is firm-specific supervisory activity (see A4, above) to deter-

mine that the complaints handling policies and procedures are effective and being adhered to.

As insurers and intermediaries increasingly leverage alternative distribution channels for product and service delivery, the role of such channels in internal complaints handling should be considered. For example, when insurers and intermediaries serve consumers primarily through agents that are closer in physical proximity to the consumer, agents should be properly trained to receive and resolve simple complaints or to forward the complaint to the insurer or intermediaries' complaints handling unit.

Requirements for complaints handling policies are becoming common in several jurisdictions including Australia, Canada, the European Union, Malaysia, Singapore, and the United States.

For further details, see the explanatory notes for E1 in chapter 1, "Deposit and Credit Products and Services."

E2: OUT-OF-COURT FORMAL DISPUTE RESOLUTION MECHANISMS

- a. **If consumers are unsatisfied with decisions resulting from the internal complaints handling at the insurer level, they should have the right to appeal, within a reasonable timeframe (for example, 90 to 180 days), to an out-of-court ADR body, that**
 - i. **Has powers to issue decisions on each case that are binding on the insurer (but not binding on the consumer);**
 - ii. **Is independent of both parties and discharges its functions impartially;**
 - iii. **Is staffed by professionals trained in the subject(s) they deal with;**
 - iv. **Has an adequate oversight structure that ensures efficient operations;**
 - v. **Is financed adequately and on a sustainable basis;**
 - vi. **Is free of charge to the consumer; and**
 - vii. **Is accessible to consumers.**
- b. **The existence of the ADR, its contact details, and basic information relating to its procedures should be made known to consumers through a wide range of means, including when a complaint is finalized at the insurer or intermediary level.**
- c. **If the ADR has a member-based structure, all insurers should be required to be members.**

Explanatory Notes

A specialized insurance ombudsman or insurance claims and inquiries service (sometimes as part of an omnibus ombudsman service, as in the United Kingdom) is increasingly regarded as a fundamental requirement for sound consumer protection. Twenty-eight countries are currently members of the International Network of Financial Services Ombudsman Schemes.²² However, it can be difficult for an ombudsman to mediate and ameliorate the problems faced by policyholders effectively without clear codes of insurance practice and standardized contracts.

One of the most advanced systems is in Australia, where an insurance inquiries and complaints resolution system based at a self-regulatory organization has evolved into a fully-fledged financial services ombudsman.²³ Some countries also use small claims courts to provide an affordable means for the average customer to bring action against sellers, service providers, and corporations. However, such courts often lack sufficient transparency, capacity, or specialized expertise in insurance issues.

For further details, see the explanatory notes for E2 in chapter 1, "Deposit and Credit Products and Services."

F: GUARANTEE SCHEMES AND INSOLVENCY

F1: GUARANTEE SCHEMES AND INSOLVENCY

- a. The existence of a policyholder protection scheme should be complementary to (not a substitute for) an effective and well-functioning insurance regulatory and supervisory system.
- b. The existence of a policyholder protection scheme should not be viewed as a substitute for meeting international standards with respect to the windup and exit of insurers from the market. These include
 - i. Establishment of clear procedures for the windup and exit of an insurer in legislation that minimize the disruption and timely provision of benefits to policyholders
 - ii. Giving the rights and entitlements of policyholders a high legal priority in the event of an insurer liquidation and windup
- c. Legislation establishing policyholder protection schemes should require clear specification of policyholders that are covered, classes of insurance covered, the limits of coverage, and mechanism for making a claim.
- d. Policyholder protection schemes, because of their opaque nature, should be subject to rigorous public reporting requirements and independent supervision and oversight to help ensure that they have the ability to meet their obligations.
- e. Consumers should be provided with clear information on what classes of insurance, products, and policyholders are covered, and the mechanism for making a claim.

Explanatory Notes

While effective insurance regulation and supervision of insurers can reduce the risk of harm to consumers, they cannot eliminate it. As a result, many jurisdictions have established policyholder protection schemes, the aim of which is to provide a minimum level of compensation to policyholders in the event of an insurer insolvency and/or license revocation. The intent of these schemes is to guarantee, in whole or in part, due payment of benefits or covered claims under insurance policies at the time of an insurer failure. Well-run schemes include those operating in Canada and the United States.

In the event of a failure of a non-life insurer, a liquidator is usually appointed to manage the windup of its operations, and policyholders are advised to arrange new coverage with another (solvent) insurer in the market. Those who have outstanding claims become creditors in the liquidation process and may or may not receive payment during the windup. Policyholder protection schemes usually offer full or partial coverage to policyholders for potential losses and act on behalf of the claimants in the liquidation process. In many jurisdictions, these schemes are restricted to compulsory classes of insurance, but in some, they cover a broader range of products.

With life insurance products, while the objectives of the protection scheme and its involvement in the windup process are similar, the products are often more sophisticated and, often, insurer policies have longer terms and complex benefit provisions. As a result, the tools used by

the liquidator to liquidate, and the involvement of the policyholder protection scheme to ensure the payment of guaranteed benefits, are more complex.

While the establishment of policyholder protection schemes can bring a level of protection for consumers, they also bring certain risks that need to be considered when assessing consumer protection standards within a jurisdiction. First, these schemes are complicated to establish, complicated to run, and difficult for consumers to understand. Consumers need to be provided with clear information on what classes of insurance, products, and policyholders are covered, and the mechanism for making a claim. In addition, scheme funding needs are complex, involving sophisticated actuarial analysis and a combination of pre- and post-failure assessments and credit facilities. If schemes are poorly designed and run, they may result in insurance consumers having a false expectation of protection that leaves them in a poorer financial position than if no scheme existed.

Second, if policyholder protection schemes are not complemented by an effective and well-functioning regulatory and supervisory system, they may end up being liable for substantially greater risk and financial payouts than originally intended. Third, unless there are clear policies, procedures, and requirements for the liquidation and windup of insurers, they are likely to be ineffective in meeting their stated purpose and simply complicate the liquidation process.

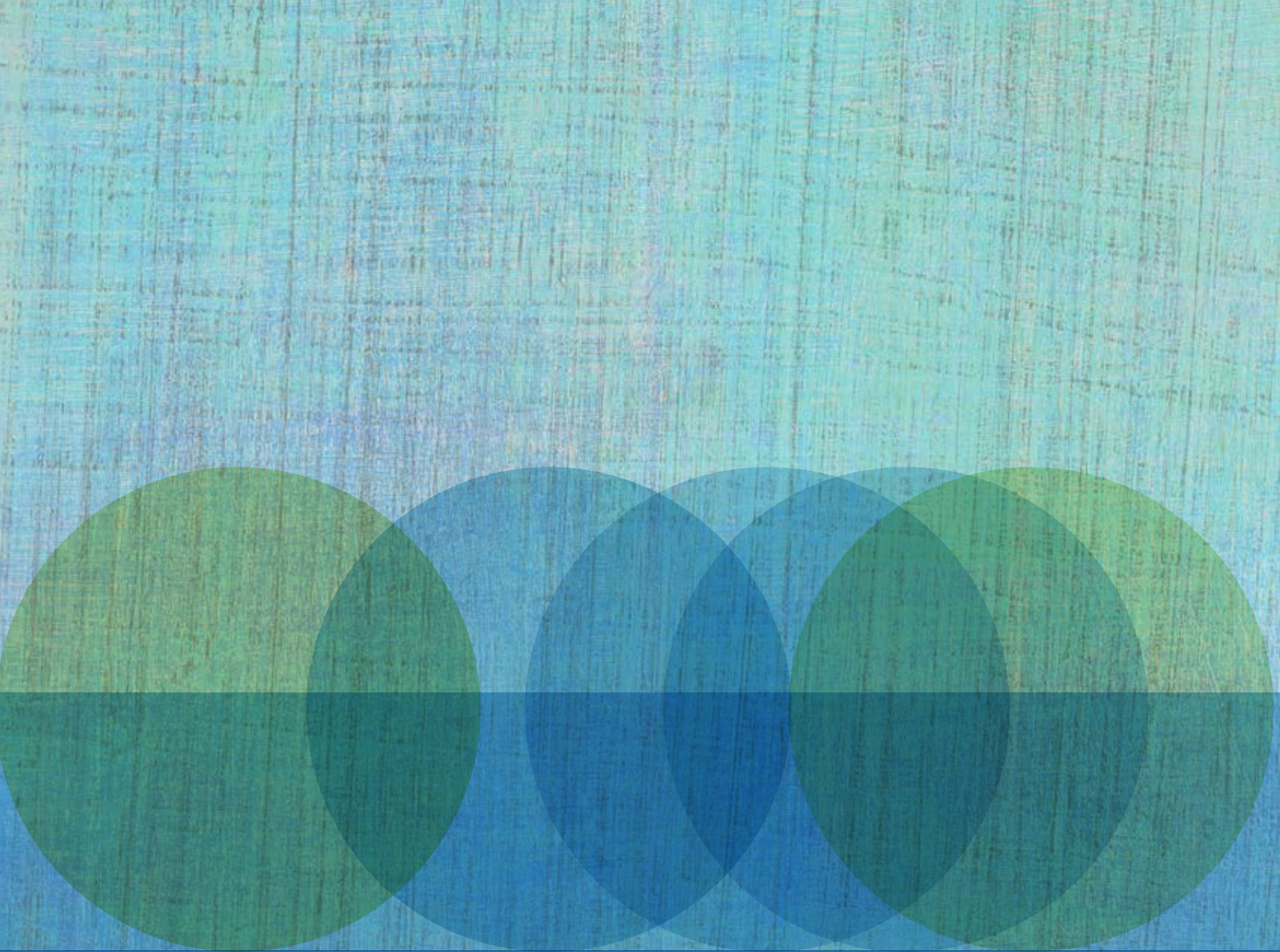
The following papers provide a thorough discussion of the risks and benefits of these schemes:

“Policyholder Protection Schemes: Selected Considerations,” Working Papers on Finance, Insurance and Private Pensions 31 (OECD, 2013)

“Issues Paper on Policyholder Protection Schemes” (IAIS, 2013)

NOTES

1. See Mark King, “FSA Wins PPI Battle in High Court,” *The Guardian*, April 20, 2011, regarding the inappropriate sale of payment protection insurance.
2. The term *conduct of business* is used in this chapter as the equivalent of *market conduct* or *financial consumer protection*, as it is the term used more frequently in the insurance sector.
3. “Application Paper on Regulation and Supervision Supporting Inclusive Insurance Markets” (IAIS, 2012).
4. EcoLife was a free life insurance product (“freemium”) made available by Econet as part of a loyalty program. The product scaled up rapidly but was withdrawn after seven months as a result of a dispute over royalties between the partnering parties (Econet, FML, and Trustco). As a result, around 1.6 million Zimbabweans lost coverage and were not compensated. For further details, see http://www.finmark.org.za/wp-content/uploads/pubs/Rep_M_insurance_Zimbabwe_20142.pdf and <http://www.southerneye.co.zw/2013/12/01/first-mutual-life-clients-limbo/>.
5. “Issues Paper on Conduct of Business in Inclusive Insurance” (IAIS, 2015).
6. “Insurance Core Principles,” as updated through 2015 (IAIS, 2011).
7. http://www.mas.gov.sg/~media/resource/legislation_guidelines/fin_advisers/fin_advisers_act/guidelines/FAA_G04.
8. http://www.clhia.ca/domino/html/clhia/CLHIA_LP4W_LND_Webstation.nsf/page/AB6B645E4DCB-1B818525780E0064AB58?OpenDocument.
9. Flesch-Kincaid readability tests are designed to indicate how difficult a passage in English is to understand. There are two tests, the Flesch Reading Ease and the Flesch-Kincaid Grade Level. They use the same core measures: word length and sentence length.
10. See “Issues Paper on Conduct of Business Risk and Its Management” (IAIS, 2015) for an extensive discussion on this point.
11. Regulators may consider imposing caps on the reasonable expenses to be charged in order to prevent financial institutions from charging exorbitant fees and thus discouraging consumers from exercising their rights.
12. See <http://www.asic.gov.au/fido/fido.nsf/byheadline/Cooling+off+rights?openDocument>.
13. Readers may wish to review recent EIOPA work on the inducement part of the 2016 EU Insurance Distribution Directive, as well as Article 17.
14. Insurers and intermediaries gather vast amounts of data, including personal information, in order to conduct their daily tasks. This information is sensitive to misuse or breaches, which has the potential to cause harm to consumers. This section touches on only a few select issues with respect to privacy and data protection that are most relevant to financial consumer protection.
15. See, for example: (a) Universal Declaration of Human Rights, Article 12 (United Nations, 1948), (b) European Convention for the Protection of Human Rights and Fundamental Freedoms, Article 8 (European Court of Human Rights, 1950), available at <http://www.coe.fr/eng/legaltxt/5e.htm>, (c) Convention for the Protection of Individuals with Regard to the Automatic Processing of Personal Data, ETS No. 108 (Council of Europe, 1981), available at <http://www.coe.fr/eng/legaltxt/108e.htm>, and (d) International Covenant on Civil and Political Rights (United Nations, 1966), available at <http://www.hrweb.org/legal/cpr.html>.
16. Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data, section 7 (OECD, 2013).
17. APEC Privacy Framework, Principle 18 (Asia-Pacific Economic Cooperation, 2005).
18. Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data (Council of Europe, 1981).
19. See, for example, Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data, Principle 10; United Nations Guidelines, Article 3; APEC Privacy Framework, Principle III, “Collection Limitation”; and COE Convention.
20. Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data (Council of Europe, 1981).
21. The document can be downloaded from the Federal Trade Commission’s website, <http://www.ftc.gov/os/2002/05/67fr36585.pdf>.
22. For more information see, <http://www.networkfso.org/Links.html>.
23. See generally, http://www.fos.org.au/centric/home_page.jsp.



PRIVATE PENSIONS

Pension savings by their nature are complex, difficult products for most consumers, both in the accumulation and the pay-out phase. Several decisions must be made that would require some understanding of finance and investments. It is not a one-off purchase, but a series of choices, such as joining a plan, picking contribution levels, selecting investment portfolios, switching among pension funds if necessary, and finally selecting a type of annuity or other type of retirement product (such as programmed withdrawal) and a provider. Pensions are purchased rarely, and individuals are typically locked in for a long time. The implications of decisions often become clear only after a significant time-lag. Due to the nature of long-term savings, a small difference in charge levels may have a significant impact on the final outcome.

Consumer protection principles require that information is provided in a way that helps consumers without particular financial knowledge understand key conditions and parameters and follow the development of their individual pension outlook. This is a hard task, and behavioral economics may help design the best methods. A special aspect of this is the consideration of default solutions to overcome difficult situations when undereducated consumers would be expected to make well-founded active choices, which is not a realistic expectation. Indeed, international evidence suggests that competition within pension markets does not work as in other financial sectors, due to the disengaged nature of most fund members. More controlled competition has therefore been introduced in many countries, particularly in those with mandatory systems, where the fund members may be particularly vulnerable.¹

This chapter contains principles mainly regarding privately managed, defined contribution (DC) funded pensions and does not cover state pensions. Though duty is due to members of public sector and publicly managed pension schemes, they are not consumers in the literal sense and therefore are not directly addressed in the Good Practices.² This chapter deals with several approaches for funding pensions and tackles special issues but does not discuss prudential and solvency issues relating to defined benefit (DB) schemes.³ Countries tend to have different regulatory frameworks (for instance, contractual or trustee-based systems, individual or occupational products, DB and DC schemes, and other frameworks). One important aspect is whether the pension savings system is mandatory or voluntary. In many countries, pension plans are mandatory or quasi-mandatory or a condition of employment and, at least implicitly, have a government stamp of approval, via tax breaks or other incentives. Extra attention to consumer protection is needed in such cases, over and above the short-run voluntary purchase of financial products that is the case in other financial sectors. Consumer protection authorities may need to accommodate the special demands of protection for these mandatory products with a long time horizon. Importantly, not only the accumulation but also the decumulation or benefit phase should utilize good practices with respect to consumer protection.

Some of the practices described herein are more emerging and aspirational than others and may not be applicable in all countries, and compliance with all aspects by all jurisdictions is not expected immediately. New practices, often based on behavioral economics, tend to take place in more developed markets. Given

the fact that many countries are still in the early phases of establishing a well-functioning, privately managed, funded pension system, such initiatives may contribute to the latecomers' advantage, though reform efforts can be strategically phased.

Examples in this chapter are drawn from a range of different countries and regions, covering both developed and emerging economies, in order to provide practical lessons and approaches that can be utilized across countries in different stages of development.⁴ For systems where pensions are sold in a retail market to individuals, consumer protection issues will be similar to those in other financial sectors, and many of the same general principles discussed throughout the Good Practices will apply. For other systems, such as occupational pension

systems where provision is by a sponsoring employer and where members do not exercise any individual choice, pension-specific issues such as the role of trustees will be of greater importance.

The findings and recommendations herein are in line with, and rely on, the G20 High-Level Principles on Financial Consumer Protection (G20 FCP Principles) of the Organisation for Economic Co-operation and Development (OECD),⁵ Several country examples throughout the chapter use findings on effective approaches to support the implementation of the G20 FCP Principles.⁶ The harmonized use of the Good Practices and the G20 FCP Principles will hopefully lead to improvements in consumer protection related to pension products and services around the world.

A: LEGAL AND SUPERVISORY FRAMEWORK

A1: CONSUMER PROTECTION LEGAL FRAMEWORK

- a. There should be a clear legal framework that establishes an effective regime for the protection of consumers who deal directly with pension management companies.
 - b. The pension law should explicitly provide for the protection of members/affiliates of occupational and personal plans, including that these plans should be run in their interests.
 - c. There should be an authority (or authorities) responsible for the implementation, oversight, and enforcement of pension consumer protection, as well as data collection and analysis (including inquiries, complaints, and disputes). If a more developed retail pensions market exists, a specialist authority dealing with financial sector and/or specific pension issues may be more appropriate.
 - d. All legal entities that provide pension-related financial services to consumers should be required to be licensed (or registered) and supervised with regard to their market conduct (that is, their business practices in relation to retail customers) by the appropriate financial supervisory authority.
 - e. The licensing process should, at a minimum, require that
 - i. The applicant's beneficial owners, board members, senior management, and people in control functions demonstrate integrity and competence;
 - ii. There are appropriate governance and internal control systems in place, including specific controls to mitigate conduct of business risk; and
 - iii. The applicant has sound business and financial plans.
 - f. The law should provide, or at least not prohibit, a role for the private sector, including voluntary consumer organizations and self-regulatory organizations, with respect to consumer protection regarding private pensions.
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Explanatory Notes

Pensions, along with other financial products, should be explicitly covered by the general consumer protection laws of a country, or by consumer protection laws specific to the financial sector. In addition, the pension law should specifically recognize the protection of members of occupational and personal pension plans. At a minimum, the law should explicitly recognize that pension funds should

be managed exclusively in their interests. Reference to trust law or fiduciary duties can be made in jurisdictions where relevant. The requirement of appropriate governance and internal control systems in the licensing process of pension service providers is essential to ensure that their market conduct is in line with consumer protection principles.⁷

A2: INSTITUTIONAL ARRANGEMENTS AND MANDATES

- a. National laws should assign clear and explicit objectives to pension regulatory authorities in relation to the protection of members of pension funds.
- b. Pension regulatory authorities require adequate financial, human, and other resources to allow them to effectively implement market conduct oversight and consumer protection, as well as prudential regulations.
- c. Appropriate legal protection should be established to protect the authority and supervisory staff from personal litigation in the good-faith exercise of their supervisory duties.
- d. Pension regulatory authorities and competition authorities should consult with one another.
- e. Pension regulatory authorities should work with the media, industry, and consumer associations to involve them in active promotion of financial consumer protection.
- f. Pension regulatory authorities should involve industry associations to play a role in analyzing complaints statistics and proposing measures to avoid recurrence of systemic consumer complaints.
- g. Government and state agencies should consult consumers of pension products, industry associations, and financial institutions providing pension-related services to develop proposals that meet consumers' needs and expectations.

Explanatory Notes

Whether within a “twin peaks” structure (with separate prudential and consumer protection authorities) or handled by either an integrated financial sector regulator or a stand-alone pension regulatory authority, consumer protection issues relating to pension fund members need to be considered as well as prudential oversight of the financial condition of their schemes. Whatever the regulatory structure, mechanisms for coordination between different financial sector authorities need to be in place to make sure that pension regulatory authorities are aware of

issues arising in another area that could affect pension fund members. Regulators should also partner with other groups—media, consumer, and industry associations—to ensure that consumers of pension products and members of pension schemes are treated well—that is, not provided with misleading information, and no mis-selling takes place. Though competition within the pension sector frequently does not operate in the same way as in other financial sectors, competition authorities could also periodically support the pension regulatory authority by examining how well the pension market is functioning.

A3: REGULATORY FRAMEWORK

- a. Regulatory requirements can be established in laws, regulations, or a in rule-making authority, but must be legally enforceable.
 - b. Regulatory requirements should be tailored to the nature, scale, and complexity of the pension industry.
 - c. A principles-based or rules-based approach (or a hybrid approach) can be used.
 - d. As well as regulatory guidance, regulatory tools can include codes of conduct and product reviews.
 - e. The pension regulatory framework relating to consumer protection should focus on reporting and disclosure, sales practices, and dispute mechanisms.
 - f. Additional regulatory tools, such as fee caps and/or techniques utilizing behavioral economics, may also be used.
 - g. Regulatory authorities of pension products and services should consult with the industry when drafting the regulatory framework.
 - h. Regulatory authorities of pension products and services should undertake consumer testing to ensure that proposed regulatory initiatives are likely to have their intended outcomes.
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Explanatory Notes

Consumer protection regulations can be enshrined in laws or in separate regulation and guidance developed by the regulatory authority. Most jurisdictions use a combination of rules-based and principles-based approaches—balancing predictability and flexibility—depending on the jurisdiction’s legal system (for example, civil code or common law), cultural factors, and history. Regulatory guidelines are the most common regulatory tool used in the pension sector. Codes of conduct are less common than in other financial sectors. Likewise, product reviews by the regulatory authority tend to be on an individual investment basis rather than regarding the issuance of pension products themselves (countries with an active retail market in personal pension products being the exception).

As with other financial sectors, consumer protection around pensions will focus on reporting and disclosure, sales practices and dispute mechanisms. These main areas are covered in detail in the following sections. The nature of the pension system will determine which areas are of greatest importance and may therefore require greater regulatory intervention. For example, for DC pension systems with competing private providers, regulatory

controls on sales and marketing practices will be particularly important. Given that competition has not been found to work well in pension systems (due to a lack of knowledge and engagement with pensions on the part of consumers), the regulatory authority may need to use additional tools, such as capping fees and using behavioral economics tools (such as specifying default providers and/or funds) to protect consumers and ensure the best outcomes for them. Consulting with stakeholders is always good practice when drafting regulations, to ensure support for the regulatory framework and aid compliance. Public consultations may also be useful tools, as they help raise consumer awareness and gather more opinions.

Whether a rules-based or principles-based approach is adopted by the regulatory authority will depend on the nature of the pension system and its operating environment—for example, how well developed the pension system is, if there are experienced pension fund managers and service providers, the nature of the legal system, the level of expertise of the regulator, and so forth. Mandatory systems generally have a tighter regulatory framework, as a higher level of consumer protection is required due to the compulsion involved.

A4: SUPERVISORY ACTIVITIES

- a. Pension supervisory authorities should adopt a risk-based approach, focusing on the consumer protection issues that pose the greatest threat to pension fund members.
- b. Pension supervisory authorities should use their standard supervisory tools to oversee consumer protection issues—for example, requesting information, on- and off-site investigations, complaints monitoring, and so forth.
- c. Pension supervisory authorities should collect data on consumer and pension fund member complaints and use these in their risk-based supervision assessments and in their industry surveys.
- d. Pension supervisory authorities should consult with the bodies they are overseeing on consumer protection issues and cooperate with other supervisory authorities domestically and internationally.
- e. Pension supervisory authorities should treat confidential information of pension fund members appropriately.
- f. Pension supervisory authorities should conduct their operations in a transparent manner.
- g. Pension supervisory authorities should adhere to their own good governance practices—including governance codes, internal risk-management systems, and performance measurement—and authorities should be accountable.

Explanatory Notes

The recommendations regarding supervisory activities and enforcement are based on the International Organisation of Pension Supervisors' (IOPS) Principles of Private Pension Supervision. These apply to general oversight of pension funds, which also includes good practice regarding the oversight of consumer protection issues in the pension field.⁸ The IOPS stresses that pension supervision should be risk-based, focusing scarce supervisory resources on the most important risks. In systems where pensions are sold as retail products, greater focus on consumer protection issues will be required than in occupational systems or those where pension fund members have little or no individual choice. In such cases, prudential supervision and regulatory protection are also required. Pension supervisory authorities themselves

need to operate on good transparency and governance standards in order to have a sufficient standing to apply consumer and other protection measures to the entities they oversee. Being a member of a regional or international supervisory organization also helps national supervisory authorities share best practices.

The tools used by pension supervisory authorities to oversee consumer protection issues are the same as for their overall supervisory task: requesting information, on- and off-site investigations, complaints monitoring, and so forth. The nature of the pension system and the approach of the supervisory authority will determine how the tools are used.⁹ For example, supervisors overseeing many pension funds will rely more on reporting and screenings, while those overseeing a limited number of pension providers may undertake more intensive investigations.

A5: ENFORCEMENT

- a. Pension supervisory authorities should be endowed with the necessary investigatory and enforcement powers to fulfill their functions and achieve their consumer protection objectives.
- b. Pension supervisory authorities should ensure that investigatory and enforcement requirements are proportional to the risks being mitigated and that their actions are consistent.
- c. Pension supervisory authorities should have an adequate range of intervention and enforcement protective and punitive tools to address contravention, including but not limited to the following:
 - i. The power to issue formal orders with respect to the pension funds, the members of the managing boards, and other managers, requiring them to take particular actions or to desist from taking particular actions

- ii. The power to replace members of the managing board and other managers of pension funds and to disqualify them from acting in responsible capacity in the future, either temporarily or permanently
- iii. The power to restrict business activities
- iv. The power to impose conditions/restrictions on, or to revoke the operating license of, the pension fund and/or its managing company
- v. The power to put the assets of a pension fund in a trust or to restrict the disposal of those assets (that is, to freeze them)
- vi. The power to impose administrative sanctions, including fines, against the pension fund managing body or individuals
- vii. The power to apply to a court for orders requiring a pension fund to undertake or refrain from undertaking certain actions
- viii. The power to accept a court-enforceable undertaking from a pension fund or other relevant person or body

Explanatory Notes

Pension supervisory authorities need sufficient powers to implement consumer protection for members of pension funds. Such powers will include the ability to direct pension fund managers and to take cases to court, if necessary. Enforcement pyramids can be used to help supervisory authorities intervene on a proportional basis with consistency across supervised entities and to communicate their approach and what is expected of supervised entities.¹⁰

The IOPS Guidelines for Supervisory Intervention, Enforcement and Sections¹¹ provide guidance on the most common tools to be used by pension supervisory authorities. In fact, despite the heterogeneity of pen-

sion fund systems in the world today, certain common approaches to pension supervision have been identified and compiled in these guidelines. The IOPS guidelines provide not only a detailed list of the powers for supervisory intervention, enforcement, and sanction, but also guidance on the scope and process of these interventions. For example, the goals of the intervention need to be well-defined, the procedures need to be clear with a well-defined decision-making process, enforcement decisions and actions need to be consistent and proportional, and if a pensions market is supervised by more than one authority, these actions need to be coordinated.

A6: DISSEMINATION OF INFORMATION BY AUTHORITIES

- a. Authorities should make readily available to the general public, at no cost, minimum relevant information on the private pension sector and about their own role and how they perform their duties to help achieve their statutory goals and increase transparency. This information should generally include
 - i. At a minimum, annual reports with summary statistics on an aggregated basis for the pension industry as a whole; and
 - ii. In markets with standardized products, information such as comparative cost data and investment performance, as well as interactive decision-making tools, presented in a standardized and easily comprehensible way (typically on a website).
- b. Reporting of costs should be standardized (including up-front costs and management fees, as well as embedded costs, such as mutual fund fees in the pension fund portfolio), in order to facilitate comparison, preferably including synthetic cost indicators.
- c. If investment performance indicators are shown, comparison should focus on longer-term performance.
- d. If comparative investment returns are provided, warnings about the use of past performance should be added.
- e. Performance measures should be updated regularly but not too frequently, as too much short-term volatility could be misleading.

- f. **Only such meaningful risk measures should be included that emphasize the risk of not achieving desired pension levels, and the significance of the life-cycle approach should be demonstrated.**
- g. **Pension supervisory authorities should publish data on enforcement actions where this is felt useful as a deterrent mechanism.**

Explanatory Notes

Pension authorities play an essential role in providing easily available, centralized, comparable, and objective information about the whole market and individual service providers. The information is equally useful for prospective clients who are selecting a pension product and for those who want to compare services provided to them with other products. Because in new, young markets, clients typically have very limited knowledge, it is a priority to establish and operate central online platforms as soon as possible. In mature markets with a large number of occupational funds, where complete data collection and provision are not typical, comparability would still be an objective, but developing a comprehensive database may take longer and receive lower priority, taking into account capacity constraints of the authorities as well. However, lacking comprehensive information may still be problematic for policy makers and savers in such markets, and surveys can substitute for such centralized data provision to only a limited extent.

Many authorities¹² provide comparative tables on their websites, primarily to compare costs. In some countries, such as Ireland and the United Kingdom, the need to compare occupational funds is not a priority, as most employees are linked to one specific plan. A detailed breakdown of pension funds' trading costs is useful but easier to compile and comprehend in smaller markets (for example, Macedonia), and it can be demonstrated that transparent cost comparisons can push down costs significantly in the whole market (as in Mexico).¹³ The benefits for customers in mass markets suggest that authorities in even more countries should aspire to develop such tools, and regulatory capacity constraints should normally not pose obstacles to this.

Cost comparison may be difficult, as different types of fees may arise (for instance, load fees and asset-based fees) and the treatment of hidden charges (such as trading fees or those of mutual funds in the portfolios) may be complicated.¹⁴ Synthetic total cost indicators (TCIs) demonstrate all charges—or the average annual investment returns needed just to cover all expenses—for an average customer with standardized parameters (such as age, size of contributions, and other variables).¹⁵ Such a tool is used in a number of countries, including Hungary, Italy, and Turkey, but some regulators (for example, Mexico) have been hesitant, considering it potentially misleading, since individuals' parameters will differ from the standardized

ones.¹⁶ It may also be useful to allow only one type of fee element (based on contributions or assets only, such as in Chile and Mexico), but the transition to such a model from a multi-fee system may create difficulties in standardized net-of-fee performance measurement (for example, Peru).¹⁷

Tables provided by the authorities that also compare investment performance and past returns are less common than for costs, but still relatively frequent. Countries like Ireland and the United Kingdom do not provide such comparisons. Australia, which until recently did not have such comparisons, either, introduced the requirement that pension funds (MySuper) should display comparisons of costs and performance on their website product dashboards.¹⁸ This is partly due to the large number of pension funds and the predominantly occupational nature of the market, but also to the fear that providing comparative information only on costs would draw attention to short-term results only. Some countries, such as Brazil, therefore provide market averages and trends without data at the individual pension fund level. Pension fund members of the Mandatory Provident Fund Scheme Authority in Hong Kong can now check annualized 5- and 10-year returns on a centralized cost-and-fees-comparison website.¹⁹

While performance comparisons sometimes include 5- and 10-year average returns, short-term annual (or biannual) figures are also typical (though they are rarely the only period compared).²⁰ Additionally, many comparisons include short-term volatility indicators, such as standard deviation. Compiled market data based on such short-term figures may lead consumers to unfounded and inappropriate decisions. It is more helpful if information provided by the authorities focuses on longer-term developments, and especially on pension projections. (See [B5\(c\).](#))

Providing free, objective information (guidance) from government sources about pension products in the payout phase is recommended, especially for low-income savers who cannot afford personal advice. It does not rule out a significant role in the provision of advice by intermediaries, as even those customers who can afford these services typically have a low level of knowledge and confidence in them.

Centralized annuity quotation systems run by authorities have operated for a while in some countries, such as Chile and the United Kingdom. Experience clearly sup-

ports these systems, since consumers receive better offers from providers. Setting up such systems is not too complicated, so constraints on authorities and providers should be possible to overcome.²¹ Selecting among types of products and providers is complex, and participants will need assistance. Because they should be able to identify the right type of pension product first, and then compare quotes from competing providers, a two-tier system that offers general information and quotations is useful. In Peru, for instance, individual decisions are facilitated by the regulatory authority and the pension fund but are still challenging for consumers.²² Additionally, in countries

where the state guarantees payouts in case of the bankruptcy of the insurance company, as in Chile, this information is an important element of disclosure before purchasing an annuity.²³

Regulatory or, more generally, government authorities may also facilitate the distribution of combined information about pension income sources from public and private pillars. It is useful if the individual can see all pension income sources on one statement, though this is very aspirational in most cases. The Netherlands provides an example of a central website that offers an overview of both public and private pensions.²⁴ (See B5[c].)

B: DISCLOSURE AND TRANSPARENCY

B1: FORMAT AND MANNER OF DISCLOSURE

- a. All information provided to customers should be easy to read and understand.
- b. Information should be available to consumers via numerous channels, such as in branches, pension fund offices, and online (particularly pension calculators).
- c. Information to be provided on paper (versus online), and the possibility of opting out of paper-based communication, should be carefully considered. Regardless of the means by which information is provided, key information should be provided in a durable medium.
- d. In all communications, adequate fonts and layout and, where appropriate, graphs should be used. Practical communication with examples should be emphasized, taking into account that participants have differing levels of knowledge and information.
- e. All communications should be based on a clear vocabulary of expressions to be used or to be avoided, and unusual words and jargon either should not be presented or, at a minimum, should be explained.
- f. Research is recommended on member attitudes and responses to statement content and design, and terms should be simplified through consumer testing, especially with the needs of vulnerable consumer groups in mind.

Explanatory Notes

Regulations traditionally require the provision of much detailed information—including prior to purchasing a pension product, at the time of purchasing, and once a member of a pension fund. Prospective and existing consumers must be aware of product characteristics and about what's going on in the institution managing their savings.²⁵ However, more information is not necessarily better. People don't like reading long statements, and a one-page summary is more likely to reach its audience than a long document with more data. For the same reason, shorter, focused communication prompts action more easily. Australia, Ireland, Italy, Mexico, Spain, the United Kingdom, and other countries require the provision of simple and understandable information, emphasize simple language, and recommend the use of graphs.²⁶

In the United Kingdom, the National Employment Savings Trust (NEST), an important provider for auto-enrollment, has a key role in communicating with people for whom the idea of saving for pensions may be completely new. (See B3[b] and endnote 53.) NEST uses a carefully designed and tested vocabulary to communicate with its consumers. (Box 2 provides an overview of NEST's use of language.)²⁷

Mexico's experience in presentation techniques reveals an interesting and important aspect of behavioral economics. Presenting fees in pesos instead of percentage rates helped financially illiterate participants select funds with lower fees. Such a small change in approach, which makes fees transparent and easier to understand, is a very useful and efficient tool for policy makers to consider.²⁸

Paper-based communication, though still the most prevalent channel,²⁹ is not the only format. A multi-layer approach may be a good way to address different consumer preferences and needs.³⁰ Automatic or on-demand information provision, as well as paper-based or online distribution methods, may be utilized, which differ according to their depth of information. An information set that is relevant for all members—such as annual accounts, investment policy, scheme rules and governance, and regulatory authority—may have to be provided automatically. General information on the running of the scheme may partly be sent out and also made fully available online. Individual information, including projections, may be updated and sent annually and also made fully available online. Other information—for instance, combined pension projections with all types of pensions—may be provided only online. For example, modular approaches are used in Australia: simple introductory materials are available on webpages, with links to more detailed documents for interested members.³¹

More and more people, and especially younger people, tend to prefer online and other electronic forms of communication. Meaningful disclosure has to find its channels in this new reality, and careful regulation must define what's absolutely necessary to be available on

paper.³² At the same time, considering the overall goal of including low-income, vulnerable groups that may lack access to the Internet, traditional communication channels—that is, paper-based distribution, facilitated at branches of financial institutions—remain relevant.³³

Most jurisdictions still do not regulate which statements must be paper-based or may be electronic. For instance, in Latvia there are no provisions requiring that consumers must opt out of receiving paper-based statements to receive information electronically. The practice of sending annual statements to consumers has been changed to issuing statements on demand and having them available on the Internet.³⁴ In Tanzania, many members have online access to their account, may receive text information about their account on mobile phones, or may go to a fund office for a detailed statement.³⁵ In Armenia, pension fund members can monitor their last activities and account balance online at account operators (banks and postal offices) and via automated teller machines (ATMs). While local context will influence which methods are the most appropriate, some regulation in this regard is essential to protect customers' interests. Complementary regulatory requirements should also be considered regarding recordkeeping for digital transactions, to ensure that records are available for supervisors and

BOX 2

NEST's Use of Language in the United Kingdom

Between 2012 and 2018, the United Kingdom has been in the process of auto-enrolling 10 million new savers—predominantly workers who have never been covered by occupational pensions before—into a funded pension system. Participation is voluntary for the individual—the employer is obliged to provide a solution for voluntary pickup—but the default for employees is membership, and they may opt out. For a large number of employees, this will be the first time they start saving for their pensions with the involvement and assistance of their employers. The National Employment Savings Trust (NEST), a new institution, has been set up to serve as the default provider for all employers who are unable or unwilling to choose an alternative scheme. NEST may not discriminate and must take on everyone who wants to join.

NEST's objective is to make people save and stay in the system after auto-enrollment. Effective and comprehensible communication with consumers is essential. It's also worth mentioning that the name NEST itself—with its suggestions of safety, warmth, and the future—was selected after thorough research. Packaging pension issues that often seem complex and frightening in a friendly and positive way is an important part of achieving policy objectives.

NEST is very cautious when choosing words in communications. In *NEST's Golden Rules of Communication and The NEST Phrasebook*,³⁷ its principles are made clear. A full vocabulary is provided, describing what sort of expressions are to be used or to be avoided, and how to explain words that may be obvious for pension industry professionals but incomprehensible jargon for the average participant. Replacement words or phrases are shown in some cases. Words and phrases that NEST does use are also listed, as are terms that need to be defined the first time they're used. The method is based on several rounds of research and surveys.

NEST emphasizes communicating with practical examples, rather than theoretical concepts. Focusing communications on rights (entitlements), rather than responsibilities, also helps. Showing participants that they are not alone but part of a large group of members to whom a similar thing (saving) is happening increases their comfort. NEST presents plain facts as they are, without overexplaining them, and it is aware that participants want to know that they have control and may have choices, even if most participants would opt not to make them. Finally, different participants may have differing levels of knowledge and information, so NEST communications take this into account as well.

can also be provided upon request to customers and used to support disputes.

Many countries require annual disclosure of investment returns. In certain cases, as in Chile, Hong Kong, Ireland, Israel, Italy, Mexico, and Peru, the period is shorter. Sometimes, the publication of net asset values is even man-

dated on a daily basis, as in Bulgaria, Poland, Slovakia, and Turkey.³⁶ Such requirements seem to contradict the long-term nature of pension savings and the objective of not prompting consumers to make unfounded decisions by emphasizing short-term volatility.

B2: ADVERTISING AND SALES MATERIALS

- a. All marketing and sales materials of pension management companies should be easily readable and understandable by the average person, in line with B1.
 - b. Pension management companies should ensure that their advertising and sales materials and procedures do not mislead consumers. This principle applies particularly to comparisons with peers, investment performance, and risks and guarantees.
 - c. The pension management company should be legally responsible for all statements made in marketing and sales materials related to its products, and for all statements made by any person acting as an agent for the company.
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Explanatory Notes

Disclosure principles and practices should cover all three stages of a consumer's relationship with a pension provider or occupational plan: presale, point-of-sale, and post-sale, or pre/post joining the plan.

In the early stages of shopping for a pension product, fair advertising is a key element of responsible disclosure. It should not be misleading, and it should not prompt consumers to make selections that might turn out to be harmful for them.³⁸ Pension providers are legally responsible for everything they say in advertising and everything that is communicated during the sales process, including by con-

tractual agents. It is useful if regulations explicitly include standardized disclosure obligations for sales materials (such as past performance not indicating future returns). Industry codes of conduct may also be useful tools for regulating advertising standards, and regulatory authorities may explicitly request pension administrators to come up with such codes (for example, Mexico).³⁹ Some countries, such as Belgium, Mexico, Nigeria, Pakistan, and Serbia, require pre-approval of advertising materials by the regulatory authority.⁴⁰ Other countries require the filing of materials, which can then be used unless the regulator objects within a pre-defined time period.

B3: DISCLOSURE OF TERMS AND CONDITIONS

- a. General considerations
 - i. Consumers should be clearly informed about the range of pension products and their key terms and conditions—including, among others, investment strategy and options, risk and benefits, fees (including fees paid indirectly), any restrictions on transfer, the procedure and fee for closing the account, anticipated contribution and/or benefit accrual rates, and vesting schedules. The full risk related to the pension product should be disclosed and all necessary warnings emphasized.
 - ii. Costs should be disclosed even where non-competing occupational pension plans play a central role (since it supports governance and efficiency by putting pressure on trustees).
 - iii. Consumers should be informed upfront of their options if they decide to change employer or retire, and they should be provided information about the rules of portability of vested benefit accruals, especially if the transfer of assets may lead to a loss of benefits or rights.
 - iv. Consumers should be informed upfront regarding the time, manner, and process of disputing information in statements.

- v. Whenever any explicit guarantee covers a pension product, details of the nature and amount of the guarantee, as well as the details of the guarantor, should be provided upfront, and the real costs of the guarantee should be shown. Additionally, if members have a right to opt out of certain guarantees, this possibility with all consequences (risks versus costs) should also be made clear.
- vi. Clear information should be provided to fund members regarding possible underfunding in a DB context and their options in such a case.
- vii. In solutions with automatic features and default options, participants should be clearly notified that they have control and may have a choice.

Explanatory Notes

Prospective pension fund clients are expected to select a provider and a product based on publicly available information. While default options may facilitate this process, and in other instances, individual selection is not even an option—such as in mandatory systems, when new entrants into the labor force are automatically allocated to the pension fund of the cheapest provider, or when employers pay to one selected occupational scheme—transparency of terms and conditions is always essential. Disclosure provides information to members about their rights and gives them the ability to compare the services they receive. Seemingly small differences in fees and conditions may lead to significant differences in final pensions. Therefore, this impact should also be made clear.⁴¹

However, more information is not necessarily better. Supervisory constraints and compliance costs on behalf of providers make it equally important to require only information that is really useful and does not lead to information overload, as too much information reduces the likelihood that the message will reach the audience and prompt action if necessary.⁴²

In markets with standardized products and free choice (for example, Bulgaria, Chile, Mexico, and others), the requirement for standardized information is emphasized more.⁴³ For example, information requirements for mandatory pension funds in Chile are more stringent than for other savings products. Even in markets where different

types of pension products compete, such as in Australia or Jamaica, such comparison is necessary. In some countries, hidden costs (such as those of mutual funds in the pension fund portfolio) have to be disclosed, or management fee duplications are explicitly prohibited (for example, Italy). A synthetic TCI that takes into account all direct and indirect fees borne by a representative individual, according to standardized parameters, is also recommended. (See A6.)

In occupational pension markets with limited free choice, such standardization is usually less of a priority. However, even in such markets (for example, the United Kingdom), regulators consider cost transparency to be essential, as this puts pressure on trustees who may require better conditions from service providers.⁴⁴

The European Insurance and Occupational Pensions Authority's (EIOPA) survey of costs and charges of Institutions for Occupational Retirement Provision (IORPs)⁴⁵ demonstrates that disclosure regimes of EU member states vary significantly. The most common forms of disclosure are pre-enrollment contract/enrollment information and member benefit statements.

EIOPA's Good Practices on Individual Transfers of Occupational Pension Rights⁴⁶ discusses the special need of information provision for transferring members (see also C3), when members should be informed about all relevant aspects of the transfer, preferably without having to inquire, and be provided with access to an online tool.

B3. DISCLOSURE OF TERMS AND CONDITIONS (continued)

b. Investment choice

- i. Clear information should be provided upfront about the method, costs, and any other consequences of selecting and changing investment portfolios.
- ii. Investment options for selecting funds or sub-portfolios should be clearly explained to fund members, supported by guidance on the choice and illustrated by easy-to-understand risk-return and benchmark profiles.
- iii. In systems with default options, the exact meaning of the elements of the default should be clearly shown to prospective and existing members.

- iv. **The consequences of staying in default versus opting out should be unambiguously demonstrated to members, by means of a clear explanation of the default investment option and other options, with differences emphasized.**
- v. **It should be made clear to members that they have the right to opt out of the default portfolio.**

Explanatory Notes

Clients have the right to choose among investment options in the case of many pension saving products. They may have the right to select mutual funds (or sometimes even individual securities) into their portfolios, or they may select a portfolio type with a pre-defined risk profile. It is difficult for the majority of clients to choose from such options. While giving a choice is useful, most pension fund members may not want to take advantage of it, and even for more educated members, providing too many choices may be counterproductive.

International experience confirms that in countries that offer a wide range of investment choices, such as Australia and Sweden, active selection is very low, below 10 percent of participants,⁴⁷ while in Latin American and Central and Eastern European markets with very limited choice, active selection is more prevalent—although a higher level of sales activities may also be a part of the explanation. Experience from the United States, where a greater number of choices more often leads to staying with the default option, is in line with this finding. The experience in Europe is discussed in EIOPA's report about investment options for occupational DC scheme members.⁴⁸

Therefore, the provision of well-designed default options is beneficial even in systems with individual choice. State-of-the-art systems utilize the life-cycle concept as a default solution. Whereas younger members

undertake more short-term investment volatility in order to increase the likelihood of achieving higher long-term returns and higher pensions, risk tolerance decreases among members closer to retirement, as they focus more on preserving accumulated wealth.⁴⁹

As multiple investment options are used (or even mandated) in many countries, and default options are also frequent or required, proper design of the default investment option is essential, because it influences the final pension levels of most participants.⁵⁰ A large percentage of fund members will stay in the default option, especially as it may be interpreted as endorsed by regulators. In most cases, the default is the life-cycle option, but in Estonia, Italy, Slovakia, and other cases, it is a low-risk, conservative portfolio with no equity investment (or a guaranteed-return portfolio), which by its nature is unlikely to lead to adequate returns and pension.⁵¹

Behavioral economics demonstrates that not only selecting a proper investment choice, but even starting to save is a decision that should be supported by a user-friendly and easy default solution.⁵² This is an essential aspect of a safe and well-functioning pension system that goes beyond the scope of consumer protection questions. Therefore, more details on recent auto-enrollment experiments in New Zealand, the United Kingdom, and the United States may be found in the endnotes.⁵³

B3. DISCLOSURE OF TERMS AND CONDITIONS (continued)

c. Payout phase

- i. **Pension management companies/pension funds should be required to start providing information to, and communicating with, members about ways to draw pensions many years before retirement, not only immediately prior to it.**
 - ii. **Fund members' attention should be drawn to the consequences of potentially locking in lower pension levels if they automatically accept products from their existing pension fund provider without collecting information about alternative products available on the market.**
 - iii. **In systems with voluntary annuity purchase, members should be informed about the consequences of longevity risk and the most optimal ways to purchase annuities.**
 - iv. **Pension regulatory authorities should consider providing or supporting comparative quotation systems to assist comparisons between different types of annuities and other payout options.**
-

Explanatory Notes

NOTE: The payout phase is typically the least regulated aspect of pensions. Many emerging funded pension markets are just starting to reach the payout phase, and only a limited number of countries operate an efficient annuity market. However, because this phase is the point where savings are translated into pensions, listing good practices for consumer protection was deemed useful, even for jurisdictions where the application of these practices may currently be aspirational.

The payout phase is at least as critical for achieving adequate pensions as the accumulation phase. A non-negligible portion of a lifetime's savings may be sacrificed by one wrong decision during this phase—such as buying an inadequate and/or overpriced product or, where there is flexibility allowed in the timing, purchasing the annuity at a poor time (that is, when interest rates are low). Without specific disclosure rules about annuitization, opaque and wide-ranging practices may emerge with harmful consequences for consumers.⁵⁴ The information-provision system should be designed so that it helps most consumers understand the information provided about complex pension products. Although customers typically start thinking about how to use their savings only very close to retirement, providing information should not be left to such a late date and should start many years before.^{55, 56}

Most people underestimate longevity risk⁵⁷—that is, the probability that in retirement they will live longer than expected and their accumulated savings will run out fast. Life annuities, in which this risk is completely borne by the insurance company instead of the individual, are often not popular for this reason. Consumers worry more often about dying too early and wasting their savings, instead of their savings being inherited by the next generation—although annuity products providing for such circumstances can be made available.

Hardly any jurisdiction requires mandatory life annuities,^{58, 59} and most allow for alternative options, such as lump sums or programmed withdrawals. While a certain degree of flexibility may be necessary (for example, requiring a minimum amount of annuitization, which balances necessary protection with the desire for liquidity),⁶⁰ insurance against longevity risk is probably required in any case, as having savings run out too early is clearly against the interest of the customer (and possibly of the taxpayer as well).

EIOPA's survey of decumulation-phase practices within the European Union⁶¹ found that in most cases, IORP members in advance of decumulation receive information that is similar or identical to what is provided in the accumulation phase. Where there are differences, the expected level of benefits and possible forms of retirement products are also covered. Members typically start receiving infor-

mation only shortly before retirement (two to six months prior), and only a few countries start providing information well in advance—for example, every five years after the age of 45 in Belgium. The majority of member states do not have comparison tools or quotation systems for payout products, the exceptions being Denmark, Estonia, the Netherlands, Norway, Sweden, and the United Kingdom.⁶² Annuities are often among the products offered, but they are mandatory only in some of the cases. Most member states do not have a default retirement option. Finally, in about half of the countries, retirees may shop around and choose their own pension product and provider.

Mandatory annuitization was abolished in the United Kingdom in March 2014, providing more freedom of choice to fund members. Previously, the United Kingdom was one of the few places with strong requirements to buy an annuity and, in that way, minimize longevity risk. In a huge experiment, the United Kingdom is currently auto-enrolling into the system around 10 million new savers who otherwise would not and did not save for their pensions. (See B3[b] and endnote 55.) Letting the same individuals manage their longevity risk freely is an interesting policy development from a behavioral standpoint.⁶³

A second-best alternative to mandatory life annuitization for managing longevity risk may be the use of programmed withdrawals, a compromise for situations in which proper annuities are not available or not preferred by regulators and/or the public. This pays pensions over the expected life span. Therefore, individuals may run out of funds if they live longer than expected, but a part of accumulated wealth may also be inherited if individuals die with a remaining account balance. The calculation of the drawdown, as linked to life expectancy, should be monitored closely by the regulatory authority. There may also be different taxation consequences of a life annuity versus programmed withdrawal, which will need to be made clear to the consumer.

Mandatory annuitization may also be relaxed to a certain extent by introducing a floor (for very small accumulations, when purchasing an annuity is not sensible) and a cap (which provides a sufficient level of safe life-long payout, above which the individual is free to take out a lump sum or use the savings in any other way).⁶⁴ This structure was previously applied to the Chilean pension system. It is useful if the calculation of such cap levels takes into consideration other sources of income, such as state pensions.

In many countries, proper annuity markets have not been developed. This is a significant risk, as many retirees do live for a long time, and without a good annuity product, their old-age living standards may easily turn out to be meager. Lacking a well-functioning, transparent, and

competitive annuity market, funded systems can hardly provide adequate and secure pensions. Efforts to create such markets are important, and then explaining to consumers why a life annuity is a good choice—and perhaps requiring it as the default solution with opt-out possibilities—is the necessary next step for policy makers to consider. While mandating the purchase of an annuity helps handle longevity risk, in cases where only a single private provider operates in the market, regulators must be prepared to manage monopoly issues as well.⁶⁵ In less developed annuity markets, a central (perhaps even state-affiliated) provider may be considered.

Centralized quotation systems operated in some countries can also facilitate the process of helping customers to the most adequate pension products. (See also A6.) Such comparative quotation systems are strongly recommended, since they tend to improve annuity parameters. If the involvement of all industry players may not be achieved otherwise, a compulsory provision of quotations for a central system may be considered, but it depends on local context. The involvement of regulatory authorities is likely to add credibility to such a system.

In addition to deciding whether to annuitize, there may be choice over the level of annuitization, above a minimum level. In such cases, advice would also be needed.

B4: KEY FACTS STATEMENTS

- a. A key facts statement (KFS), disclosing the key characteristics, terms, and conditions of the pension product in plain language and preferably no more than two pages long, should be presented to the consumer before signing the contract/joining the plan.
 - b. Before signing the contract, the consumer should sign and deliver to the provider a statement about having received, read, and understood the KFS.
 - c. The KFS should be provided in a standardized format that makes it easy for consumers to compare products offered by different pension providers.
 - d. The industry should be consulted and KFSs pre-tested with consumers in order to find the most suitable standard format for such statements.
 - e. Required standardized formats should be published on the website of the regulatory authority (and preferably also on the website of the pension industry association).
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Explanatory Notes

NOTE: Traditionally a more common practice for deposit and credit products and services, KFSs have been increasingly required by pension-related regulations in recent years.⁶⁶ This section summarizes emerging practice and recommendations. KFSs may be referred to by other terms, including key information documents (KIDs), in European legislation.

A KFS provides consumers, in a legible way,⁶⁷ with a simple and standardized summary of key contractual information and leads to better understanding of the product or service. A long information prospectus, often required by law, does not substitute for such easy-to-read documents. Where standardized, KFSs make it easier for consumers to compare offers by different providers before purchase. Such statements also provide a useful summary for later

reference during the life of the product or service, and they even play a role in complaint handling. These uses make KFSs of special importance in countries with new, inexperienced financial consumers.⁶⁸

EIOPA deals extensively with risks related to DC pension plans and with information provision.⁶⁹ A statement by the EIOPA Occupational Pensions Stakeholder Group⁷⁰ includes a recommendation for a basic information document (BID), and EIOPA's survey on costs and charges also emphasizes the importance of such documents.⁷¹ Such documents should include the following:

- Name of the pension scheme
- Nature and main features of the pension scheme
- Whether loss of capital is possible
- Consequences of an early exit
- Risk and reward profile of the pension scheme

- Contributions to be paid by the member and all costs and charges
- Past performance of the pension scheme
- Not legally binding projections of possible retirement benefits

Such a BID could then form the first layer in a multi-layered disclosure approach. (See also B1.)

This has a parallel in the requirement for a summary plan description for employer-sponsored plans in the United States. The actual plan document is too difficult for most workers to read and understand. The summary plan description presents the plan's features in an easier-to-read format.

B5: STATEMENTS AND ONGOING POST-SALE COMMUNICATIONS

a. General considerations

- i. Pension plan members and consumers should receive a streamlined statement (typically on an annual basis) about their account providing the details of account activity, including investment performance on a standardized basis.
- ii. Information included in annual statements should enable the plan member to identify current benefit accruals or account balances and the extent to which the accruals or account balances are vested (if applicable).
- iii. There should be a simple summary of the most essential information and data on the first page of the statement.
- iv. Statements should not be sent more frequently than annually, including particularly the reporting and comparison of investment performances.
- v. Pension companies should disclose information regarding their financial position.
- vi. In the case of DB funds, actuarial reports on funding levels (supported by regulatory guidelines) should be prepared annually, and members should be informed about the condition of the plan in a concise report.
- vii. The pension plan's general description delivered to the consumer upon joining should be made available on request on an ongoing basis, and changes in key characteristics should be automatically and immediately communicated.
- viii. Plan documents, accounts, and reports in general should either be disclosed automatically or made readily available to members/beneficiaries for copying for a reasonable charge.

Explanatory Notes

Pension fund members need to be able to follow developments in their accounts.⁷² They can monitor whether contributions have been properly transferred and check current balances, including investment returns. In line with general principles of providing information, the most important data have to be presented clearly on the front page. Long-term pension products generally do not justify releasing statements more frequently than annually.

Whenever possible, a combined statement that demonstrates the individual's main pension sources, including state (public) pensions, is useful. Including all private plans is also helpful, since this can draw attention to forgotten accounts (from previous jobs) and prompt consolidation of plans, where appropriate.

Participants should also have an easy way to check on the general developments and financial health of their pension fund.

B5: STATEMENTS AND ONGOING POST-SALE COMMUNICATIONS *(continued)*
b. Investment performance publication

- i. For past return figures published, the measurement period should be long, preferably 5–10 years, but at the very least 24- to 36-month averages.
- ii. Notice should always be given that past returns are no indicators for future performance.
- iii. Pension funds should be required to use standardized valuation and investment reporting criteria, to allow for comparison.
- iv. Pension funds should be required to communicate to members that the real risk of pension investments is not short-term volatility, but rather not reaching adequate (targeted) final pensions. Disclosure of standard deviation, Sharpe ratios, or value-at-risk (VAR) indicators should be avoided.

Explanatory Notes

Investment performance is a key part of statements. Members have to know the investment results of their contributions and savings and see how their future pension benefits develop. However, an annual return figure is not sufficient and may in fact be misleading. One year is not an adequate measurement period for pension savings, so besides reporting about the last financial year, describing the performance of a longer period is necessary. Showing return figures without giving some adequate information about the risks undertaken to achieve those returns is also meaningless. At the same time, statements should make it clear that the relevant risk is not short-term volatility but final underperformance of targeted pension levels. Easily com-

prehensible charts may help this communication. At the same time, short-term risk (volatility) indicators,⁷³ which are meaningless in the long run, difficult to understand, and potentially even frightening, should not be disclosed.

Many countries emphasize the need to show results obtained over a reasonably long time horizon and typically require providers to disclose returns for periods of at least five years. At the same time, disclosure of volatility indicators is required in many countries.⁷⁴ This is not necessarily helpful in adequately explaining real pension risk to consumers.

Nineteen countries, approximately half of the countries that responded to the IOPS (2016) survey, mandate providers to disclose performance in a standardized way.

B5: STATEMENTS AND ONGOING POST-SALE COMMUNICATIONS *(continued)*
c. Pension projections

- i. Personal statements should focus more on outcome (final pensions) than on simple return figures and past performance. The statement should include a well-developed, simple-to-understand projection of future pension income, and should demonstrate the potential impact of increased (and continuous) contributions and the postponement of retirement.
- ii. Projected monthly income, which is the most important figure for the consumer, should be highlighted, whereas projected fund values at retirement are secondary (but also to be included).
- iii. The regulatory authority should consider providing assumptions for the projections and supplying the range in which the estimates may vary.

Explanatory Notes

NOTE: The following recommendations include evolving good practice in countries where pension projections already play an important role. For many countries where projections are not required yet, the objective should be to facilitate the development of future standards. This section therefore includes fewer good practices but longer explanations to help this process.

The most important piece of information, even more essential than investment performance, is an estimate of future pensions. A pension projection translates investment performance data into meaningful and comprehensible numbers for the average fund member. This can prompt such action as increasing contributions, reconsidering whether one has the proper long-term investment

profile, and adjusting targeted retirement age. While such projections are used in only a limited number of jurisdictions presently, a user-friendly online application that allows a member to estimate the effect of several options may be the most important ingredient of statements with strong implications for old-age living standards. In a number of countries,⁷⁵ an interactive pension calculator helps members to personalize projections.⁷⁶

The Chilean pensions regulatory authority,⁷⁷ in collaboration with the OECD, has developed a web-based simulator using stochastic modeling. (See Box 3.) Probability density functions are used to estimate pension risk,⁷⁸ taking into consideration contributions (their level and how continuously they arrive), investments, career wage curves, and other inputs. The simulator provides useful information not only on expected pension levels but also on pension risk, which is the danger of not reaching desired pension levels (target replacement rates).

Contribution density (continuity), the importance of which is easily forgotten in simpler models, is emphasized

in Mexico, too. Sweden uses stochastic modeling in online applications. (Such tools would be difficult to use and inefficient in a paper-based mode.) Uncertainty of projections is communicated by only a simple caveat in most countries. In Austria, Turkey, and the United Kingdom, uncertainty is illustrated by different rates of returns.

In communications about projected pensions, it is important to demonstrate the effect of starting to save earlier. The illustration of the impact of any employer or state match on final pensions is also useful, because it may prompt the individual to contribute and thus use the match. A traffic-light system may be useful as it can be easier for users to understand, in which green means that no action is required and red indicates a risk of not attaining desired pension levels and the need to take action (such as making higher or more regular contributions).

Who sets assumptions for projections—for instance, expected rates of return or future inflation rates—is a key question. If done by regulatory authorities (or regulation),

BOX 3

Pension Projection and Pension Risk Modeling in Chile

In Chile, pension fund members have received personalized information about pension projections in their annual pension statements since 2005, forecasting expected pension levels depending on current contribution levels and regularity and retirement age. For fund members with 10 years or more before retirement, personalized pension projections show the expected pension levels if regular contributions are maintained. For members who have less than 10 years to the legal retirement age, the projections show the pension to be expected if retirement is postponed. The information has prompted action and led to increases in voluntary contributions.

The Chilean Pension Supervisor (Superintendencia de Pensiones) has been modeling pension risk for a number of years, analyzing the probability density function of replacement rates. Pension risk is the probability of final underperformance (lower-than-expected benefits). Since 2012, the supervisory webpage has provided help to fund members via a pension simulator model.⁸² Users input their age, gender, retirement age, investment strategy, and contribution level and density. The simulator then uses probability densities to produce outputs that illustrate in an easily comprehensible way the likelihood of reaching proper pension levels (the target replacement rate). Instead of formulas for risk that the average user may find difficult to comprehend, charts show possible outcomes and actions to take (such as making regular contributions, increasing contribution rates, or working longer) in order to decrease the chances of not achieving desired pension levels.

The Chilean multifund system includes five subfunds with risk profiles ranging from A (mostly equity) to E (almost exclu-

sively fixed income), where the default life-cycle de-risking path for an individual moving from young age to retirement is *B-C-D*, but other options may also be selected, with some restrictions (such as limiting volatility prior to retirement). In addition to inputs such as contributions, career income profiles, human capital risk and annuitization risk, stochastic modeling of the probability density function of replacement rates also requires investment-return estimates. Long-term average return and volatility forecasts are prepared for all subfunds, and then scenario analysis is undertaken for different life-cycle investment strategies—for instance, staying in the default path; using the balanced *C* fund for the whole career; or using a *C-D-E* path, rather than the default *B-C-D*, which results in somewhat less volatility). Thousands of runs are tested and then aggregated during the stochastic modeling. This leads to an output of probability density functions, based on the combination of the individual's characteristics and the selected investment profiles.

Such an exercise may be recommended to regulatory authorities in other countries. Developing such a tool is not likely to overwhelm regulatory capacities, especially given that the above-described blueprint already exists. All such experiments, however, call for caution and conservative estimates. With fixed contribution rates (typical in mandatory systems), if the risk of not reaching the target pension levels remains too high, then assuming higher returns is not the reliable and prudent answer. Instead, working longer (or, if affordable, saving more on a voluntary basis) is the variable to be adjusted.

“competition in optimism” by providers may be eliminated. On the other hand, a setup in which providers set assumptions may lead to more flexibility when market conditions change rapidly. In most of those cases where projections exist, the regulatory or supervisory authority sets the assumption (or range of assumptions). Projections are not permitted in some countries (for example, Romania), as decision makers worry that members may misunderstand them and that inaccurate projections may hinder consumer confidence in the system. In general, projections ought to use cautious investment and inflation assumptions and actual plan charges, as doing this may address some concerns about the uncertainty associated

with deterministic projections.⁷⁹ Assumptions should be net of fees and inflation.

While it is useful for the individual to receive projections that combine several sources of pensions, including both public and private, not many countries do this.⁸⁰ It may be difficult to coordinate among more bodies (pension pillars). Sweden’s “orange” envelope, which is sent out annually, contains projections from the public first pillar and the funded second pillar (both mandatory). In the Netherlands, standardized data by pension providers (including the important assumption that current savings are maintained until retirement) allow the accumulation of estimated future pension incomes from different schemes.⁸¹

B6: NOTIFICATION OF CHANGES IN RATES, TERMS, AND CONDITIONS

- a. Customers should be notified a reasonable period in advance of any planned change in fees or any other change that significantly affects members’ rights and benefits.
- b. Future benefit accruals should not be reduced without appropriate advance notice to employees.
- c. An exception to the generally recommended annual frequency of statements should be alerts, such as those that draw attention to a new pension reform or reassure members in a financial crisis.
- d. Members and beneficiaries should be notified in timely fashion if required employer and member contributions have not been made to the pension plan.

Explanatory Notes

A general feature of pension products is that it is unnecessary to check on them too frequently. Short-term noise may lead to rash and unfounded steps. However, when important changes occur or when external factors justify it, extraordinary communications may be called for.⁸³ Similarly, a notification about missing contributions is important, because the easiest way to end up with low pensions is by not making contributions.

A more precise specification of what is “reasonable”, “appropriate” or “timely” may depend on the individual context and usual notification periods in the given jurisdiction. In general, advance notification about changes in conditions should leave time for customers to act, and alerts ought to go out as soon as possible.⁸⁴

C: FAIR TREATMENT AND BUSINESS CONDUCT

C1: UNFAIR TERMS AND CONDITIONS

- a. The purchase of pension products should not be restricted by, and rights or benefits arising from a pension product should not be linked to, a compulsory purchase of other products.
- b. Once members send notification indicating their wish to switch investment options, they should not be locked into the earlier option for more than a short period (for example, one week), with particular concern to investments into the stock of the employer.
- c. Employees should not be discriminated against, and should not receive unequal treatment regarding disclosure, portability and other rights, based on age, gender, marital status, or nationality. In mandatory systems, exclusions based on salary, periods of service, and terms of employment should also be avoided.

- d. **Employees should not be retaliated against by employers or pension plan representatives as regards pension benefits and the exercising of rights.**
- e. **Accrued benefits of employees should be protected in a way that, with limited exceptions (see explanatory notes), there should be no possibility for retroactive reduction.**
- f. **Employees' benefits should be vested quickly by employers (between immediately and five years), to prevent employers from unfairly terminating employment just before contributions would start vesting.**

Explanatory Notes

Existing and prospective pension fund clients must be free to choose among providers, products, and options, without having to undertake commitments not linked to the given selection. Investment choice also should be free (within the framework provided by the pension fund), and implementation should be quick.

Participants and especially employees have the right to be free from unfair, unequal treatment that is discriminatory or even retaliatory. The rights apply in the direction of the pension fund and the administration company as well as the employer.⁸⁵

Vesting should be immediate or occur in a reasonable time given the length of employment, and members' own contributions should always be vested immediately. (See also C3.) In a collective bargaining process, the rate of vesting of member contributions may exceptionally be subject to bargaining, and members may also give their free consent to a retroactive reduction in accrued benefit.

Certain types of pension plans (such as risk-sharing, defined-ambition, or target benefit plans) allow for the reduction of accrued (not-yet-paid) benefits in some circumstances. Members should be informed in a clear manner that accrued benefits can be reduced, and they must receive adequate pre-notification when such reductions happen.

C2: SALES PRACTICES AND CONFLICTS OF INTEREST

a. General considerations

- i. **Regulations should ensure that high-pressure sales tactics or misrepresentations during the sales process are not be used.**
- ii. **To recommend adequate pension products, sales officers should be required to examine important characteristics of any potential customer, such as age, employment prospects, and financial position, and to be aware of the customer's risk appetite and long-term retirement objectives. Those selling pension products should be required to apply caveat venditor, instead of caveat emptor, rules—that is, "seller beware," rather than the more traditional "buyer beware."**
- iii. **Consumers should be made aware of the importance of sharing relevant, accurate, and available information with pension providers.**
- iv. **The consumer's circumstances and the advice given should be put in writing and retained.**
- v. **At the sales stage, potential conflicts of interests may arise from the way internal staff and agents are remunerated. All such conflicts, and the way they are managed, should be clearly disclosed.**

Explanatory Notes

Providers should be responsible for designing products and systems with behavioral realities in mind. Providers need to ensure that the products are appropriate and adequately suited to consumers' needs and circumstances, and that they are delivered in a responsible fashion. Aggressive or misleading sales practices contradict the basic requirement of acting in the best interests of consumers.⁸⁶ For vulnerable consumer groups, providers should assume an even greater level of responsibility.

It is essential that those who influence decisions in this process—a salesperson or even the employer's representative, in case of occupational schemes—exercise due care. They should not be allowed to take advantage of any informational asymmetry.⁸⁷ "Seller beware" principles⁸⁸ should drive providers' behavior, and suitability requirements apply in most IOPS member countries. (Suitability is less of an issue in mandatory pension systems.) As a minimum, age is a standard suitability requirement—in some cases, such as in Nigeria and Mexico, it is the only

one—but risk appetite, income, family situation, tax position, and net worth are also frequently taken into consideration.⁸⁹ Treating customers fairly (TCF) principles may facilitate the principles of responsible finance in pensions as well.⁹⁰ Bans on high-pressure selling can include a general prohibition on cold-calling or a requirement that only pension providers from a pre-approved list are allowed to contact the consumer.⁹¹

It is equally important that consumers always provide exact and up-to-date information to service providers and agents, so that products can be accurately recommended on this basis, and that providers seek all relevant information from consumers.⁹² Consumers in many countries (such as Australia, Colombia, Costa Rica, Israel, Mexico, and Thailand) are warned if providers lack sufficient information, and/or the sales may not go ahead in such instances (for example, in Hong Kong, India, and Pakistan). Australia, Hong Kong, and many other jurisdictions require that the consumer's circumstances and the advice given be put in writing and retained. Based on complaints and compli-

ance testing, these suitability checks may be supervised, as in Colombia, Israel, and Slovakia.

The principles apply even more when dealing with vulnerable consumers with low incomes, low levels of financial capability, and limited access to or experience with formal financial services. Such consumer groups characterize particularly, but not exclusively, emerging/developing economies. It must be acknowledged, however, that especially in these economies, it may be demanding to supervise providers' implementation of these financial consumer protection rules effectively. Therefore, the objectives of financial inclusion may have to be balanced with capacity constraints of providers and supervisors. Even in developing economies, though, supervisory authorities may assist service providers with annual regulatory seminars in which responsibilities to clients are emphasized (South Africa).⁹³

The licensing of agents is further discussed in **C5, "Agents and Intermediaries."**

C2: SALES PRACTICES AND CONFLICTS OF INTEREST (continued)

b. Employer responsibilities

- i. Employers should be responsible for ensuring that new plan members are made fully aware of their rights and obligations under occupational pension arrangements, including rights to mobility.**
- ii. Employers should properly collect and transfer contributions. Supervisory and regulatory authorities should be able to go after, and initiate prosecution, against the employers in this respect.**

Explanatory Notes

Employers play a key role in pensions. They often influence (or even make) the employee's decision about which scheme to contribute to. Employers also collect and transfer contributions in most cases. It is useful, therefore, to monitor the interaction between the human resources departments and sales agents as much as possible, to minimize the danger that decisions serve the interest of the employer (or, in extreme cases, even individual staff members) more than the fund participant.⁹⁴ It is also

essential that pension administrators send a timely warning to the employee (and preferably also to the authorities) if contributions do not arrive properly.⁹⁵

Personnel departments have an important role in providing information about possibilities related to pension accumulation. They should also be prepared to become the first point of contact for dispute resolution. Supervisory authorities should support personnel departments in their role to help employees.

C3: CUSTOMER MOBILITY AND COOLING-OFF PERIODS

- a. Pension providers should be required to establish clear and transparent rules and procedures for switching pension funds and providers, including the right to switch in a swift manner. (For example, assets should not be withheld for an unreasonably long time after the initiation of a transfer.)**
- b. Employees who change jobs should have the right to transfer their vested account balance, valued in a fair and reasonable way, with a reasonably short time of execution.**
- c. Portability rights should not be inhibited by unreasonable fees, and members (and beneficiaries) should be informed of any such charges in any case.**

- d. Individuals should not be required to exercise their portability rights and should be allowed to leave vested benefits in the plan of their former employer. Such vested benefits should be protected.**
- e. A reasonable cooling-off period should be associated with any individual pension product.**

Explanatory Notes

In general, consumers should enjoy a great degree of mobility among pension funds.⁹⁶ Because the standards of service they receive during the accumulation period have a large impact on old-age well-being, it must be possible to switch if performance is poor. This principle has to be balanced with the cost of too-frequent changes, and also with the fact that the long-term nature of pension investments means that decisions based on short-term “noise” may not always be well founded. Switching fees may be applied to cover transfer costs, but unreasonable charges should not complicate mobility. However, the structure of fees may be a tool in minimizing exaggerated switching. (For instance, charges may be punitive within a short period after the previous switch.)

A special case is the occupational plan with employer contributions. Employers have a large role in assisting employees to adequate pensions by running occupational schemes to which they contribute. This is also a tool of retention in many cases, and that is why employers do not prefer to support employees who leave after a short period. Vesting rules⁹⁷ serve this purpose. Therefore, a reasonable period may be acceptable, but this cannot be exaggerated, since that would harm the individual’s pension rights and adequacy and would hinder job mobility. Such constraints need to be minimized, but unreasonable costs to employers should not be imposed either. Periods for vesting are typically between immediate to five years.⁹⁸ Entitlements derived from member contributions to the pension plan should be vested immediately.⁹⁹

The implementation of transfers requires that they are settled in a reasonably short time (such as 14 days or less), and that the valuation of the vested account balance happens according to proper actuarial methods. There should be supervisory tools developed and used to monitor

whether the interests of members who change pension plans are protected in these regards.

Obstacles in portability rights may decrease mobility. Additionally, retirement savings may often be managed more efficiently if portability rights enable consolidation as the employee moves to the next job. For instance, certain DB plans in the United Kingdom convert savings into a lump sum when the employee leaves, making it possible to transfer them into the scheme of the new employer, which is probably a DC pension fund.¹⁰⁰ On the other hand, inflation indexation of vested benefits is stopped for early leavers in some cases, which does not help protecting the value of benefits. “Pot follows member” rules have also been considered in the United Kingdom.¹⁰¹

Pension products are complex, long-term products. This justifies a reasonable cooling-off period after purchase, during which consumers may change their minds in a no-pressure environment.¹⁰² A general approach to cooling-off periods for similar products (such as life insurance) suggests that this may be between 14 and 30 days. In systems with mandatory participation, this rule does not apply.

EIOPA’s Good Practices on Individual Transfers of Occupational Pension Rights¹⁰³ includes, among other things, that any reason why transfers might be suspended should be clearly formulated in advance; a sufficiently long period should be allowed for out-transfers and in-transfers at any time during the membership in the new scheme; if the member is charged for the transfer, charges should reflect the actual work; and transfers should be processed and executed within a reasonable timeframe. The Good Practices also suggests that members should be informed about all aspects of the transfer—for example, value, options, timeframe, reductions and costs, possible impact on benefits, risk coverage, and taxes—preferably automatically upon termination of employment, and along with access to an online tool. (See also B3[a].)

C4: PROFESSIONAL COMPETENCE

- a. The assets of pension fund members should be invested by professionally qualified staff, equally in the case of internal and external asset management.**
- b. Trustees of occupational schemes should be required to have minimum qualifications and to qualify for fit-and-proper requirements.**
- c. Trustees should be required to have the necessary skills collectively to fulfill their functions.**
- d. Standardized trustee training should be required on an ongoing basis.**

Explanatory Notes

Future living standards of fund members depend on how professionally and responsibly their pension savings are looked after. All parties involved in the process, including trustees, directors, and asset managers, must possess the necessary competence and qualification. For pension fund managers and other service providers, their professional competence should be checked as part of the licensing process by the supervisory authority. It is also an important recommendation of the OECD that “the governing body should *collectively* have the necessary skills and knowledge to oversee all the functions performed by a pension fund, and to monitor those delegates and advisors to whom such functions have been delegated” (emphasis added).¹⁰⁴ Additionally, outsourcing should not eliminate fiduciary responsibilities. Those entities that outsource must monitor the performance of the person or organization to which they have outsourced.

Suitability requirements of trustees and senior management have recently been tightened in a number of countries, such as Australia, Mauritius, the Netherlands, Portugal, and others.¹⁰⁵ Local context and legal requirements influence what counts for minimum or professional

qualifications, or fit-and-proper requirements. For example, Chile has established requirements that providers be tested about their knowledge in securities brokerage.¹⁰⁶ Israel similarly has legislation about the competence of advisors and portfolio managers.¹⁰⁷ In South Africa, staff employed by pension administrators must be trained and then supervised in this respect.¹⁰⁸

The IORP II Directive’s definition for “fit” is that qualifications, knowledge, and experience must be adequate for managing the IORP or fulfilling key functions, while persons must be of good repute and integrity to be considered “proper.” Those running the IORP must collectively be able to deliver sound and prudent management. Persons who carry out actuarial or internal audit key functions must have sufficient professional qualifications, knowledge, and experience, while other key function-holders must also be fit to carry out their job.

The pension regulator in the United Kingdom runs an online trustee toolkit for new trustees to complete.¹⁰⁹ This could be studied by countries that operate trustee-governed private pension systems but lack adequate training and licensing approaches, as such a toolkit may be useful in general.

C5: AGENTS AND INTERMEDIARIES

- a. Regulation should be clear about who is authorized to market and sell pension products, and it should define the exact role of agents, brokers, and advisors.
- b. If agents, brokers, or advisors play a role in the private pensions market, regulation should clearly specify their licensing requirements.
- c. Licensing regimes should include requirements for suitability, competency, and professional conduct, and for the discipline of agents, brokers, and advisors.
- d. As part of their licensing requirements, agents, brokers, and advisors should be required to hold professional errors-and-omissions insurance relating to the conduct of their business.
- e. Licensing requirements should not relieve pension fund managers from responsibility for appropriate oversight and control of their in-house sales staff and their distribution channels.
- f. The agency relationship should be governed by an agency agreement between the agent, broker, or advisor and the pension fund manager that should not exclude the pension fund manager from liability for misconduct by the agent, broker, or advisor.

Explanatory Notes

Sales intermediaries are the principal interface between the client and the service provider. Unless it is clearly defined who may sell pension products and what qualifications and licensing are required to do that, the danger of mis-selling remains high. In fact, licensing of agents, brokers, and advisors helps ensure that interactions with consumers are conducted in a professional manner. The licensing function should extend beyond simple registra-

tion and include clear requirements for suitability, competency, professional conduct, and discipline. Professional indemnity insurance should also be required for error and omissions by intermediaries in the conduct of business.

Pension intermediaries are controlled in a number of countries.¹¹⁰ Standard fit-and-proper criteria apply to pension intermediaries in most IOPS member jurisdictions. In some countries, such as Colombia, Lithuania, and Mexico, given the lack of legal regulations, pension fund manag-

ers should impose requirements on the sales agents. Qualifications required may be an appropriate academic degree¹¹¹ and/or credentials issued by the industry.¹¹² Many jurisdictions maintain ongoing training requirements.¹¹³ In Pakistan, Spain, and Turkey, as well as in many Latin American countries, such as Brazil, Chile, Costa Rica, and Peru, pension fund providers themselves sell the product—and in such cases, requirements apply to internal staff. At the other extreme, in countries such as Korea, Jamaica, and Romania, only agents are involved; pension providers do not handle distribution directly. Most countries allow sales by both internal staff and agents.¹¹⁴

In special cases, the role of sales agents may be minimized. In mandatory individual account systems, where young people entering the labor force must join the system, a costly marketing war among pension funds is not beneficial for the public good. Instead, automatic allocation of new members (in a lottery system) or a bidding process with the lowest charges may be more useful. In

Mexico, for instance, net returns of the providers indicate who will receive new members by default, whereas in Chile or Peru, new entrants must join the pension fund with the lowest fee (by a bidding process) and stay there for a minimum of two years. In other countries, including Bulgaria, Macedonia, Poland, and others, new members are allocated according to a formula.¹¹⁵

Intermediaries in such cases may not necessarily be required at all and have been removed in some cases. In Romania, intermediaries may not advise on switching, and in Poland, pension funds and managing companies may not practice active sales. In Sweden and Latvia, there is a central administrative interface, and fund providers (asset managers) may not contact consumers directly, since they receive bulk orders from the interface, which collects the savers' individual investment decisions.¹¹⁶ By unbundling administration and asset management, competition takes place only where it may add real value.

C6: COMPENSATION OF STAFF, AGENTS, AND INTERMEDIARIES

- a. **Internal staff and agents should be remunerated in a way that helps avoid conflicts of interest and leads to fair treatment and responsible business conduct.**
 - b. **Commissions paid to sales agents purely on the basis of the volume of pension products sold should be banned.**
 - c. **Conflicts of interest between the pension fund and its service providers should be minimized as much as possible. All such conflicts, and the way they are managed, should be clearly disclosed, including the structure in which staff and agents are remunerated.**
 - d. **Fees to asset managers based on short-term performance measurement should be avoided.**
-

Explanatory Notes

A basic principle of consumer protection is that incentives of service providers and sales personnel should be in line with the interests of the client. No one should ever receive compensation for actions that harm consumers. Conflicts of interest should be avoided or, if impossible to avoid, managed, and appropriate disclosure is expected in such situations.¹¹⁷ Advisers or sales staff might fail to recommend the most appropriate product for several reasons. Short-term profit pressure on them may not be in line with the long-term financial interests of the consumer, or commission structures may incentivize sales staff to push a particular product. Staff remuneration should therefore include many other factors besides sales performance.^{118, 119}

For their advice, intermediaries may be paid a flat fee by individuals,¹²⁰ receive commission from the pension company whose product they sell, or a combination of the two. In this latter case, which applies to about half of IOPS

member countries, the distinction is not always transparent to consumers.

In the interest of customer protection, Australia, the Netherlands, South Africa, and the United Kingdom have introduced legislation that bans (or strictly regulates and limits) commissions in the process of selling pension products. Fee caps may also be useful tools, and some countries have caps on the fees that intermediaries may charge.¹²¹ Fee caps and/or flat switching fees have also been introduced in the Czech Republic and Slovakia. In a number of countries, no regulations control fee setting.¹²² This may also be appropriate if supervisors have alternative tools to boost competition.

In mandatory systems, provider staff members frequently sell products and give advice, decreasing the scope for conflicts, as such stand-alone entities do not cross-sell other products, being allowed to deal only with pensions. In practice, however, pension providers often

belong to a financial group, so conflicts of interest may not be ruled out completely.

For pension products that have long-term savings features, the proper long-term incentive of asset managers is also a key requirement. This element of the compensation structure does not apply to the sales process, but the implications are at least as important for the protection of

consumer interests.¹²³ The objective of asset managers should also be the optimization of members' final pensions, which may be achieved by benchmark-driven solutions,¹²⁴ where the performance of the investment manager is compared to that of a portfolio structured for long-term optimization and not to short-term indicators, such as an annual bank deposit rate or inflation.

C7: FRAUD AND MISUSE OF CUSTOMER ASSETS

- a. Adequate custodian arrangements, including safekeeping, monitoring, settlement, and control functions, should be in place to ensure that assets are safeguarded.
 - b. Pension fund assets should be segregated from all other funds.
 - c. Vested benefits should be protected from creditors of the sponsor and service providers, and also when the sponsor or a service provider changes ownership.
 - d. Trustees/boards should be legally responsible for ensuring that the funds are only used for the benefit of the pension fund members.
 - e. Investments in instruments issued by entities related to the pension fund should be prohibited or strictly limited.
-

Explanatory Notes

Segregation of pension assets is a key requirement to avoid fraud and misuse. Normally, a custodian, independent from the pension fund and the asset manager, fulfills safekeeping and monitoring functions, settles transactions, and checks investment limits (and, in most cases, also calculates net asset values).

When managing pension fund assets, insurance companies are required to ensure that those pension savings are fully separated from other assets or liabilities arising from different activities of the company.¹²⁵ Because in the case of traditional insurance, client assets are on the books of the insurance company, this is an important aspect of segregation.

Investment regulations and approaches are also expected to minimize the chances of fraud and misuse of customer assets. Investing in instruments issued by entities related to the pension fund is generally prohibited or

strictly limited.¹²⁶ Transactions between different funds managed by the same pension fund administrator—which may make perfect business sense—are normally to be reported to the authorities. Investment in non-regulated assets may also lead to misappropriation (South Africa).¹²⁷

Special care must also be taken when investing in bank deposits, as deposit insurance guarantees generally do not cover deposits of pension funds (which are deemed professional institutional investors). Strict diversification rules and a close monitoring of the financial situation of pre-approved banks must be applied. These principles are obvious when investing in stocks or bonds, but plain-vanilla bank deposits may sometimes seem more secure than in reality.

Corporate governance principles are also fundamental in preventing fraud. Since this is on the borderline of consumer protection, further references are listed in the endnotes.¹²⁸

C8: BANKRUPTCY

- a. Regulations should ensure that customer assets are not affected by bankruptcy procedures of the plan sponsor or any service provider.
-

Explanatory Notes

In the case of bankruptcy, it is essential that client assets are segregated and fully protected from legal processes against any service provider. This is indeed the case in many jurisdictions.¹²⁹ In some countries, such as Germany, the United Kingdom, and the United States, pension benefit guarantee schemes would protect some level of mem-

ber benefits if a plan sponsor were to go bankrupt while a scheme is underfunded. The OECD recommends that these protection schemes be in place in the book reserve pension systems and has discussed the challenges that need to be addressed to ensure that they are well designed and sustainable.¹³⁰

D: DATA PROTECTION AND PRIVACY¹³¹

D1: LAWFUL COLLECTION AND USAGE OF CUSTOMER DATA

- a. Intermediaries, advisers, and pension schemes should be allowed to collect customer data within the limits established by law or regulation and, where applicable, with the customer's consent.
- b. The law or regulation should establish rules for the lawful collection and use of data by intermediaries, advisers, and pension schemes, including when consumer consent is required, and clearly establishing at a minimum
 - i. How data can be lawfully collected;
 - ii. How data can be lawfully retained;
 - iii. The purposes for which data can be collected; and
 - iv. The types of data that can be collected.
- c. The law or regulation should provide the minimum period for retaining all customer records and, throughout this period, the customer should be provided ready access to such records for a reasonable cost or at no cost.
- d. For data collected and retained by intermediaries, advisers, and pension schemes, intermediaries, advisers, and pension schemes should be required to comply with data privacy and confidentiality requirements that limit the use of consumer data exclusively to the purposes specified at the time the data were collected or as permitted by law, or otherwise specifically agreed with the consumer.

Explanatory Notes

Consumers have a right to financial privacy and to be free from unwarranted intrusions into their privacy. Because of the requirement for intermediaries, advisers, and pension schemes to know their customers, pension sector professionals often have large sources of information regarding the financial situation of their customers, including personal information, contact details, consumer agreements, transaction logs, passwords, and so forth. Given the potential for abuse and misuse of such information, it is essential that this type of collection is regulated to avoid the risk of potential harm for consumers. For example, providers may otherwise collect sensitive data and use it for unfit purposes that may harm consumers. The various reasons for ensuring privacy and data protection include:

- The sensitivity of the personal information held and used in pension products

- The extensive information flows that take place, including between providers and intermediaries and between members of a corporate group that includes one or more financial service providers
- The ever-increasing likelihood of information being received and held electronically, with a corresponding increase in the risk of remote, unauthorized access
- The fact that privacy is a fundamental human right deserving of protection, as indicated in various international instruments to which many countries are signatories¹³³

Pension sector professionals should be allowed to legally obtain, retain, and use consumers' personal information after obtaining lawful and informed consent from the consumer or on some other legitimate basis, including when

related to the provision of the specific pension product or service the consumer acquired. International guidance is clear in establishing that “the collection of personal data and any such data should be obtained by lawful and fair means and, where appropriate, with the knowledge or consent of the data subject.”¹³⁴ While the policies and practices regarding what constitutes lawful collection of data differ both across jurisdictions and among international guidance and principles, lawful and informed consent represents an underlying and cross-cutting theme.

Further, following the approach of treating data privacy as a human right, Convention 108 of the Council of Europe (COE Convention) establishes that data shall undergo automatic processing only for a legitimate purpose, and that certain categories of sensitive data cannot be processed automatically, unless national legislation provides appropriate safeguards.¹³⁵

The lawful collection of data with customer consent is strictly connected to the purpose for which it was collected, and pension sector professionals should be permitted to use the data only for these purposes. Data should be considered legally used only if it is processed for the purpose for which it was collected. If this issue is not regulated by law or regulation, there is a risk that pension sector professionals may collect information for certain purposes for which customers may be willing to give consent but then use that same information for other purposes that may be detrimental to customers’ interests and for which the customer otherwise may not have given consent. Pension sector professionals should also be prohibited from disclosing consumer information to third parties for unauthorized (that is, without the consumer’s prior consent) uses, such as for marketing purposes.

D2: CONFIDENTIALITY AND SECURITY OF CUSTOMER'S INFORMATION

- a. Pension management companies should be required to have and implement policies and procedures that ensure the confidentiality, security, and integrity of all data stored in their databases that relate to customers’ personal information, accounts, and transactions.
- b. In order to ensure confidentiality, when establishing policies and procedures, pension management companies should also establish different levels of permissible access to customers’ data for employees, depending on the role they play within the organization and the different needs they may have to access such data.
- c. Confidential information of members of occupational pension plans should be protected along with their general employee, employment, compensation, and other records.
- d. In order to maintain the security and integrity of customers’ data, pension management companies should also be required to have and implement policies and procedures to ensure security related to networks and databases.
- e. Pension management companies should be held legally liable for misuse of consumer data.
- f. Pension management companies should be held legally liable for any breaches in data security that result in loss or other harm to the customer and should put in place clear procedures to deal with security breaches, including mechanisms to reimburse or compensate consumers.

Explanatory Notes

The protection of pension fund members’ confidential information is of particular importance for systems where pension products are sold to individuals, as with other financial products. Given the nature of the industry, pension management companies may collect, store, and process significant amounts of financial and personal information. Safeguarding personal and financial data is one of the key responsibilities of the financial services industry. Security should be put in place to protect against unauthorized access to a consumer’s information.

A guiding principle in this area is that pension management companies should ensure that personal information in their custody or under their control is used only for the purpose for which that information was obtained or compiled, or for a use consistent with that purpose. Pension management companies have a clear responsibility to provide their customers with a level of comfort regarding information disclosure and the security of personal information. Information that a consumer expects to be confidential should be treated as such. Customers should be informed about which information might be disclosed and to whom.

D3: SHARING CUSTOMER'S INFORMATION

- a. The law should state specific procedures and exceptions concerning the release of customers' financial records to government authorities.
- b. Whenever a pension management company is legally required to share a customer's information with a governmental authority, the company should be required to inform the customer in writing (including in an electronic form) in a timely manner of
 - i. The governmental authority's precise request;
 - ii. The specific information of the customer that has been or will be provided; and
 - iii. How and when that information has been or will be provided.
- c. Subject to the exception noted in clauses D3(a) and (b), without a consumer's prior written consent as to the form and purpose for which their data will be shared, the law should prevent pension management companies from selling or sharing any of a consumer's information with any third party, unless such third party is acting on behalf of the pension management company and the information is being used for a purpose that is consistent with the purpose for which that information was originally obtained.
- d. Before any such sharing for the first time, pension management companies should be required to inform consumers in writing of his or her data privacy rights in this respect and how they intend to use and share customers' personal information.
- e. Pension management companies should be required to allow customers to stop or opt out of any sharing by the pension management company of information regarding the customer that they previously authorized (unless such sharing is mandated by law), and the pension management company should inform its customers of his or her opt-out right.
- f. Third parties should be prohibited from disclosing the shared information regarding a consumer.

Explanatory Notes

Customers should be aware of how information can be shared with third parties, including within the various units or subsidiaries of a financial institution. The sharing of data is generally not allowed, but should be made very explicit when this is not the case. Generally, the sharing of customer data should be done only with the customer's affirmative consent and only for those specific purposes to which the customer has provided consent.

Governmental regulatory authorities have the need to obtain customer information for regulatory and law enforcement purposes, such as to monitor suspicious transactions for anti-money laundering efforts and to combat the financing of terrorism (AML/CFT) purposes. The instances where this is permitted should be clearly stated in the law, which should also include procedures for notification or situations where notification is not required.

E: DISPUTE RESOLUTION MECHANISMS

E1: INTERNAL COMPLAINTS HANDLING

- a. Pension management companies should be required to have an adequate structure in place as well as written policies regarding their complaints handling procedures and systems—that is, a complaints handling function or unit, with a designated member of senior management responsible for this area, to resolve complaints registered by consumers against the company effectively, promptly, and justly.
- b. Pension management companies should be required to comply with minimum standards with respect to their complaints handling function and procedures. These include the following:
 - i. Resolve a complaint within a maximum number of days, which should not be longer than the maximum period applicable to a third-party external dispute resolution mechanism. (See E2.)

- ii. Make available a range of channels—telephone, fax, email, web—for submitting consumer complaints appropriate to the type of consumers served and their physical location, including offering a toll-free telephone number to the extent possible, depending on the size and complexity of the financial service provider’s operations.
 - iii. Widely publicize clear information on how a consumer may submit a complaint and the channels made available for that purpose, including on pension management companies’ websites, marketing and sales materials, KFSs, standard agreements, and locations where their products and services are sold. (See B1, “Format and Manner of Disclosure.”)
 - iv. Publicize and inform consumers throughout the complaints handling process, and particularly in the final response to the consumer, regarding the availability of any existing ADR schemes. (See E2.)
 - v. Adequately train staff and agents who handle consumer complaints.
 - vi. Keep the complaints handling function independent from business units such as marketing, sales, and product design, to ensure fair and unbiased handling of the complaints, to the extent possible, depending on the size and complexity of the pension management company.
 - vii. Within a short period following the date the pension management company receives a complaint, acknowledge receipt of the complaint in a durable medium—that is, in writing or in another form or manner that the consumer can store—and inform the consumer about the maximum period within which the company will give a final response and by what means.
 - viii. Within the maximum number of days, inform the consumer in a durable medium of the company’s decision with respect to the complaint and, where applicable, explain the terms of any settlement being offered to the consumer.
 - ix. Keep written records of all complaints, while not requiring that the complaint itself be submitted in writing—that is, allow for oral submission.
- c. Pension management companies should be required to maintain and make available to the supervisory authority up-to-date and detailed records of all individual complaints.
 - d. The pension management company’s complaints handling and database system should allow the company to report complaints statistics to the supervisory authority.
 - e. Pension management companies should be encouraged to use analysis of complaints information to continuously improve their policies, procedures, and products.
 - f. For occupational pension systems, pension fund members should be informed of the right to contact the supervisory authority should any disputes with the sponsoring employer of their pension plan arise.

Explanatory Notes

Pension fund management companies normally have personnel or departments responsible for handling disputes with their clients. Frequently, this would be corporate clients, as the companies are dealing with corporate plan sponsors, but they may also have to deal with pension fund trustees. In a pure retail market, individuals should be made aware of where to lodge complaints, and standard good practices that apply across financial products should also be adopted. For occupational pension funds, human resources managers would normally deal with questions or problems, but individual members should be

informed of how to contact the supervisory authority if disputes with their employer over their pension provision arise. This would include the important consumer protection issue of notifying the supervisory authority if employees’ pension contributions have been taken from their compensation package by their employer but not remitted to the pension fund. Pension management companies should be required to keep a log of complaints and regularly report complaints statistics to the regulator.

For further details, see the explanatory notes for E1 in chapter 1, “Deposit and Credit Products and Services.”

E2: OUT-OF-COURT FORMAL DISPUTE RESOLUTION MECHANISMS

- a. If consumers are unsatisfied with the decision resulting from the internal complaints handling of their employer or a pension management company, they should have the right to appeal within a reasonable timeframe (for example, 90 to 180 days) to an out-of-court ADR mechanism that
 - i. Has powers to issue decisions on each case that are binding on the employer or pension management company (but not binding on the consumer);
 - ii. Is independent of all parties and discharges its functions impartially;
 - iii. Is staffed by professionals trained in the subject(s) they deal with;
 - iv. Has an adequate oversight structure that ensures efficient operations;
 - v. Is financed adequately and on a sustainable basis;
 - vi. Is free of charge to the consumer; and
 - vii. Is accessible to consumers.
 - b. The existence of the ADR mechanism, its contact details, and basic information relating to its procedures should be made known to consumers through a wide range of means, including when a complaint is finalized at the employer or pension management company level.
 - c. If the ADR mechanism has a member-based structure, all pension management companies should be required to be members.
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Explanatory Notes

Having out-of-court dispute resolution mechanisms for consumers to seek redress when they are not satisfied with the result of internal complaints handling at the employer or pension management company is very important, particularly in the many countries where the justice system does not work properly for retail consumers—that is, it is too burdensome, expensive, unreliable, or not timely. ADR bodies should be in place and follow the minimum standards listed above. When establishing an ADR mechanism for resolving consumers' disputes with financial institutions, policy makers should consider a range of possible models, and the law or regulation should set out clear minimum standards for ADR mechanisms, which should be monitored by a supervisory authority.

There could also be arbitration mechanisms in place as well which could be used by consumers. However, consumers should not be obliged to use such mechanisms and forgo their right to go to court. Ideally, the compulsory use of arbitration should be prohibited. For instance, the United States' Consumer Financial Protection Bureau issued a comprehensive study in 2015 that found that arbitration clauses in consumer agreements limit consumer redress choices, as most consumers do not seek arbitration or courts but would be eligible to relief—for instance, through class-action settlements.¹³⁶ The study also found that consumers did not realize that arbitration clauses limited their right to go to court.

For further details, [see the explanatory notes for E2 in chapter 1, "Deposit and Credit Products and Services."](#)

NOTES

1. See “Managing and Supervising Risks in Defined Contribution Pension Systems,” Working Papers on Effective Pensions Supervision 12 (International Organisation of Pension Supervisors, October 2010).
2. The governance of public sector schemes has been covered in numerous publications by the World Bank and other organizations. For example, see Sudhir Rajkumar and Mark Dorfman, eds., *Governance and Investment of Public Pension Assets: Practitioners’ Perspectives* (Washington, DC: World Bank, 2011).
3. Members of occupational DB schemes are not consumers in the pure sense, as they are not voluntary purchasers of a product. Though the protection of members of these schemes is an important topic, it is largely covered by prudential issues, such as solvency rules and protection schemes in the case of plan sponsor bankruptcy. These issues are beyond the scope of the Good Practices, which focuses on market conduct issues.
4. The area of micropensions and how these should be supervised is a developing area and one not addressed directly in this chapter. As argued elsewhere in this chapter, an additional duty of care should be afforded to low-income, vulnerable consumers. Therefore, it is suggested that this topic deserves further investigation.
5. See G20 High-Level Principles on Financial Consumer Protection (OECD, October 2011).
6. See G20/OECD Task Force on Financial Consumer Protection, “Update Report on the Work to Support the Implementation of the G20 High-Level Principles on Financial Consumer Protection, Principles 4, 6 and 9” (OECD, September 2013) and “Effective Approaches to Support the Implementation of the Remaining G20 High-Level Principles on Financial Consumer Protection” (OECD, September 2014).
7. The December 2016 directive of the European Parliament and of the Council of the European Union on the activities and supervision of institutions for occupational retirement provision (IORP II Directive) dedicates a full chapter to discussing governance systems.
8. The IOPS diagnostic tool for undertaking a complete and comprehensive review of the IOPS Principles can be found at www.iopsweb.org.
9. See also “The Role of Supervision Related to Consumer Protection in Private Pension Systems,” Working Papers on Effective Pensions Supervision 27 (IOPS, 2016).
10. For further details, see <http://www.iopsweb.org/toolkit/>.
11. For further details, see [http://www.iopsweb.org/principle-sandguidelines/IOPS%20Guidelines%20for%20Supervisory%20Intervention%20Enforcement%20and%20Sanctions%20\(final%20new%20coverpage\).pdf](http://www.iopsweb.org/principle-sandguidelines/IOPS%20Guidelines%20for%20Supervisory%20Intervention%20Enforcement%20and%20Sanctions%20(final%20new%20coverpage).pdf).
12. Australia, Bulgaria, Chile, Israel, Jamaica, Mexico, and Turkey, among others. See Ambrogio I. Rinaldi and Elisabetta Giacomel, “Information to Members of DC Pension Plans: Conceptual Framework and International Trends,” Working Paper 5 (IOPS, September 2008) for several parts of this GP, as well as G20/OECD Task Force, “Update Report” (OECD, 2013), Annex, Principle 4, Item 23. “The Role of Supervision” also shows that 10 jurisdictions provide information on fees and charges through comparative online platforms on the websites of the pension supervisory authority, and others intend to follow suit.
13. For several parts of the section, see “Comparative Information Provided by Pension Supervisory Authorities,” Working Papers on Effective Pension Supervision 15 (IOPS, December 2011).
14. See also “Update of IOPS Work on Fees and Charges,” Working Papers on Effective Pensions Supervision 20 (IOPS, April 2014).
15. A well-defined and universally applied formula is necessary for the use of such indicators, which is not detailed in the Good Practices.
16. See Justine S. Hastings and Lydia Tejeda-Ashton, “Financial Literacy, Information, and Demand Elasticity: Survey and Experimental Evidence from Mexico,” National Bureau of Economic Research Working Paper 14538 (National Bureau of Economic Research, December 2008).
17. See *Diagnostic Review of Consumer Protection and Financial Capability, Peru* (World Bank, November 2013).
18. See “The Role of Supervision.”
19. <http://cplatform.mpfa.org.hk/MPFA/english/index.jsp>.
20. See, for instance, *Diagnostic Review of Consumer Protection and Financial Literacy, Romania* (World Bank, July 2009).
21. See Gonzalo Reyes and Fiona Stewart, “Transparency and Competition in the Choice of Pension Products: The Chilean and UK Experience,” Working Paper 7 (IOPS, May 2008).
22. See *Diagnostic Review, Peru*. The individual must select among four types that differ in guarantees, survivor benefits, and other criteria, and insurance companies receive the individual’s details and provide quotes on the adequate pension products available. The highest bid must be accepted by the affiliate, which must receive at least three bids, with one day to consider the options and one possibility for re-quotes. The pension fund must assist by providing information and explaining options but is prohibited from giving specific product recommendations. Making decisions on these bases is still difficult, especially given the lack of standardized information for comparing offers.
23. See G20/OECD Task Force, “Effective Approaches” (OECD, 2014), Annex, Principle 7, Items 347 and 534.
24. See G20/OECD Task Force, “Update Report” (OECD, 2013), Annex, Principle 4, Item 99.
25. The IORP II Directive requires that all information to prospective members, members, or beneficiaries must be written in a clear manner using comprehensible language and should avoid jargon and technical terms as much as possible. IORPs must also provide their annual accounts and reports and the statement of investment policy principles at the request of the member or beneficiary.
26. See Rinaldi and Giacomel and “The Role of Supervision.”
27. See National Employment Savings Trust (NEST), *The NEST Phrasebook: Clear Communication about Pensions*, Version 2.0 (NEST Corporation, 2014), available at <http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/NEST-phrasebook.PDF.pdf>, and *NEST’s Golden Rules of Communications: Talking about Pensions with a New Generation of Savers* (NEST Corporation, 2014), available at <http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/golden-rules-of-communication.PDF.pdf>.

28. See Hastings and Tejada-Ashton.
29. The European Insurance and Occupational Pensions Authority's (EIOPA) Good Practices on Communication Tools and Channels for Communicating to Occupational Scheme Members show that in EU member states, paper-based communication is the most commonly used channel, followed typically by e-mail, and then websites. This applies equally to communication to new members, regular communication to members and beneficiaries, and ad hoc communications. Examples of exceptions to the general trend include Denmark, where ad hoc information about changes directly affecting active members is communicated on a public website with an automated decision tool and in face-to-face meetings with an adviser, and Denmark and Croatia, where pre-retirement or at retirement information is communicated in the first instance via a website. Similar to the case in Malta, the Netherlands, and the United Kingdom, telephone calls are the second or third most frequent communication channel. See "Report on Good Practices on Communication Tools and Channels for Communicating to Occupational Scheme Members" (EIOPA, August 2016).
30. "Report on Good Practices" (EIOPA, 2016) lists among good practices if coherent communication strategies with communication tools and elements are implemented, and if a multi-channel strategy is used in communication to members. See also Occupational Pensions Stakeholder Group (OPSG), "OPSG Statement on Information for Members of Occupational Pension Plans" (EIOPA, March 2013).
31. See Rinaldi and Giacomel.
32. "Report on Good Practices" (EIOPA, 2016) also considers it a good practice if all communication with members can be stored in one online platform, and if the employer combines related human resource matters (such as information about benefits and entitlements) and pensions in one online platform.
33. See G20/OECD Task Force, "Update Report" (OECD, 2013), Principle 4, Item 13: "Information for consumers is displayed on the websites of financial services providers and is made available in branches, offices and other client or consumer areas. This is particularly important for lower income users of financial services or other more vulnerable consumers who may lack access to the internet. Regulators and supervisors provide guidance to financial services providers on disclosure requirements for product information, including when it is provided online or through electronic devices."
34. See *Diagnostic Review of Consumer Protection and Financial Capability, Latvia* (World Bank, April 2010).
35. See *Diagnostic Review of Consumer Protection and Financial Literacy, Tanzania* (World Bank, November 2013).
36. See Rinaldi and Giacomel; G20/OECD Task Force, "Update Report" (OECD, 2013), Annex, Principle 4, Items 23 and 232; and *Diagnostic Review, Peru*.
37. Available at <http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/golden-rules-of-communication,PDF.pdf> and <http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/NEST-phrasbook,PDF.pdf>, respectively.
38. The IORP II Directive requires that the information must not be misleading, and consistency must be ensured in the vocabulary and content.
39. See G20/OECD Task Force, "Update Report" (OECD, 2013), Annex, Principle 4, Item 482.
40. See "The Role of Supervision."
41. See, for instance, G20/OECD Task Force, "Update Report" (OECD, 2013), Annex, Principle 4, Item 127 for an example from the United Kingdom.
42. As stated in G20/OECD Task Force, "Update Report" (OECD, 2013), Principle 4, Item 19: "Before the imposition of a specific disclosure obligation, appropriate and effective consumer testing is carried out to gauge their benefits and avoid the risk of an overload of information."
43. The IORP II Directive also provides detailed regulation about information provision. "The Role of Supervision" lists a number of jurisdictions, including Colombia, Lithuania, and Portugal, where pre-contractual information must be approved/monitored by the supervisory authority.
44. For details and examples for the whole GP, see Rinaldi and Giacomel.
45. See "EIOPA Report on Costs and Charges of IORPs" (EIOPA, January 2015).
46. See "Final Report on Good Practices on Individual Transfers of Occupational Pension Rights" (EIOPA, July 2015).
47. See Waldo Tapia and Juan Yermo, "Implications of Behavioural Economics for Mandatory Individual Account Pension Systems," OECD Working Papers on Insurance and Private Pensions 11 (OECD, July 2007).
48. According to "Report on Investment Options for Occupational DC Scheme Members" (EIOPA, January 2015), both the availability of a default investment option and limiting the choice for investment options are among the main instruments to facilitate effective investment decision making. A majority of member states have occupational DC schemes in which members have no choice. Where member choice applies, it is mostly up to five investment options, and a default (passive choice) is often available. In most cases, the employer is involved in choosing the default strategy, which typically consists of life-cycling.
49. For more details, see, for instance, John Y. Campbell and Luis M. Viceira, *Strategic Asset Allocation: Portfolio Choice for Long-Term Investors* (Oxford: Oxford University Press, 2002); Fabio C. Bagliano, Carolina Fugazza, and Giovanna Nicodano, "Pension Funds, Life-Cycle Asset Allocation, and Performance Evaluation," in *Evaluating the Financial Performance of Pension Funds*, eds. Richard Hinz, Heinz P. Rudolph, Pablo Antolin, and Juan Yermo (Washington, DC: World Bank, 2010); Gregorio Impavido, Esperanza Lasagabaster, and Manuel Garcia-Huitron, *New Policies for Defined Contribution Pensions: Industrial Organization Models and Investment Products* (Washington, DC: World Bank, 2010); Solange Berstein, Olga Fuentes, and Felix Villatoro, "Default Investment Strategies in a Defined Contribution Pension System: A Pension Risk Model Application for the Chilean Case," *Journal of Pension Economics and Finance* 12, no. 4 (October 2013), 379–414; "EIOPA's Fact Finding Report on Decumulation Phase Practices" (EIOPA, October 2014); and Fiona Stewart, "Proving Incentives for Long-Term Investment by Pension Funds: The Use of Outcome-Based Benchmarks," Policy Research Working Paper 6885 (World Bank, May 2014).
50. The IOPS survey shows that 13 jurisdictions (about one-third of respondents) require that pension service

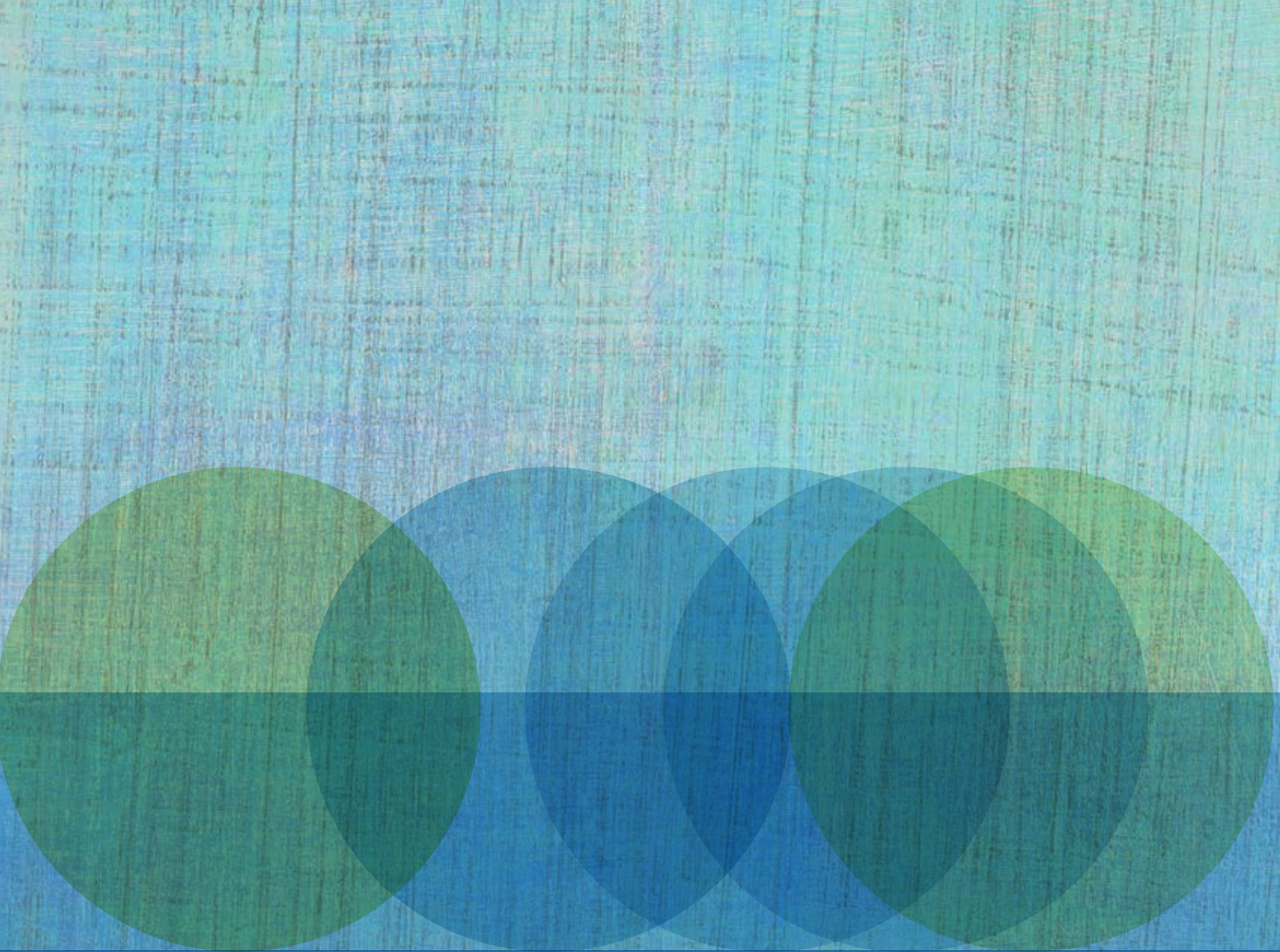
- providers disclose information on the available default investment fund(s) and their strategies. See “The Role of Supervision.” Six regulatory authorities require information disclosure on default contribution rates. Only a few jurisdictions (for example, Australia, Chile, Colombia, Mexico) publish on their websites information on default investment funds and default pension schemes.
51. For this section, see details in Tapia and Yermo, Rinaldi and Giacomel, and “Supervision of Pension Intermediaries,” Working Papers on Effective Pensions Supervision 17 (IOPS, December 2012).
 52. See Richard H. Thaler and Cass R. Sunstein, *Nudge: Improving Decisions about Health, Wealth and Happiness* (New Haven: Yale University Press, 2008).
 53. Voluntary pension systems often have low participation rates, even if supported by tax benefits, matching contributions by the employer and the state. Auto-enrollment features with opt-out possibilities change the default option: The worker automatically gets into the system and has an option to step out, whereas traditional voluntary systems require active decisions to start saving. The New Zealand and United States 401(k) experiences show that participation rates indeed increase dramatically. The United Kingdom is in the process of enrolling 10 million new savers into the auto-enrollment system. Regulators naturally have large responsibility in setting the default parameters, such as contribution rates or investment portfolios, properly, because most participants will take no active decision after enrolled. The New Zealand, United Kingdom, and United States experience is important to watch for regulators around the world, since this is a key element of protecting consumers from a strong foe: themselves, for not saving enough. For more details on the topic, see Brigitte C. Madrian and Dennis F. Shea, “The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior,” *The Quarterly Journal of Economics* 116, no. 4 (November 2001), 1149–1187; James J. Choi, David Laibson, Brigitte C. Madrian, and Andrew Metrick, “For Better or for Worse: Default Effects and 401(k) Savings Behavior,” Working Paper 8651 (NBER, May 2001), and “Defined Contribution Pensions: Plan Rules, Participant Decisions, and the Path of Least Resistance,” Working Paper 8655 (NBER, December 2001); Richard H. Thaler and Shlomo Benartzi, “Save More Tomorrow: Using Behavioral Economics to Increase Employee Savings,” *Journal of Political Economy* 112, no. 1 (2004); Shlomo Benartzi and Richard H. Thaler, “Behavioral Economics and the Retirement Savings Crisis,” *Science* 339, no. 6124 (March 8, 2013), “Automatic Enrollment Shows Promise for Some Workers, but Proposals to Broaden Retirement Savings for Other Workers Could Face Challenges” (United States Government Accountability Office, October 2009); “Trends and Experience in 401(k) Plans” (Hewitt Associates, 2009); “2013 Trends and Experience in Defined Contribution Plans: An Evolving Retirement Landscape” (Aon Hewitt, 2013); Jack VanDerhei, “The Impact of Automatic Enrollment in 401(k) Plans on Future Retirement Accumulations: A Simulation Study Based on Plan Design Modifications of Large Plan Sponsors,” Brief 341 (EBRI, August 2010); James J. Choi, David Laibson, and Brigitte C. Madrian, “\$100 Bills on the Sidewalk: Violations of No-Arbitrage in 401(k) Accounts,” *The Review of Economics and Statistics* 113, no. 3 (August 2011), 748–63; Brigitte C. Madrian, “Matching Contributions and Savings Outcomes: A Behavioral Economics Perspective,” Working Paper 18220 (NBER, July 2012); Raj Chetty, John N. Friedman, Soren Leth-Petersen, Torben Nielsen, and Tore Olsen, “Active vs. Passive Decisions and Crowding out in Retirement Savings Accounts: Evidence from Denmark,” Working Paper 18665 (NBER, November 2012); John Beshears, James J. Choi, David Laibson, and Brigitte C. Madrian, “Financial Inertia among Low-Income Individuals: Plan Carefully When Setting 401(k) Defaults” (Retirement Made Simpler, February 2013), www.retirementmadesimpler.org; “Trends in 401(k) Plans and Retirement Rewards” (WorldatWork and the American Benefit Institute, 2013); Will Sandbrook and Tim Gosling, “Pension Reform in the United Kingdom: The Unfolding NEST Story,” *Rotman International Journal of Pension Management* 7, no. 1 (spring 2014); “Role of Pension Supervisory Authorities in Automatic Enrolment,” Working Papers on Effective Pensions Supervision 22 (IOPS, December 2014); and KiwiSaver Annual Statistics, Inland Revenue (New Zealand).
 54. See, for example, *Diagnostic Review of Consumer Protection in Financial Services, Russia* (World Bank, July 2009), where the lack of clear disclosure rules about annuitization was the major source of complaints received by the regulatory authorities.
 55. The IORP II Directive requires that IORPs provide information about pay-out options to members “in due time before the retirement age,” or upon request.
 56. One not very obvious and often under-appreciated reason, among many others, for starting early communication with customers about their planned retirement products is that the investment strategy in the accumulation phase, and especially the details of the life-cycle (de-risking) path, should take into account the way the customer is expected to use savings. For example, if a portion is destined for lump-sum payout, a segment of the portfolio ought to run out to cash by the time of retirement, to minimize investment risks. The amount to be used for annuitization should be linked to a fixed-income portfolio with the same duration as that of the annuity product for hedging annuitization risk—and it’s also important to know the time of the planned annuitization, whether immediately at retirement or via a deferred annuity. If a part of the savings is to be left behind for inheritance, that could follow an equity-dominant strategy similar to the most active ages of the accumulation period. See *The Future of Retirement: A Consultation on Investing for NEST’s Members in a New Regulatory Landscape* (NEST Corporation, 2014) and *The Future of Retirement: A Retirement Income Blueprint for NEST’s Members* (NEST Corporation, 2015).
 57. See Chris O’Brien, Paul Fenn, and Stephen Diacon, “How Long Do People Expect to Live? Results and Implications,” Research Report 2005-1 (Centre for Risk and Insurance Studies, June 2005) and David Blake, “The Consequences of Not Having to Buy an Annuity,” Discussion Paper PI-1409 (Pensions Institute, June 2014).
 58. These include Armenia, Austria, Bulgaria, Iceland, Israel, Mauritius, and the Netherlands. In some other jurisdictions, life annuity is the default product. See “Supervising the Distribution of Annuities and Other Forms of Pension Pay-Out,” Working Papers on Effective Pensions Supervision 21 (IOPS, December 2014).
 59. There is an additional implication of voluntary annuitization, rather than mandatory, and that is possible negative selection. There is a danger (for insurers) that those

shunning life annuities may have undisclosed insider knowledge about their shorter life expectancy, while those expecting to live longer (for instance, based on family histories) would be overrepresented among clients purchasing annuities. Such a potential selection bias motivates insurance companies to charge a higher risk premium across the board. Mandatory annuitization solves the problem and leads to lower prices, contributing in this way to consumer protection.

60. Retirees may have urgent needs for cash, such as for paying back debts, or they may want to leave a part of their savings behind as inheritance. Other legitimate uses may also exist.
61. See "EIOPA's Fact Finding Report on Decumulation Phase Practices."
62. For a useful summary of their systems, see "EIOPA's Fact Finding Report on Decumulation Phase Practices."
63. See David Blake, "The Consequences of Not Having to Buy an Annuity."
64. See also "Supervising the Distribution of Annuities and Other Forms of Pension Pay-Out."
65. See *Diagnostic Review of Consumer Protection and Financial Literacy, Croatia* (World Bank, February 2010).
66. More than 20 jurisdictions introduced such requirements. See the IOPS survey in "The Role of Supervision," which also shows that a key information document for pension products is still not a very common practice, and it typically covers the accumulation phase only. Therefore, according to IOPS, a similar document for the benefit pay-out options could require supervisory attention or action in the future.
67. A standard requirement is a minimum font size of 11 points.
68. It has to be noted that in previous World Bank diagnostic surveys, practically no country had regulations in place regarding standardized KFSs for pension products. The G20 FCP Principles do not list pension-related country-level best practices in this area, either.
69. For important details, see "Risks Related to DC Pension Plan Members," "Risk Mitigation Mechanisms for DC Related Risks," and "Report on Pre-Enrolment Information to Pension Plan Members" (EIOPA, July 2011); "Good Practices on Information Provision for DC Schemes" (EIOPA, January 2013); and "Report on Good Practices" (EIOPA, 2016).
70. See OPSG, "OPSG Statement on Information for Members of Occupational Pension Plans."
71. See "EIOPA Report on Costs and Charges of IORPs."
72. For example, the IORP II Directive gives detailed regulation about the pension benefit statement to be provided to members. In 15 jurisdictions responding to the IOPS (2016) survey, there is a requirement to disclose benefit statements in a standardized format. See "The Role of Supervision."
73. Such as Sharpe ratios or value-at-risk indicators.
74. Such as Australia, Austria, Bulgaria, Hong Kong, Ireland, Israel, Italy, Mexico or Turkey. See Rinaldi and Giacomel.
75. Australia, Chile, Hong Kong, Ireland, Mexico, Poland, Turkey, and the United Kingdom, among others. For this whole section, see Rinaldi and Giacomel; Pablo Antolín and Debbie Harrison, "Annual DC Pension Statements and the Communications Challenge," Working Papers on Finance, Insurance and Private Pensions 19 (OECD, 2012); and "The Role of Supervision," which shows that 10 jurisdictions require pension projections from pension service providers, or regulatory authorities provide projections themselves. In Austria, Lithuania, and Poland, benefit projections are made by public authorities other than pension regulatory authorities. Ten regulatory authorities provide pension projections via online calculators on their (or other educational) websites. See also "The Role of Supervision" for a useful summary and description of different benefit projection tools.
76. "Report on Good Practices" (EIOPA, 2016) considers it a good practice if members are offered the use of pension calculators.
77. See Pablo Antolín and Olga Fuentes, "Communicating Pension Risk to DC Plan Members: The Chilean Case of a Pension Risk Simulator," Working Papers on Finance, Insurance and Private Pensions 28 (OECD, October 2012) and Berstein, Fuentes, and Villatoro.
78. See "Comparative Information Provided by Pension Supervisory Authorities."
79. The IORP II Directive requires that the pension benefit statement sent to members includes "information on pension benefit projections based on the retirement age, and a disclaimer that those projections may differ from the final value of the benefits received. If the pension benefit projections are based on economic scenarios, that information shall also include a best estimate scenario and an unfavourable scenario, taking into consideration the specific nature of the pension scheme." The directive leaves it to member states to "set out rules to determine the assumptions of the projections. Those rules shall be applied by IORPs to determine, where relevant, the annual rate of nominal investment returns, the annual rate of inflation and the trend of future wages." Finally, on request, the IORP must provide additional information to members or beneficiaries about the assumptions used in projections.
80. See "The Role of Supervision."
81. See G20/OECD Task Force, "Update Report" (OECD, 2013), Annex, Principle 4, Item 100.
82. The application may be found at <http://www.safp.cl/apps/simuladorPensiones/>.
83. "Report on Good Practices" (EIOPA, 2016) considers it a good practice if online tracking services (which provide members accurate knowledge about their entitlements) can also serve as a communication channel to send out alerts. "Report on Good Practices" also acknowledges that members 17 member states receive such ad hoc information via paper-based channels most frequently, followed by email and then personal online accounts. See also endnote 29.
84. For instance, the IORP II Directive requires that "IORPs shall inform beneficiaries without delay after a final decision has been taken resulting in any reduction in the level of benefits due, and three months before that decision is implemented."
85. For further details for the whole section, see "OECD Guidelines for the Protection of Rights of Members and Beneficiaries in Occupational Pension Plans" (OECD, 2003). See also "OECD Core Principles of Private Pension Regulation" (OECD, 2016), Core Principle 10: "Access to personal private pension plans should be non-discriminatory. Regulation should ensure that individuals are treated equally and fairly.... Pension funds and pension entities,

- their external service providers and authorised agents, and other intermediaries operating in the personal pensions market should work in the best interest of plan members and be responsible and be held accountable for upholding financial consumer protection. In general, members of personal pension plans should have the right to full portability.”
86. See G20/OECD Task Force, “Update Report” (OECD, 2013), Principle 6, Item 6: “Acting in the best interest of the consumer excludes practices such as misleading or aggressive commercial practices or exploitation of consumer vulnerabilities and unfair contractual terms.” See also “OECD Core Principles of Private Pension Regulation,” Core Principle 10.
 87. For instance, mystery shopping exercises in India and Mexico found that agents offered better advice to consumers who emphasized that they had shopped around, whereas inexperienced consumers, perceived to have lower levels of financial literacy, received inferior advice and less product information. See Rafe Mazer, Katharine McKee, and Alexandra Fiorillo, “Applying Behavioral Insights in Consumer Protection Policy,” *Focus Note 95* (CGAP, June 2014).
 88. See Debbie Harrison, David Blake, and Kevin Dowd, “Caveat Venditor: The Brave New World of Auto-Enrolment Should Be Governed by the Principle of Seller Not Buyer Beware” (Pensions Institute, October 2012).
 89. See “Supervision of Pension Intermediaries” (IOPS, December 2012).
 90. Within the framework of the TCF approach, providers develop their own internal set of policies and procedures. Malaysia, South Africa, the United Kingdom, and other countries have put in place or are planning such frameworks. See Mazer, McKee, and Fiorillo.
 91. See *Diagnostic Review, Peru* (World Bank, 2013).
 92. See G20/OECD Task Force, “Update Report” (OECD, 2013), Principle 4, Item 41: “Regulators remind consumers to provide the financial services provider or authorised agent with as much relevant information as necessary about their circumstances and not to withhold relevant information so that the latter can fully assess their financial situation and risk appetite and expectations, appropriately characterize them and understand what the consumer really needs and wishes. Consumers’ responsibility to provide information is balanced by a regulatory requirement for financial service providers to seek all relevant information from the consumer.”
 93. See G20/OECD Task Force, “Update Report” (OECD, 2013), Annex, Principle 6, Item 56.
 94. For instance, in Russia, it is illegal to prompt participants to switch to a private non-governmental pension fund, but transfer agents may still be able to initiate this at the level of human resources managers. See *Diagnostic Review, Russia* (World Bank, July 2009).
 95. For example, in Hong Kong, Israel, Kenya, Peru, and Turkey. See Rinaldi and Giacomel, and *Diagnostic Review, Peru* (World Bank, 2013).
 96. The broader question of whether switching in general, and its frequency in particular, should be allowed for pension fund members is a policy issue which is beyond the scope of this chapter. The GPs herein focus on addressing how to facilitate switching in a manner that protects members’ interests.
 97. Benefits are vested if the employee has a fixed and immediate right to the benefits accrued. The value may still fluctuate in DC plans with market valuations, while in DB plans with interest rate assumptions.
 98. See “OECD Guidelines for the Protection of Rights of Members and Beneficiaries in Occupational Pension Plans.”
 99. See “OECD Core Principles of Private Pension Regulation,” Core Principle 8.
 100. Ninety percent of UK private-sector DB schemes are closed to new members now, and around 40 percent are closed to future accrual of benefits. See, for instance, “Workplace Pensions: Challenging Times. Final Report of the ACA’s 2011 Pension Trends Survey” (Association of Consulting Actuaries, 2012).
 101. See “Automatic Transfers: Consolidating Pension Savings” (Department for Work and Pensions, April 2013).
 102. It has to be noted that in previous World Bank diagnostic surveys undertaken, there was hardly any country found which would have cooling-off rules for voluntary pension products. The OECD/G20 Effective Approaches illustrating the High-Level Principles of Consumer Protection do not list pension-related country-level best practices in this area, either.
 103. See “Final Report on Good Practices on Individual Transfers of Occupational Pension Rights.”
 104. See “OECD Guidelines for Pension Fund Governance: (OECD, 2009) and “OECD Core Principles of Private Pension Regulation,” Core Principle 3.
 105. See “The Role of Supervision.”
 106. See G20/OECD Task Force, “Update Report” (OECD, 2013), Annex, Principle 6, Items 134 and 136.
 107. See G20/OECD Task Force, “Update Report” (OECD, 2013), Annex, Principle 6, Item 161.
 108. See G20/OECD Task Force, “Update Report” (OECD, 2013), Annex, Principle 6, Item 175.
 109. See at <https://trusteetoolkit.thepensionsregulator.gov.uk/>.
 110. For instance, in Australia, Bulgaria, Hong Kong, Namibia and the Netherlands. For examples for this section, see “Supervision of Pension Intermediaries” (IOPS, December 2012).
 111. For example, in Costa Rica, Serbia, Slovakia, Thailand, and Turkey.
 112. For instance, in Austria, Hong Kong, Mexico, or the Netherlands.
 113. Such as Costa Rica, Hong Kong, India, Mexico, Nigeria, Peru, Slovakia and Turkey.
 114. See “Supervision of Pension Intermediaries” (IOPS, December 2012) and *Diagnostic Review, Peru* (World Bank, 2013).
 115. See “Supervision of Pension Intermediaries” (IOPS, December 2012) and *Diagnostic Review, Peru* (World Bank, 2013).
 116. This is the so-called blind account system. See R. Kent Weaver, “Design and Implementation Issues in Swedish Individual Pension Accounts,” Working Paper 2005-05 (Center for Retirement Research at Boston College, April 2005); *Diagnostic Review, Latvia* (World Bank, April 2010); and “Supervision of Pension Intermediaries” (IOPS, December 2012).

117. As stated in "G20 High-Level Principles on Financial Consumer Protection" (OECD, October 2011), Item 6: "The remuneration structure for staff of both financial services providers and authorised agents should be designed to encourage responsible business conduct, fair treatment of consumers and to avoid conflicts of interest. The remuneration structure should be disclosed to customers where appropriate, such as when potential conflicts of interest cannot be managed or avoided."
118. See G20/OECD Task Force, "Update Report" (OECD, 2013), Principle 6, Item 29: "Financial services providers and authorised agents ensure adequate procedures and controls are in place so that staff are not remunerated solely on sales performance but include factors such as consumer satisfaction, loan repayment performance, product retention, compliance with regulatory requirements/best practices guidelines and codes of conduct which are related to best interest of customers, satisfactory audit/compliance review results and complaint investigation results."
119. The IORP II Directive requires that a remuneration policy should be in place. It must be in line with the long-term interests of members and beneficiaries, include measures to avoid conflicts of interest, and not encourage risk-taking that is inconsistent with the risk profiles and rules of the IORP.
120. For example, in India, Nigeria, and Pakistan, only flat fees are allowed. For this whole GP, see "Supervision of Pension Intermediaries" (IOPS, December 2012).
121. Albania, Bulgaria, Colombia, Costa Rica, India, Macedonia, Nigeria, the Netherlands, and Pakistan, among others.
122. For example, in Mexico, Spain, and Thailand.
123. See for instance David Blake, Bruce N. Lehmann, and Allan Timmermann, "Performance Clustering and Incentives in the UK Pension Fund Industry," Discussion Paper PI-9901 (Pensions Institute, July 2001); David Blake and Allan Timmermann, "Performance Benchmarks for Institutional Investors: Measuring, Monitoring and Modifying Investment Behaviour," Discussion Paper PI-0106 (Pensions Institute, June 2002); and Pablo Castañeda and Heinz Rudolph, "Portfolio Choice, Minimum Return Guarantees, and Competition in Defined Contribution Pension Systems," and Luis Viceira, "Application of Advances in Financial Theory and Evidence to Pension Fund Design in Developing Economies," in *Evaluating the Financial Performance of Pension Funds*, eds. Richard Hinz, Heinz P. Rudolph, Pablo Antolín, and Juan Yermo (Washington, DC: World Bank, 2010).
124. See Stewart, "Proving Incentives for Long-Term Investment by Pension Funds."
125. See G20/OECD Task Force, "Effective Approaches" (OECD, 2014), Items 217–218: "When pension funds are managed by insurance undertakings, all assets and liabilities corresponding to pension funds are ring-fenced, managed and organised separately from the other activities of the insurance undertakings, without any possibility of transfer. Insurance companies set aside special accounts for pension savings, retirement insurance and variable insurance. Thus insurance companies separate the assets in the special accounts from the rest of the assets of the companies for actuarial process." See also Annex, Principle 7, Item 512 (Korea).
126. For instance, see G20/OECD Task Force, "Effective Approaches" (OECD, 2014), Annex, Principle 7, Item 20 (Chile).
127. See G20/OECD Task Force, "Effective Approaches" (OECD, 2014), Annex, Principle 7, Item 78.
128. Regulations in Chile require, among others, that the pension fund must vote for suitable and independent directors in portfolio companies; that at least two of the five directors of the pension fund must be independent; or that top officers, asset managers, and sales agents be prohibited from simultaneously holding similar positions in entities that belong to the same holding as the pension fund administrator. Insider trading disclosure is likewise required. Similar rules in many countries ensure that clients' interests are not overshadowed by those of service providers and insider individuals. See G20/OECD Task Force, "Effective Approaches" (OECD, 2014), Annex, Principle 7, Item 20. For a more detailed discussion of pension fund governance in general, see Fiona Stewart and Juan Yermo, "Pension Fund Governance: Challenges and Potential Solutions," Working Papers on Insurance and Private Pensions 18 (OECD, June 2008).
129. See, for instance, G20/OECD Task Force, "Effective Approaches" (OECD, 2014), Annex, Principle 7, Item 259 (Chile).
130. See "OECD Guidelines on Funding and Benefit Security in Occupational Pension Plans" (OECD, 2006) and Fiona Stewart, "Benefit Security Pension Fund Guarantee Schemes," Working Papers on Insurance and Private Pensions 5 (OECD, January 2007).
131. Intermediaries, advisers, and pension schemes gather vast amounts of data, including personal information, in order to conduct their daily tasks. This information is sensitive to misuse or breaches, which has the potential to cause harm to consumers. This section touches on only a few select issues with respect to data protection and privacy that are most relevant to financial consumer protection.
132. See, for example, (a) Universal Declaration of Human Rights, Article 12 (United Nations, 1948), (b) Convention for the Protection of Human Rights and Fundamental Freedoms, Article 8 (European Court of Human Rights, 1950), available at <http://www.coe.fr/eng/legaltxt/5e.htm>, (c) Convention for the Protection of Individuals with Regard to the Automatic Processing of Personal Data, ETS No. 108 (Council of Europe, 1981), available at <http://www.coe.fr/eng/legaltxt/108e.htm>, and (d) International Covenant on Civil and Political Rights (United Nations, 1966), available at <http://www.hrweb.org/legal/cpr.html>.
133. OECD Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data (2013), Section 7.
134. Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data (Council of Europe, 1981).
135. The study was mandated by the Dodd-Frank Act. See <http://www.consumerfinance.gov/newsroom/cfpb-study-finds-that-arbitration-agreements-limit-relief-for-consumers/>.



SECURITIES

Consumer protection in the securities sector is critical to the development of the depth and integrity of the securities markets.¹ The relationship between an entity offering to purchase or sell securities, investment advice, or collective investments—such as a securities intermediary (intermediary),² investment adviser (adviser),³ or collective investment undertaking (CIU)⁴—and its clients is one of the core pillars for the fair, sound, and efficient functioning of the securities markets. The creation, maintenance, and enforcement of the integrity of that relationship are key objectives of governmental regulatory activity, industry self-regulation, and international cooperation that form the basis for the development of these good practices (GPs).

Consumer protection in the securities sector requires a robust legal framework. Consumer protection provisions for clients of intermediaries, advisers, and CIUs are generally found in securities laws but can also be found in other laws regarding financial consumer protection. Regulations implementing these laws should contain detailed provisions regarding consumer protection, such as prohibitions against false advertising, misrepresentations, and mis-selling in marketing literature and oral sales presentations. In addition, civil courts, as well as non-judicial dispute resolution schemes, should give consumers appropriate and accessible forums for resolving complaints of misconduct.

Consumer protection needs experienced and competent government institutions to implement the legal framework. A securities authority (authority)⁵ should have the primary responsibility for consumer protection and must be able to use robust supervisory and disciplinary mechanisms and processes to enforce compliance with

the regulatory framework protecting consumers. The basic laws must give the government institutions charged with overseeing the securities markets the necessary funding, staffing, and regulatory powers to carry out their job. The authority must be able to establish entry requirements for intermediaries, advisers, and CIUs that wish to be licensed by the authority to engage in activities in the securities markets. The authority should require reporting from licensed entities and conduct examinations as needed. If violations of the financial consumer protection laws and regulations for securities are found, the authority must be able to seek administrative and civil sanctions and related orders aimed at prohibiting the continuation of the prohibited conduct; recover client assets; make referrals to criminal authorities; and discourage the prohibited conduct in the future in such venue as provided by law. Self-regulatory organizations (SROs) can assist the authority in providing consumer protection. The authority should also be responsible, along with the stock exchanges and SROs, for dissemination of information about the market, in order to inform consumers about the basic financial instruments available in the market and how they are traded; the activity on the stock exchanges and the more informal over-the-counter (OTC) markets; and possible fraudulent schemes that are being used in the authority's jurisdiction.

The development of consumer protection in the securities markets requires a transparent market and a regulatory system that mandates full disclosure of material information that is critical to consumers in making their decisions to invest. Intermediaries, advisers, and CIUs should disclose all significant terms and conditions of their contracts with consumers, including fees, charges, and

risks related to investments. In particular, CIUs should also have a key facts statement (KFS) that summarizes the primary characteristics of the CIU. Material conflicts that may exist between consumers and their intermediaries, advisers, CIUs, and their service providers should be disclosed, along with the way in which conflicts are being managed.

The requirement for high business ethics and conduct must be firmly embedded in the consumer protection regime. It is a core principle of consumer protection that there should be no unfair terms in contracts between consumers and intermediaries, advisers, and CIUs, particularly terms that take away the basic rights of consumers. Sales materials and advertisements, as well as oral presentations, should fully disclose the characteristics of the securities, advice, or CIUs that are being offered and should not contain any deceptive information. Intermediaries, advisers, and CIUs should make sure that all investments recommended to consumers are suitable, based on the information disclosed by the consumers regarding their investment experience, financial condition, and investing goals.

In addition, rules must be in place to protect consumers from the misuse and misappropriation of their assets, as well as the theft of their confidential information or invasion of their privacy. The safeguarding of assets is critical to creating consumer confidence in the securities markets and should be structured so a client's assets can be transferred quickly in the event that the client's intermediary, adviser, or CIU is required to wind up its activities.

These GPs provide a framework for evaluating the protection of consumers in their relationship with intermediaries, advisers, and CIUs. In terms of scope, this chapter focuses specifically on the relationship between intermediaries, advisers, and CIUs and the consumers of their services. These GPs include CIUs since they are one of the most common retail products in the securities markets; they can and do sell directly to retail investors, and their sales practices have been recognized as a particular subject for the analysis of retail transactions by national securities regulators and international securities organiza-

tions. However, many areas of the securities markets that can be considered related to “investor protection”—such as securities exchanges, clearing and settlement, and corporate governance of issuers—are not covered in this chapter, since they do not deal directly with the relationship between the seller and consumer of securities products and services. Such areas are also already extensively covered by principles and good practices prepared by other international organizations.

These GPs follow on and draw from work conducted by the World Bank to evaluate financial consumer protection in more than 35 countries⁶, and are a refinement of the 2012 edition of the Good Practices for Financial Consumer Protection.⁷ Due to the increasing interconnectedness across different financial sectors, such as banking, insurance, pensions, and securities, and the increasing similarity and overlapping characteristics of the products and services they provide, the GPs are cross-sectoral and use a uniform structure to analyze the various financial sectors. This approach assists the World Bank in preparing its development programs in the financial sector and helps to shine a light on the gaps that exist in certain sectors in providing good financial consumer protection.

In the securities sector, these GPs draw on work done by the International Organization of Securities Commissions (IOSCO) in the field of investor protection, including the Objectives and Principles of Securities Regulation (IOSCO, June 2010) and other studies cited throughout the chapter. However, unlike the IOSCO Principles of Securities Regulation, these GPs are not mandatory principles; rather, they are good practices culled from a range of international materials and country examples that expand on more general principles and can be drawn upon by policy makers as a resource. Moreover, they deal in detail with the issues related to the relationship between the seller and consumer of securities products or services, including specific sales practices, advertising, recordkeeping, and specific information to be given to consumers, such as warnings, KFSs for CIUs, the existence of conflicts of interest, and dispute resolution mechanisms.

A: LEGAL AND SUPERVISORY FRAMEWORK

A1: CONSUMER PROTECTION LEGAL FRAMEWORK

- a. There should be legal provisions that create an effective regime for the protection of consumers in the securities sector.
- b. The legal regime should contain specific, enforceable laws, rules, and regulations setting forth the legal duties, obligations, and prohibitions for licensed and unlicensed persons⁸ acting as intermediaries, advisers,

- and CIUs in their dealings with consumers, particularly in the solicitation of funds from, and giving advice to, consumers.
- c. The legal regime should provide for the entry criteria and licensing of persons who solicit, manage, safe keep, or give advice regarding consumer funds in order to provide protection to the consumers who use the services of such persons. The following persons should be licensed:
 - i. Persons who solicit funds from the public for securities, investment products, and financial services, including employees, agents, representatives, or contractors of such persons who personally engage in the solicitation of funds from the public
 - ii. Persons who hold or safe keep funds and assets for clients in relation to securities, investment products, and financial services
 - iii. Persons who manage or control funds solicited from the public in relation to securities, investment products, and financial services
 - iv. Persons who give investment advice to specific consumers; however, if a jurisdiction does not require licensing for persons who only give investment advice, such persons should be subject to the anti-fraud provisions of the securities laws, or other consumer laws should apply to the activity of such persons
 - d. The licensing process should, at a minimum, require that
 - i. The applicant's beneficial owners, board members, senior management, and people in control functions demonstrate integrity and competence; and
 - ii. There are appropriate governance and internal control systems in place, including specific controls to mitigate conduct of business risk.
 - e. The legal regime should provide for the supervision of intermediaries, advisers, and CIUs to ensure their compliance with the law and regulations governing their activity.
 - f. The legal regime should provide for legal proceedings and sanctions for violations of the laws, rules, and regulations regarding dealings with consumers, including conducting business without a license, improper sales practices, and advice regarding securities.
 - g. The legal regime should provide for a standard of care that intermediaries, advisers, and CIUs should follow when dealing with consumers.
 - h. There should be an effective governmental authority with the authority to promulgate or recommend the promulgation of regulations and sufficient powers to carry out regulatory and supervisory responsibilities with respect to consumer protection.

Explanatory Notes

Consumer protection in the securities markets requires a robust legal framework.⁹ A legal framework provides clarity as to the responsibilities of intermediaries, advisers, and CIUs in dealing with potential and existing clients. The framework also provides the basis for the protection of consumers by requiring disclosure and prohibiting unfair and fraudulent acts. A robust legal framework gives the authority the power to monitor the activity in the securities market directed at consumers and to take legal action to enforce compliance with the law. Specific laws—such as securities laws, collective investment laws, central depository laws, and exchange laws—address different consumer protection issues. Regulations are required to implement these laws and to describe legal requirements in sufficient detail in order to allow the authority to supervise the market and market participants to be informed as to the proper conduct for operating in the market.

Laws that are specific to the securities market provide needed detail in terms of the conduct required of market actors and the consequences for violating regulations. General business-oriented and fraud statutes do not provide sufficient clarity at a granular level to guide a market participant in the conduct of business in the securities markets. In some countries, a general financial consumer protection law will overlap with the securities laws in the regulation of consumer protection. These provisions should be harmonized with the securities laws and give precedence to the securities law as the specific subject-matter law in the event of a conflict between the two.

The legal framework for the regulation of the securities market is grounded in the power of the authority to give approval to persons to conduct business in the securities sector.¹⁰ Different jurisdictions set different requirements regarding which officers and employees of a business entity should be licensed, but at least the managers of a

licensed person should also obtain a license, in addition to the entity itself. A process for providing approval through licensing allows authorities to evaluate which persons are ethically and operationally capable and qualified to operate in the sector and to exclude persons who are not. By consenting to enter into a licensed environment, a person agrees to allow the authority to have full access to his or her activities for the purpose of supervision. Further, by obtaining a license, persons consent to the use of administrative procedures to determine their suitability to retain a license and, if warranted, to have sanctions imposed for violations of securities laws and regulations.

Persons who provide investment advice but don't intermediate securities have become an increasingly important issue for the protection of financial consumers.¹¹ If such persons hold client assets, they should be licensed by the securities authority. If they only give advice, the oversight of such persons varies greatly between jurisdictions. Some jurisdictions, such as Hong Kong, Singapore, and the United States, require a separate license for advisers. Other jurisdictions, such as the Czech Republic, Indonesia, and the Jersey Islands, do not have a separate license for advisers whose activity is generally within a general inter-

mediation license. Principle 29 of the IOSCO Methodology for Assessing Principles recognizes that registration of advisers may not be required if they do not hold client money or deal in securities on behalf of clients.¹² Nonetheless, there should be legal norms and oversight for these advisers. At the minimum, advisers should be subject to the anti-fraud provisions of securities and consumer protection laws.

Since salespersons for securities or advice are the direct link between the intermediary, adviser, or CIU and consumers in the securities sector, they should be properly qualified and knowledgeable about the products and advice that they are selling. In addition to evaluating the background and education of the salespeople, the authority, in collaboration with SROs and industry associations, could prepare an examination to determine such competency. The authority could administer the examination or delegate the responsibility to an SRO or other qualified test administrator to be conducted under the supervision of the authority. The authority should adopt continuing-education requirements for licensed salespeople so that they are up to date on new products and practices in the securities sector.

A2: INSTITUTIONAL ARRANGEMENTS AND MANDATES

- a. There should be a regulatory authority or authorities ("authority" or "authorities") with a clear legal mandate for the implementation and enforcement of the legal regime for consumer protection in the securities sector.
- b. The authority should have powers in the law to fully carry out its responsibilities.
- c. The authority should have sufficient funding and staff to perform its mandate.
- d. The authority should have legal protections to protect supervisory staff from personal litigation in the good-faith exercise of their supervisory duties.
- e. The authority should be operationally independent from external interference from political, commercial, and other sectoral interests.
- f. The authority should be responsible for the following:
 - i. Licensing and supervising persons who solicit funds from the public for securities, investment products, and financial services
 - ii. If permitted by law, promulgating rules and regulations related to consumer protection
 - iii. Implementing the laws, rules, and regulations related to consumer protection
 - iv. Enforcing consumer protection laws, rules, and regulations
 - v. Educating the public in the area of the securities markets
 - vi. Collecting and analyzing data (including complaints, disputes, and inquiries) regarding the extent of consumer protection in the market
 - vii. Giving advice to the public regarding compliance with the law
 - viii. Giving advice to the government regarding the state of the securities market
 - ix. If regulations are promulgated by other government institutions, making recommendations to the government regarding the regulations needed to implement the provisions in the securities and consumer protection laws

- g. If there is more than one governmental authority responsible for the supervision of intermediaries, advisers, and CIUs, the different authorities should have a memorandum of understanding between themselves to share information related to all consumer protection issues, including the results of examinations.**
- h. If the authority has delegated responsibilities regarding consumer protection to a SRO, the SRO should act under the supervision of the authority and provide the authority with unfettered access to information regarding its activities.**
- i. If there are industry associations in the securities sector, they should coordinate their activities with the authority, including by doing the following:**
 - i. Encouraging high ethical standards in their membership through adherence to codes of conduct**
 - ii. Establishing a process for complaint handling and resolution**
 - iii. Promoting financial literacy**
 - iv. Disseminating statistics and analyses regarding the securities sector**

Explanatory Notes

An authority should be given the primary responsibility for regulating consumer protection in the securities sector. IOSCO Principles of Securities Regulation 1–8 set forth the primary responsibilities of a securities authority. The responsibilities of the authority need to be clear and well defined, and its regulatory processes need to be clear, transparent, and consistent. The authority cannot fulfill its responsibilities without sufficient staffing and funding. Even more important, it must have the full set of regulatory powers to establish regulations, license participants, conduct audits and investigations, and bring disciplinary proceedings to impose sanctions for misconduct and non-compliance with the regulatory framework. This ensures that a comprehensive, integrated system of rules will apply to participants in the market and that the participants will have clarity as to their regulatory obligations.

The authority should be independent of political and industry interference in the regulation of the securities market. This does not mean that it is not accountable to the legislature or executive branches of the government. However, as clarified in Principle 2 of the IOSCO Methodology for Assessing Principles, it does mean the authority should be operationally independent as it carries out its responsibilities—which is to say that day-to-day implementation of its regulatory responsibilities, including examinations and proceedings to enforce the law, should be handled without external political interference or interference from commercial or other financial sector interests.¹³

These GPs do not take a position on the structure of regulatory and institutional arrangements, as long as the overall result is effective regulation. In some jurisdictions, such as Australia and the United Kingdom, regulation for the securities markets is done by more than one governmental authority, such as in the twin peaks supervisory model, which creates both prudential and market conduct authorities.

In the event of multiple authorities that deal with financial consumer protection, memorandums of understanding need to be entered into by the different authorities, to ensure that their responsibilities complement and support each other without creating gaps in regulation, supervision, and enforcement.¹⁴ This is also needed if consumer protection and financial literacy for the securities sector are covered by governmental agencies with a more general jurisdiction over consumer protection across all of the finance sector and economy.

SROs are useful in the regulation of the securities markets. There are several different models for SROs. With respect to the securities sector, the term SRO is somewhat of a misnomer since the authority of a self-regulatory organization to carry out its regulatory activity is often based on legislative acts or delegated powers from the securities authority and it is subject to supervision by the securities authority. The key characteristic of the SRO is the delegated authority to regulate parts of the securities market and to create rules that it can enforce through meaningful sanctions. In some jurisdictions, such as the United States, securities and derivative broker/dealers are required to be a member of a SRO that conducts examinations and determines the qualifications of broker/dealers and their officers and employees. The SROs also have a set of regulations for the conduct of the member broker/dealers and their officers and employees that the SRO can enforce with disciplinary action, including the loss of the license and right to operate in the securities market as a broker/dealer.

Many jurisdictions have industry associations that advocate and lobby for the interests of their particular subsector, such as brokers and asset managers, and provide standards of conduct for their members in the area of consumer protection. These institutions also play an important role in encouraging good practices toward consumers by their members.

A3: REGULATORY FRAMEWORK

- a. There should be a comprehensive regulatory framework for the functioning of the securities sector that provides strong consumer protection.
- b. The regulatory framework should ensure that the processes used by the authority for exercising its mandate are consistently applied, comprehensible, transparent, and fair and equitable.
- c. The regulatory framework should include a clear statement of the policy basis for regulation, such as a principles-based, rules-based, or a hybrid regulatory system.
- d. An effective regulatory framework to implement consumer protection provisions in the securities laws should include at least the following:
 - i. Effective enforcement of legal norms for consumer protection
 - ii. A system for handling consumer complaints, both internally at intermediaries, advisers, and CIUs and externally through a non-judicial alternative dispute resolution (ADR) mechanism in the event that matters cannot be resolved informally
 - iii. Legal provisions requiring intermediaries, advisers and CIUs to maintain the privacy and confidentiality of consumers' personal and financial information
 - iv. Legal provisions for the safekeeping of customer funds and assets, including segregation of funds and assets, the creation of depositories, and custodians for investor securities and assets in CIUs
 - v. Legal provisions for the speedy return of funds and assets to consumers in the event of the insolvency of an intermediary, investment adviser, and CIU, including, if appropriate, the creation of an investor guarantee fund
 - vi. A program for financial literacy for consumers
 - vii. A requirement for continuing education for professionals in the securities sector
- e. The regulatory framework should also provide for the following:
 - i. The power for the authority to provide advice to the government as an expert agency regarding the operation of the securities market and needed legislation for consumer protection
 - ii. The power for the authority to conduct research and issue studies on the condition and operation of the securities market as it provides consumer protection, for use by policy makers and investors in evaluating the operation of the market
 - iii. A requirement that the authority should cooperate with other agencies and foreign authorities in the enforcement of the securities laws for the protection of consumers

Explanatory Notes

In order for consumer protection in the securities sector to be effective, it must have a sound framework for the regulation of the sector. The laws and regulations that contain consumer protection provisions must be robust and comprehensive. The regulatory process must also be open and transparent and provide for input from the public and industry participants so that the process is viewed as fair and impartial.¹⁵ The IOSCO Principles of Securities Regulation emphasize that the regulatory structure, in the form of rules, regulations, guidance, and policy positions, must be comprehensible and available to the public and securities sector participants. This will enable them to evaluate whether the regulatory structure is being consistently applied in a fair and equitable manner.

There are currently several types of regulatory approaches. The rules-based approach is the most common and relies on compliance with detailed rules regarding conduct in the securities sector.¹⁶ The principles-based approach relies more on securities sector participants following general principles of behavior. It focuses on outcomes of behavior, rather than compliance with specific rules, and is considered to be a lighter type of regulation that relies a great deal on self-regulation. The United Kingdom adopted principles-based regulation¹⁷ but has recently replaced it with a twin peaks form of regulation that is more rules-oriented. A hybrid system still relies on self-regulation by market participants but has a more prescriptive set of rules than a full principles-based system. Rwanda currently follows a hybrid model. The GPs do not

take a position on which type or regulatory approach is best, but the regulatory framework should clearly decide what regulatory approach it wishes to follow.

In addition to formulating regulations and policy, the authority must be able to take action to verify compliance with the regulatory structure. As mandated in the IOSCO Principles for Securities Regulation Principles 10–12, the authority must have the power to conduct surveillance of the activity of intermediaries, advisers, and CIUs to determine their level of compliance. This would include the power to request information and to conduct off-site and on-site audits and investigations if the authority has reason to evaluate the level of compliance in an intermediary, adviser, or CIU. If noncompliance or intentional violations of the regulatory structure are found, the authority must be able to institute disciplinary proceeding and assess sanctions, if necessary. In cases where matters may be left

to the courts—such as orders freezing assets, appointment of a trustee, injunctions against violations, and similar actions—the authority must have the power to go before a court and request that such action be taken.

The authority should also take steps to increase the financial literacy of the investing public so that their actions in the securities markets are informed and well considered. Even professionals in the securities markets need continuing education to keep abreast of new market developments and the evolving character of the securities that they are selling to consumers or advising consumers about. If other governmental agencies or industry organizations are also tasked with giving such education, then the authority should coordinate with them and be the lead supervisor of financial education in the securities markets.

A4: SUPERVISORY ACTIVITIES

- a. The authority should supervise persons in the securities sector who are licensed by the authority, such as intermediaries, advisers, and CIUs in order to verify their compliance with their duties and obligations for consumer protection.
- b. The authority should have
 - i. A long-term plan setting forth its strategic priorities in the area of supervision over a multiyear timeframe; and
 - ii. An operational plan to carry out its supervisory activity over the near- to medium-term timeframe.
- c. The authority should use an effective approach for planning and conducting its regulatory activities (for example, a risk-based approach), taking into account the circumstances of the market that it regulates and its own capacity.
- d. The authority should have a system of market surveillance to oversee the activity on the securities markets to determine if the consumers, intermediaries, advisers, and CIUs are in compliance with the laws and regulations providing for consumer protection.
- e. The authority and SROs should have the authority to engage in the following supervisory activities:
 - i. Require reporting by licensed persons as to their activity, including all complaints and internal dispute resolution, on a periodic or as-needed basis without giving prior notice
 - ii. Conduct off-site examinations of licensed persons on a periodic or as-needed basis without giving prior notice
 - iii. Conduct on-site examinations of licensed persons on a periodic or as-needed basis without giving prior notice
- f. The authority should provide guidance to licensed persons as to the manner of complying with the obligations and duties established by the legal regime for consumer protection.
- g. The system of supervision established by the authority should, to the extent possible, include all agents, representatives, intermediaries, or contractors of a licensed person.
- h. The staff of the authority should be well trained in the law and regulations that licensed persons must adhere to and the requirements and the procedures for conducting supervision.

- i. **The authority should evaluate its supervisory approach, tools, and techniques, as well as supporting information systems, on a regular basis, to enable its staff to effectively assess institution-specific and market-wide risks.**

Explanatory Notes

The supervision of licensed persons, such as intermediaries, advisers, and CIUs, is necessary to determine if they are in compliance with the regulatory regime for consumer protection. To do this, the authority must have full and frequent access to the records of licensed and unlicensed persons who solicit funds from the public on their behalf. IOSCO Principles of Securities Regulation, Principle 10 provides that an authority should have the power to obtain information in the ordinary course of business and whenever it deems it necessary to determine compliance with the law and regulations.¹⁸ Supervisory procedures usually consist of periodic off-site and on-site examinations of licensed persons. From time to time, due to special circumstances, the authority may need to conduct an immediate examination to determine the existence of a violation and to protect client assets. In addition, the authority may conduct examinations or studies regarding specific themes or issues that have arisen in the securities markets that involve obtaining information from licensed persons.

The authority will need to prepare a near-term and long-term plan for how and when it conducts its supervisory activities. Risk-based supervision has proven to be

one of the most efficient means of establishing priorities to determine which licensed persons are to be examined, the priority and timing of the examination, and the matters to be reviewed during an examination. However, the use of risk-based supervision can pose challenges for authorities who will need, among other things, to use more supervisory discretion in determining which intermediaries, advisers, and CIUs pose the highest risk for noncompliance with the securities laws. In addition, authorities will need to evaluate the proprietary risk management systems of intermediaries, advisers, and CIUs to determine if they are effective.¹⁹ The authority in each jurisdiction will need to determine the most effective supervision techniques for the particular market that it is supervising and its own capacity, which may involve different forms or models of risk-based supervision.

Licensed persons need clarity as to their regulatory obligations in order to comply with them in good faith. To assure compliance with the regulatory regime, the authority needs to advise and give guidance to licensed persons about how they can fully comply with their legal duties and obligations. Such guidance decreases the costs of supervision by helping to create a uniform method of compliance that is more easily reviewed during examinations.

A5: ENFORCEMENT

- a. **The authority should have the authority, powers, and tools to investigate and take disciplinary action against licensed and unlicensed persons who violate the provisions of the legal regime for consumer protection.**
- b. **To investigate conduct in the securities markets, the authority should have broad powers, including the following:**
 - i. **The authority to obtain access to any and all records of a licensed or unlicensed person to the extent that they are relevant to potential fraud or misuse of client assets**
 - ii. **The authority to take a statement from any person or any of his or her employees, agents, or representatives, subject to any legal rights they have under the law**
 - iii. **The authority to obtain books and records of persons who are relevant to an ongoing investigation, including records in the hands of third parties, such as bank and telephone records**
 - iv. **The authority to take actions to ensure compliance with these powers, such as seeking a court or judicial order**
- c. **The authority should have the authority to bring administrative proceedings against persons for violations of the legal regime for consumer protection.**
- d. **The authority should be able to impose effective, proportional, and dissuasive sanctions and penalties in administrative proceedings for violation of the legal regime, including warnings, suspension of licenses, revocation of licenses, fines, and freezing assets or placing them under the control of a trustee.**

- e. If permitted within a legal jurisdiction, the authority should have the authority to seek orders in civil court to enforce the provisions of the legal regime for consumer protection.
- f. If permitted within a legal jurisdiction, there should be a wide range of sanctions that the authority can obtain in civil court for violations of the securities law, including injunctions, orders for the return of client funds, repayment of any illegally obtained profits that can be enhanced to deter future violations, and freezing assets or placing them under the control of a trustee.
- g. The authority should have the authority to initiate criminal proceedings or refer a matter to criminal authorities.

Explanatory Notes

The enforcement regime varies from country to country. Some countries use rules-based supervision and enforcement, as in the United States, while others use a principles-based system, such as Rwanda and, previously, the United Kingdom. These GPs do not advocate one system over the other. In either system, the authority must have the ability to bring enforcement actions against persons who intentionally violate the law.

In order for the authority to be able to enforce the legal regime for consumer protection, it must have the necessary investigative tools.²⁰ The ability to obtain books and records and interview people with information is critical to the authority's ability to determine if violations of the consumer protection laws and regulations have been made. In addition, the authority needs the authority to pursue investigations and proceedings against unlicensed persons for violating the consumer protection provisions in the law, in order to maintain the integrity of the regulatory system. To do this, it needs the authority to obtain records of unli-

censed persons and statements, subject to limitations in the law, such as rules against self-incrimination.

The authority must be able to institute proceedings and seek a wide range of sanctions, such as warnings, suspensions, fines, and withdrawal of licenses, for violations of the consumer protection regime in both administrative and civil proceedings.²¹ Since client funds could be quickly hidden or transferred out of reach of investors, the authority must have the ability—on its own order or by court order, depending on the requirements of the legal system—to freeze assets and place receivers or trustees in control of the assets of licensees. In addition, the authority must be able to prevent future violations through injunctions against violations of the law and the return to clients of client funds, to the extent possible.

In some instances, criminal prosecution is necessary to protect clients and their assets, and the authority must have the power to cooperate with criminal authorities in the investigation of securities law crimes.²²

A6: CODES OF CONDUCT

- a. The legal and regulatory framework should allow for the emergence of industry associations in the securities sector.
- b. Codes of conduct in industry associations should be encouraged to provide for a foundation for the development of a compliance culture in intermediaries, advisers, and CIUs.
- c. SROs, if used in the regulatory structure in the securities sector, should have a code of conduct that encourages high ethical standards in their membership.
- d. Codes of conduct should be written in plain language and without industry jargon to ensure that consumers and industry participants can easily understand them.
- e. SROs and their members should widely publicize their code of conduct to the general public through the media, financial literacy events, and other appropriate means, including through websites and branches.
- f. SROs and industry associations should have an appropriate mechanism in place to provide incentives to comply with the code of conduct and other legal norms, such as fines, the withdrawal of membership, and, if so empowered, the withdrawal of the right to participate in the securities markets.

Explanatory Notes

As mentioned in A2 above, many jurisdictions have industry associations that advocate the interests of their particular subsector, such as brokers and asset managers, and provide codes of conduct for their members in the area of consumer protection. These codes can differ depending on the subsector. Nonetheless, the codes will have the same underlying goal of protecting consumers and encouraging good conduct in the industry. In addition, codes established in different industry associations will provide a foundation for self-regulation in the securities industry and serve as a first step toward the implementation of a system of SROs with more formal regulatory responsibilities and procedures. Codes also encourage the development of internal compliance systems at industry participants, by giving the compliance units of industry participants a codified ethical framework that they can use to develop a compliance culture with internal consumer protection rules and laws and regulations related to consumer protection.

In addition to governmental regulation, if a jurisdiction uses SROs for the regulation of professionals in the securities sector, the SRO should have a code of conduct. The code of conduct of a SRO does not supplant the need for or use of more detailed rules for regulating the conduct of market participants, such as anti-fraud provisions stipulated in law or regulation, but codes can provide guidance, in layman's terms, for industry participants and a means by which their clients can understand the participants' ethical responsibilities regarding their conduct. Importantly, a code of conduct evidences a

consensus among industry participants as to, among other things, what constitutes good conduct when dealing with consumers. Codes emphasize to the salespeople in the industry and the public that ethical behavior should be the normal way of conducting business and that the securities industry finds deviations from this to be unacceptable. This should have a positive impact on the behavior of salespeople. It should also provide a model for addressing ethical issues. Codes should provide for a mechanism for identifying new issues in the securities sector regarding ethical behavior, frequently resulting from rapid technological change in the sector, and the proper way to address those issues. They provide a focal point for ongoing debate and discussion about the evolving ethical obligations of industry participants in light of new market developments and the development of new legal and regulatory norms in meeting the new developments.

Adherence to codes of conduct can be encouraged in a number of ways. For example, the publication of a sanction by an association or SRO would have a shaming effect on the person against whom it is levied, while a fine would have a direct economic effect. In addition, the monitoring of members' conduct by the disciplinary committee of an industry association after the imposition of a sanction would be a way of reinforcing the need to change the conduct that led to the sanction. Discipline by the stock exchange against a member could also lead to reduced access to the market. This would encourage compliance with the exchange's code of conduct in order to lift the sanction.

BOX 4

IOSCO'S Model Code of Ethics:²³ Concepts That Should Be Included in the Code

Integrity and truthfulness. Stresses the critical element of trust that is essential in all business relationships. Trust is dependent upon one's confidence in the integrity and truthfulness of other parties in any relationship. Integrity is honesty and the adherence to values and principles despite the costs and consequences. Integrity also demands forthrightness and candor, which must not be subordinated to personal gain and advantage. Integrity cannot coexist with deceit or subordination of principles.

Promise keeping. Involves the ability to keep one's word regardless of whether there is a legal obligation to do so. This is key to being an ethical individual or an ethical business.

Loyalty. Managing and fully disclosing conflicts of interest covers any conduct that could compromise loyalty to one's company or clients. Although certain conflicts may be inevitable, to the extent feasible, they should be avoided or at least appro-

priately managed. For example, while not necessarily sufficient to cure a conflict, firms, at a minimum, would ensure full, fair, accurate, timely, and understandable disclosure.

Fairness. Requires impartiality, objectivity, and honesty.

Doing no harm. Means avoiding conduct that jeopardizes investor trust and confidence.

Maintaining confidentiality. Refers to developing a relationship of personal trust and confidence with clients and employers by safeguarding information entrusted to the professional. A professional must refrain from using confidential information, or appearing to use it, for unethical or illegal advantage. Information that employees obtain through their employer's work would not be used by the employee either personally or through a competitor.

A7: DISSEMINATION OF INFORMATION BY AUTHORITIES

- a. The authority should make readily available to the general public, at no cost, minimum relevant information about its own role and how it performs its duties to help achieve its statutory goals and increase transparency. This could include the following:
 - i. A clear description of its regulatory and supervisory mandate and remit and the role of other agencies, if applicable, as well as whether any sectors are not covered by any authority
 - ii. A report, at least annually and in a timely manner, on its activities, including an analysis of the state of the securities market and its duties and activities with respect to consumer protection
- b. The authority should make readily available to the general public, at no cost and in a standardized and easily comprehensible and comparable format, independent information that could include the following:
 - i. The key features, benefits, risks, and costs of the main types of securities, investment products, and financial services
 - ii. The regulatory status of licensed persons
 - iii. The history of licensed persons upon whom disciplinary actions have been taken by the authority, and reference to other agencies or SROs that have the authority to bring disciplinary actions against licensed persons
 - iv. Copies of all public filings of registered issuers and licensed persons
 - v. Information on the mechanisms, processes, and points of contact for consumers to resolve grievances and file complaints and queries with the authority or other governmental agencies authorized to hear the complaints
 - vi. Aggregated data for the market as a whole regarding complaints, disciplinary proceedings, and conduct issues
 - vii. Studies on the state of the market
 - viii. Reports on problems that retail consumers might face, such as particular types of fraudulent conduct
 - ix. Information on financial literacy in the securities sector, including dissemination through publications, seminars, presentations, and workshops

Explanatory Notes

As stated in Principle 3 of the IOSCO Principles of Securities Regulation, the authority should provide information in the form of financial literacy and education for retail consumers.²⁴ This would include, among other things, information on the types of products offered as well as how the authority supervises the market. In order for the consumers to have a means of dealing with their concerns, the authority should educate consumers on the available mechanisms that they can use to make and resolve complaints. If other government agencies or non-governmental organizations also have responsibility for financial literacy across the financial sector, the authority should coordinate its activities with these other agencies regarding financial literacy in the securities sector. Nonetheless, the authority should take the lead in providing consumers with information about the securities markets and how the consumers can protect themselves. However, one size does not fit all in the area of financial literacy, and the manner in which this activity is carried out

will depend on the circumstances and condition of the securities market for which the authority is responsible.

In addition, one of the important responsibilities of the authority is to provide unbiased, objective information about the securities markets to the market's participants. This should include, for example, public filings of issuers, disciplinary actions against licensed persons, and aggregate statistics on market instruments, such as margins and options. This would enable consumers, service providers, and analysts to have a readily accessible database on the condition of the market.

The authority should also conduct research and issue reports on the state of the securities market that deal with current, critical issues on how the market functions. In addition, the authority should issue warnings regarding matters that are of immediate interest to consumers, such as ongoing fraudulent schemes or particular types of investment products, such as the complex financial instruments and alternative investments discussed in B4, below.

B: DISCLOSURE AND TRANSPARENCY

B1: FORMAT AND MANNER OF DISCLOSURE

- a. Information regarding securities and financial services provided to consumers in all types of marketing communications and informational documents, such as KFSs, advertising, product information sheets, and account documents, as well as oral communications, should be in plain language that is clear, succinct, and comprehensible while avoiding unnecessary jargon and technical terms. If technical terms are used, they should be explained in a comprehensible manner.
- b. Written presentation of information should be done in a manner that prominently displays key information and facts on the informational document in a font size and spacing that is easily readable.
- c. Where feasible, key features should also be communicated orally by the provider to the consumer during the pre-contractual stage and at the point of sale.
- d. Consumers should receive the required information in a reasonable time before entering into a transaction, so that they can use the information while making their investment decisions.
- e. When a client signs up for paperless statements, such statements should be in an easy-to-read and readily understandable format and provided in a durable medium.

Explanatory Notes

Information, including facts regarding, and the terms and conditions of, a security, financial advisory contract, or an account with a collective investment scheme, should always be prepared and conveyed in a manner that a consumer can easily understand and that is useful in a consumer's decision making.²⁵ Disclosure of information is not effective if the disclosure documents and other information are not presented in a manner that is clear and readable. To be effective, oral communications should also be equally understandable to the non-professional, retail consumer. The authority should provide standards for the manner of presentation and clarity of facts and information that are required to be disclosed to consumers.

It is increasingly recognized that arcane jargon and unnecessarily complicated writing and oral communication hinder, rather than help, the intent of informational rules. As far as possible, plain language should be used in all types of documents and in oral communications that are required by law or used by licensed persons to provide information to consumers in the offer and sales of securities and financial products and services.

Advertisements or brochures that are intended to summarize specific information about an investment product or service in an easily understandable format, such as KFSs for CIUs (set out in more detail in B6), should be developed for the particular circumstances where they will be used and should be subject to testing—for example, through focus groups of consumers—to determine if the documents successfully convey the relevant information.²⁶

B2: ADVERTISING AND SALES MATERIALS

- a. If sales, advertising, and other marketing materials are used in the offer and purchase or sale of securities, intermediaries, advisers, CIUs, and persons acting on their behalf, in addition to applying the general requirements described in B1, should also ensure that such sales and advertising materials do not mislead clients or potential clients regarding the characteristics and benefits of the securities or CIUs.
- b. Advertising, sales, and other marketing materials regarding advisory or other securities services offered by intermediaries, advisers, and CIUs should not mislead clients or potential clients regarding the characteristics and benefits of the service, such as the past performance, future performance, or costs of the service.
- c. Intermediaries, advisers, and CIUs should disclose in all advertising, sales, and other marketing materials, including print, TV and radio, the fact that they are regulated and by whom.

Explanatory Notes

Advertising of general services by an intermediary, adviser, or CIU must not mislead consumers about the results that could be obtained from using its services.²⁷ As explained by the Financial Industry Regulatory Authority (US FINRA), a SRO authorized by the US Securities and Exchange Commission (US SEC), this includes “any false, exaggerated, unwarranted or misleading statement or claim in any communication with the public.”²⁸ Representations of the characteristics of the service—such as cost comparisons, use of past performance statistics, or hypothetical profits—must be accompanied by a disclaimer describing the character of the representations and stating that they do not predict future results from the use the service. These rules would apply to any form of advertisement or com-

munication with the public. The Securities and Exchange Board of India sets out a number of different types of communication, such as TV interviews, seminars, workshops, tombstone advertisements, and product launch advertisements, among others.²⁹

In addition to the securities laws, some countries have separate laws on advertising that apply to the advertising materials of intermediaries, advisers, and CIUs.³⁰ Although advertising laws are usually more general than laws and regulations for the securities sector, they provide useful additional protection for consumers.

Sales materials must indicate regulatory status, so that the consumer can verify the good standing of the intermediary, adviser, or CIU and its license to engage in the activity it is advertising.

B3: DISCLOSURE OF TERMS AND CONDITIONS

- a. **There should be comprehensive disclosure of terms and conditions that cover a consumer’s relationship with an intermediary, adviser, CIU, and their sales representatives, in all three stages of the relationship: pre-sale, point-of-sale, and post-sale.**
 - b. **An intermediary, adviser, or CIU should provide a client or potential client with information about**
 - i. **The choice of accounts, products, and services; and**
 - ii. **The characteristics of each type of account, product, and service being offered or recommended.**
 - c. **An intermediary, adviser, or CIU should provide to a client**
 - i. **A copy of its general terms and conditions, as well as any terms and conditions that apply to the particular account the client is opening, sufficiently before commencing a relationship with a client so that the client can read and understand the document; and**
 - ii. **The final signed document at the point of sale.**
 - d. **The terms and conditions should, at a minimum, disclose the following:**
 - i. **Details of all commissions, charges, transaction taxes, and costs, of any nature, related to the accounts, products, and services offered and how they are determined**
 - ii. **The effect of all such commissions, charges, transaction taxes, and costs on the profitability of the accounts, products, and services**
 - iii. **The complaints procedures, and contact information for internal and external dispute resolution mechanisms**
 - iv. **Information about any compensation scheme that the intermediary or CIU is a member of, and an outline of the action and remedies that the client may take in the event of default by the intermediary**
 - v. **The details of the terms of any leverage or margin being offered to the client and how the leverage functions**
 - vi. **Any restrictions on account transfers**
 - vii. **The procedures for closing an account and transfer of funds**
-

Explanatory Notes

As IOSCO Principles of Securities Regulation, Principle 31 observes, consumers need to know the terms of the contract to make an informed decision whether to invest with an intermediary, adviser, or CIU.³¹ The information must be given to the client sufficiently before the contract is finalized in order for the disclosures to be meaningful and useful to the consumer. At the point of sale, in order to verify the terms of the agreement, the consumer should receive a written, executed document setting forth the terms of the agreement of the parties.

The information contained in the terms and conditions is critical to an understanding of the contract. The characteristics of the account—particularly the charges, commis-

sions, and the use of leverage—can have a significant impact on the results that the consumer can realize. The effect of the fees on the profitability of the accounts also needs to be fully disclosed. Additional information regarding the transfer and closing procedures give consumers the confidence that they can change firms if they are not satisfied with the firm's performance.

In addition, information regarding consumers' right to file complaints and the means by which they are resolved, as well as the existence of and procedures for filing a claim with a compensation scheme, provides reassurance that consumers' interests will be protected and informs consumers how to assert their rights.

B4: DISCLOSURE OF PRODUCT RISK

- a. **Intermediaries, advisers, and CIUs should disclose to consumers the risks and consequences of investing in securities, derivatives, and any other investment products, such as real estate, currency, commodities, alternative funds, and non-traditional, complex financial instruments.**
- b. **The risks and consequences of any services, investment strategies, trading strategies (including margin and short trading), electronic advisory or trading systems, and cash management strategies should also be disclosed.**

Explanatory Notes

The types of securities and investment products and services being offered and sold to retail investors have become increasingly diverse and complicated. They can include:

- Exchange-traded equities and bonds
- OTC equities and bonds
- Financial instruments using leverage, often called margin, in purchasing or selling securities
- Derivative products, such as exchange-traded options and futures contracts on financial instruments and commodities, such as oil, gold, and currency
- Alternative investment funds, such as hedge funds, funds of hedge funds, equity funds, and venture capital funds
- Non-traditional, complex financial instruments, such as contracts for difference and binary options
- Computerized advisory programs
- New financial mechanisms and instruments, such as peer-to-peer (P2P) lending

Intermediaries and advisers should explain to clients the risks of trading in exchange-traded stocks and bonds.³²

The importance of understanding the prospectus and annual report as well as other periodic filings should be emphasized in order to understand how to value a stock or bond. Clients should be made aware that stocks and bonds can rise and fall based on their own economic performance, as well as the interaction of the stock or bond's sector with the economy as a whole. Intermediaries and advisers should explain that the market for OTC stocks is less transparent and often less liquid than the market for exchange-traded stocks. The use of margin—that is, taking out loans to buy stock or bonds—can expose a client to much larger risk than fully paid ownership of the stocks and bonds. Clients need to understand that they can be called on to place more cash on deposit with the intermediary if the price of the stock or bond that they have margined goes against them.

Financial instruments that derive their value from the performance of underlying assets, such as financial futures contracts and options, are high-risk investments, and intermediaries and advisers must explain this to their clients. OTC derivative instruments require even more risk disclosure.³³ The use of margin to purchase futures contracts at a fraction of their value can result in very high financial exposures with the possibility of significant loss. Options trading can also subject clients to high losses in addition to the premium paid for the option, if the option is exercised against the client.

In addition to futures and options, new non-traditional, complex financial instruments have been created and are being sold to retail customers, especially OTC-leveraged products such as contracts for difference or binary options.³⁴ In this document, the term complex financial instruments is broadly construed and generally refers to financial products whose terms, features, and risks are not reasonably likely to be understood by a retail customer because of their complex structure and the difficulty in determining their value. Different types of these instruments may not exist in all jurisdictions, but if they are permitted, the authority will need to promulgate specific disclosure rules to deal with them.

KFS-related disclosure requirements for traditional CIUs are set out in detail in B6, below. A number of new types of collective investment funds, known as alternative funds, have been growing in popularity. They engage in types of investing that carry a much higher risk than the traditional CIU.³⁵ Hedge funds, funds of hedge funds, equity funds, and venture capital funds invest in start-up companies, newly public companies, derivatives, commodities, high-yield loans, and other high-risk investments. In addition, the common valuation and reporting of traditional CIUs may not be required for alternative

investment funds. In regards to these alternative investment funds, intermediaries, advisers, and CIUs should disclose the following to clients:

- Any high-risk strategies used in connection with the investment fund
- The illiquid nature of the assets held
- The limited disclosure and reporting of the funds
- The difficulty in valuing the assets held
- The higher fees associated with such investments
- The limitations on withdrawal of money from the investment fund

Moreover, new financial mechanisms, such as P2P lending and crowd-source funding, are being developed to expand the financial sector.³⁶ Depending on how these programs are structured and developed, they may be considered securities by the authority. Sellers of these products must disclose the risks involved in investing in them and the possibility of default. Due to the new and developing nature of these products, international standards are still being developed.

B5: DISCLOSURE OF CONFLICTS OF INTEREST

- a. **An intermediary, adviser, or CIU should disclose to potential clients and clients all material conflicts of interest that it and all service providers have with the client.**
 - b. **An intermediary, adviser, or CIU should actively manage any conflicts that it and all service providers have with clients and should disclose the manner in which the conflicts are being managed.**
 - c. **If an intermediary, adviser, or CIU delegates or outsources any of its functions or activities to another person, it should determine whether, under the circumstances, such delegation or outsourcing should be disclosed to potential clients and clients.**
-

Explanatory Notes

An intermediary, adviser, or CIU should disclose to a client all material³⁷ conflicts that it has with the client, as well as all material conflicts that all service providers for clients, such as banks, custodians, advisers, intermediaries, or other entities, have with the client.³⁸ This is the most commonly used method of dealing with conflicts.³⁹ Since intermediaries have superior market information due to their relations with their clients, conflicts can arise from the intermediary's proprietary trading to the disadvantage of a client, or giving exaggerated solicitation or sales of securities underwritten by the intermediary.⁴⁰ For example, an adviser should disclose to a client if it is also licensed in another capacity and whether the adviser deals with the client's account in the second licensed

capacity, either by acting as a principle in transactions with the client or by earning fees and commissions for the work in the second capacity, which could result in higher fees than would be charged by an independent entity. Similarly, analysts for intermediaries that make a market in a stock being analyzed and recommended should disclose the market making.⁴¹ An asset manager of a CIU should disclose if it has arrangements with brokers for the CIU that could result in higher brokerage fees for the CIU than could be obtained from a broker without such an arrangement. One example of this is a "soft money" arrangement, in which a broker provides free market research to a CIU's manager in exchange for the CIU's use of the broker to conduct transactions.⁴² In addition, a CIU should disclose if the CIU permits fre-

quent trading of units in the CIU for certain customers. In the mutual funds scandal in the United States in the early 2000s, favored large customers in certain funds were allowed to engage in frequent trading in and out of the funds, at other than published times, to the disadvantage of other customers.

In addition, the way in which an intermediary, adviser, or CIU is managing a conflict should be disclosed, to allow clients to decide whether to begin or continue as a client. If an intermediary, adviser, or CIU determines that the conflict is not manageable, it should inform the client that it must decline to act on behalf of the client in the areas subject to the conflict.

In order for consumers to evaluate the services being offered to them, there should be full transparency with

regard to the identity of the market institutions that will provide services that can have an impact on their accounts. Most firms surveyed by IOSCO inform clients that they use external service providers, although many firms do not inform clients that their data may be transmitted to others.⁴³ Such disclosure would enable consumers to do an independent review of the service providers and determine if they are appropriate for the consumer and if, to the consumer's knowledge, there are any conflicts with the service providers. To date, however, it is not general practice to mandate such disclosure by law, and firms are merely advised to consider if it is appropriate to notify clients that customer data may be transmitted to a service provider in light of the circumstances and applicable law.⁴⁴

B6: KEY FACTS STATEMENTS FOR CIUs

- a. **The authority should require that an intermediary, adviser, or CIU provide a KFS for each CIU that it is offering or has sold to a consumer that succinctly explains the CIU in clear language and in a format that is easily comparable with other CIUs.**
- b. **The key facts to be disclosed are material facts that are important to a consumer's decision to invest, such as the following:**
 - i. **Investment objectives and strategy**
 - ii. **Risk profile**
 - iii. **Pricing of purchases and sales of interests in the CIU**
 - iv. **Redemption and withdrawal rights,**
 - v. **Fees and costs**
 - vi. **Conflicts of interest**
 - vii. **Key rights of a consumer, including the complaint procedure**
 - viii. **A fair and honest description of the performance of the CIU or investments over several different periods of time that accurately reflect overall performance**
- c. **The intermediary, adviser, or CIU should disclose that the KFS does not contain all required disclosures, which can be found in the full prospectus or other primary disclosure document that is required by law to be delivered to the consumer.**

Explanatory Notes

A consensus has developed that the prospectus that CIUs must give to consumers is too complex and lengthy to convey to a consumer the key information about a CIU in an understandable form. As a result, many jurisdictions have implemented regulations that call for a simpler disclosure document, referred to in different countries by different names, such as a KFS, summary prospectus, or short-form product disclosure statement. The KFS is

shorter than a short form or summary prospectus and is intended to be one-two pages in length, although some KFSs might extend to three or four pages.

To date, the use of KFSs in the securities sector has generally been limited to CIUs.⁴⁵ However, some jurisdictions, such as Germany, have begun implementing a general requirement that when a financial instrument is recommended to a consumer, the consumer must be given a product information sheet explaining the financial

instrument.⁴⁶ Financial products similar to CIUs in other financial subsectors, such as index-linked insurance policies, have also been considered appropriate for KFS.⁴⁷ These products, known as PRIIPS (packaged retail and insurance-based investment products), are required to have a KFS in some jurisdictions, such as in the European Union, but are outside of the scope of this review of the securities sector.

The content of a KFS covers the most important facts related to the CIU, such as investment strategy, commissions, other fees, performance, and risk warnings. This information is presented in a standardized format prescribed by the authority so that consumers can easily compare CIUs to evaluate their goals and costs. The standard format should be prepared jointly between the authority and the industry and undergo consumer testing to make sure that it conveys the relevant information effectively. Consumer testing helps determine the format that is most useful, such as the positioning of information on the KFS, the different types of graphic displays, and the specific issues that need to be highlighted. The KFS can be a stand-alone document or attached to or layered into (that

is, made a detachable part of) the prospectus or other primary disclosure document. Table 3, derived from IOSCO's Principles on Point of Sales Disclosure, lays out the contents of a KFS.⁴⁸

To avoid "cherry-picking" the best performance periods for a CIU, performance should be given for several event-neutral periods of time, letting a consumer evaluate the CIU over short and long holding periods, such as one-, five-, or 10-year periods.

The ability of favored clients to engage in frequent trading in a CIU can have an effect on long-term clients. A CIU's policies regarding such practices and the attendant risks would have an impact on a consumer's decision to invest and should be disclosed to consumers in the KFS.

Inducements paid to a CIU or adviser to use market services, such as brokerage services, sometimes referred to as "soft-money" payments, could create a conflict of interest and affect the ability of the CIU or adviser to give impartial investment advice. Such relationships should be disclosed to consumers in the KFS, enabling them to fully evaluate the services of the CIU or adviser.

TABLE 3: Contents of a KFS for Collective Investment Schemes

SUBJECT TO BE DISCLOSED	ELEMENTS
Information about the CIU	Name and license of CIU Name and license of asset manager and employees Name and license of key service providers
Investment characteristics of CIU	Investment objectives and strategy Information on underlying investments or reference asset Risks of investment Past performance Nature of any guarantees offered Summary of tax implications on performance and distribution
Operational characteristics of CIU	Time when prices of purchases and sales of interests in the CIU are determined and where prices can be obtained Methods of valuation—net asset value Fees and costs
Consumer rights in the CIU	Redemption, distribution, and withdrawal rights and procedures Existence of customer protection scheme
Consumer complaints regarding the CIU	Internal procedure for handling complaints and dispute resolution External dispute resolution mechanisms
Conflicts of interests between CIU and consumer	Disclosure of conflicts of interest The CIU's policies with regard to frequent trading Inducements that it receives, such as "soft-money" arrangements Disclosure of resolution of conflicts
Key information on intermediary	Name and license Compensation and fees Conflicts of interest

B7: CONTRACT NOTES

- a. Clients should receive a contract note from an intermediary, an adviser who conducts trades, or a CIU containing and confirming the characteristics of each trade executed with them or on their behalf.
- b. The contract note should disclose the following characteristics of the trade:
 - i. The volume of securities traded
 - ii. The price at which the trade(s) were executed
 - iii. The commission received by the intermediary, adviser, CIU, and their sales representatives
 - iv. The total expense ratio (expressed as total expenses as a percentage of total assets purchased)
 - v. The trading venue where the transaction took place
 - vi. Whether the trade was broker or client initiated
 - vii. Whether the intermediary, adviser, or CIU for the transaction
 1. Acted as a broker in the transaction,
 2. Acted as a dealer in the transaction—that is, the counterparty to its customer—or
 3. The trade was conducted internally between its clients.
- c. Clients should receive the note immediately after the execution of the transaction.

Explanatory Notes

Customers should have immediate information about the terms of any transactions in their accounts. This enables customers to verify that the transaction was executed pursuant to the authorization given by the customer. This

information must be sent on the day the transaction was completed, even if that is before the settlement day. Waiting for such information for a long period of time reduces the ability of the customer, intermediary, adviser, or CIU to correct any mistakes in the transaction.

B8: STATEMENTS

- a. A client should receive periodic statements for each account with an intermediary, adviser, or CIU that provide the complete details of account activity. The intermediaries, advisers, and CIUs should
 - i. Prepare the periodic statements at least once a year for inactive accounts and quarterly for accounts that have a transaction during the quarter;
 - ii. Make timely delivery of the periodic statements;
 - iii. Provide a procedure for clients to dispute the accuracy of the transactions recorded in the statement within a stipulated period; and
 - iv. When a client signs up for paperless statements, provide such statements in an easy-to-read and readily understandable format.
 - b. The information in the account statement should, at a minimum, contain the following:
 - i. The account balance
 - ii. All holdings in the account, including number of shares and value
 - iii. All transactions in the account, including purchase and sale price
 - iv. All commissions, charges, transaction taxes, and fees against the account in the relevant time period
 - v. All dividends and interest earned on securities in the account
 - c. If an adviser who provides only investment advice to customers also holds client assets, the client statements should be prepared by and sent from the custodian for the assets and not from the adviser itself.
-

Explanatory Notes

As Principle 31 of the IOSCO Principles of Securities Regulation sets forth,⁴⁹ an intermediary should promptly, and at regular intervals, provide customers with a report regarding their accounts, including, as appropriate, information about holdings, transactions, and balances. Issuing regular statements on a periodic basis has been generally accepted as one of the best means to provide customers with this information. Good practice is that the statements should be sent out at least once a year, and more frequently depending on the activity in the account—for example, a statement should be sent in any quarter in which a transaction takes place.⁵⁰ If the customer has agreed to delivery of paperless statements, the statements must be available at least as frequently as

paper statements, although often they are more frequent. Account statements provide one of the best mechanisms to ensure safekeeping of client assets.⁵¹ If the statements do not reconcile with the customer's records, efforts can be taken to determine the true status of the assets in the account. If assets are missing, action can be taken to recover the assets or seek compensation.

Customers should have confidence that the information that an adviser is giving them is accurate. Consequently, if the adviser manages customer assets, the account statements for the customer accounts should be sent directly from the custodian of the funds to the clients to avoid the possibility of incorrect information being given to clients by an adviser.

C: FAIR TREATMENT AND BUSINESS CONDUCT

C1: UNFAIR TERMS AND CONDITIONS

- a. The securities laws and regulations should prohibit the use of unfair terms and conditions in the contract between a client and an intermediary, adviser, or CIU. For example, a contract should not
 - i. Contain provisions that provide for fees, markups, or commissions that are excessive in light of market practice;
 - ii. Require deposits, margin, or other advance payment that are higher than required by law or market practice; or
 - iii. Require customers to maintain deposits in accounts that have excessive fees or are not protected by existing deposit insurance plans.
 - b. The securities laws and regulations should prohibit the use of terms and conditions that decrease or restrict the rights of clients given to them in the law. For example, other than permitted by law, a contract should not do the following:
 - i. Reduce the amount of disclosure
 - ii. Exclude or restrict, or seek to exclude or restrict, any legal liability or duty of care to a client
 - iii. Limit damages for violations of the securities laws
 - iv. Limit the venue for dispute resolution
 - v. Limit priority in insolvency
 - vi. Limit the ability of the customer to examine records
 - vii. Limit the rights to privacy
 - c. Unfair terms and conditions in a contract should be void by law, and a client should be able to obtain legal redress for any damages or loss caused by the unfair terms and conditions.
-

Explanatory Notes

Intermediaries, advisers and CIUs should deal equitably and fairly with their clients.⁵² The fees and charges should not be in excess of market practice and should be fully disclosed. The market practice may vary in different jurisdictions, and what is acceptable will depend on local market conditions.

The legal regime will provide consumers with rights and protections that should always be fully available to the consumers. Due to their unequal bargaining power, some intermediaries, advisers, and CIUs may attempt to

obtain an advantage in the contractual relationship with clients by inserting clauses into contracts that limit or waive the rights that clients have under the law. Such clauses may attempt to limit the damages due to fraud or negligence that can be recovered by a client, or require a client to seek redress in a venue that will be unfavorable to the client. Since such limitations or waivers would be against the public policy that gives consumers the protections in the first place, the legal regime should prohibit the waiver or modification of consumer protection provisions in relevant law.

C2: SALES PRACTICES AND DUTY OF CARE

- a. **Securities laws and regulations should contain clear rules on misleading and fraudulent sales practices in the solicitation, sale, and purchase of securities or investment advice. Intermediaries, advisers, CIUs, and their sales representatives should**
 - i. **Not use sales tactics that create undue pressure on a consumer to invest;**
 - ii. **Not engage in misrepresentations and half-truths regarding products being sold or purchased;**
 - iii. **Fully disclose the risks of investing in a security or following investment advice being sold;**
 - iv. **Not downplay or dismiss warnings or cautionary statements in written sales literature; and**
 - v. **Not recommend the purchase and sale of securities solely to obtain fees and without a sound basis for the recommendation.**
- b. **Securities laws and regulations should contain a legally enforceable duty of due skill, care, and diligence for intermediaries, advisers, and CIUs that sets forth a standard of care that must be used in dealings with consumers and can be used by consumers to seek redress for intermediaries, advisers, or CIUs' misconduct and violation of the consumer protection laws and regulations.**

Explanatory Notes

The obligation to deal fairly and honestly with consumers includes the obligation to use sales practices that do not unduly pressure consumers to make investment decisions. Consumers are frequently cold-called in hours outside the normal business day and bombarded with urgent pitches to buy or sell securities immediately. In addition, the following persuasive techniques are used:

- Promising unrealistic or exaggerated returns and guaranteed results
- Pretending to be an expert or from a legitimate business or government agency that gives the salesperson and his or her company special insights or authority
- Telling people that regulatory information or sales warnings should be ignored
- Creating the illusion that other members of one's community are also investing, also known as "affinity fraud"
- Creating a false sense of urgency by claiming that the supply or time to make the transaction is limited⁵³

The authority can implement solutions to combat such tactics. For example, regulations can provide that telephone sales calls should be made only within specific hours and that consumers should have the right to be on a no-call list. The EU Directive on Distance Marketing⁵⁴ provides a European standard for regulating distance marketing, requiring that consumers must consent or at least not object to unsolicited communications. This can be accomplished by a no-call list. Registered intermediaries, advisers, and CIUs can also be required to electronically record all of their employees' phone calls with potential and existing clients, so that the authority can review them during an examination to determine if there has been mis-selling.

In addition to the securities laws, some countries have separate, general laws on advertising that would apply to the sales practices of intermediaries, advisers, and CIUs when they engage in sales activity by phone.⁵⁵ These laws should be viewed as an integral part of the consumer protection laws for the securities sector.

A number of investment schemes target retail consumers, including pyramid schemes; high-yield invest-

ment programs, particularly to invest in foreign stocks; “pump and dump” schemes that inflate the value of worthless small-cap stocks through misinformation and market manipulation; fraudulent offerings of unregistered securities, where proceeds are used for purposes other than stated in the offering information; and foreign exchange schemes offering non-existent trades in foreign currency.⁵⁶ The securities laws should clearly prohibit these schemes, so that the authority can take action to prosecute the violators.

The authority and SROs can provide specialized training and information programs to warn consumers of these sales tactics. In addition, information regarding fraudulent sales practices should be part of a more general financial literacy campaign.

The legal framework should contain provisions that establish a duty of due care, skill, and diligence for the intermediaries, advisers, and CIUs that deal with consumers. In addition, the legal framework must establish a legal standard of care that can be used to evaluate the actions of intermediaries, advisers, and CIUs to determine if they have fulfilled their duty of skill and care and that clients can use to establish whether the intermediaries, advisers, and CIUs have breached that standard when dealing with the clients, causing losses to the clients. Consumers should be able to use the civil courts or non-judicial dispute resolution mechanisms to obtain redress in the event of a failure to fulfill the duty of due care, skill and diligence or misconduct by an intermediary, adviser, or CIU.

C3: PRODUCT SUITABILITY

- a. **Before providing a product or service to a consumer, an intermediary, adviser, or CIU should obtain, record, and retain sufficient information to enable it to form a professional view of the consumer’s background, financial condition, investment experience, and attitude toward risk in order to provide a recommendation, product, or service appropriate to that consumer.**
 - b. **An intermediary, adviser, or CIU, taking into account the facts disclosed by a client and other relevant facts about that client of which it is aware, should ensure that any security, investment product, or financial service recommended to the client is suitable for the client.**
-

Explanatory Notes

Intermediaries, advisers, and CIUs should obtain sufficient information from their clients so that they can deal with their clients in a manner appropriate to their circumstances.⁵⁷ Clients should be honest with licensed persons regarding their investment knowledge and experience. Based on that information, licensed persons should determine what investments are suitable for the client and avoid recommending securities that do not meet the client’s financial sophistication, investment objectives, or risk tolerance.

Approaches differ with regard to unsolicited orders, in which a client initiates an order and there is no recommendation by the intermediary, adviser, or CIU to purchase the security that is the subject of the order.⁵⁸ In Europe, Directive 2004/39/EC on Markets in Financial Instruments (EU MiFID I) requires that if a client makes an

unsolicited order for an investment that is not suitable for the client, the licensed person should inform the client and explain why the investment is unsuitable. Directive 2014/65/EU on Markets in Financial Instruments (EU MiFID II) extends such a warning to all products or services that are offered or demanded.⁵⁹ On the other hand, in the United States, the licensed person is required to determine suitability only when a recommendation is made.⁶⁰ This appears to have been the most commonly used approach to suitability.⁶¹

The suitability of an investment for a customer will be different for different types of financial instruments. For example, complex financial products such as hedge funds, derivatives, and structured products will be more suitable for clients with extensive experience in investing and knowledge of the markets.⁶²

C4: CUSTOMER MOBILITY

- a. When clients request the payment of funds in their account, or the transfer of funds and assets to another intermediary, adviser, or CIU
 - i. The payment or transfer should be made promptly and within no more than three days after the settlement of any outstanding transactions;
 - ii. The closing/transfer costs should be supervised by the authority to ensure that such costs are not unreasonably excessive; and
 - iii. The procedures for closing should be clear and easy to complete.
- b. An intermediary, adviser, or CIU should disclose any circumstances in which payment may be delayed, such as the difficulty in selling a security due to its illiquid nature.

Explanatory Notes

Clients may need immediate access to their funds in order to meet other financial and personal obligations. The delay in payment of account balances or the closing of accounts reduces confidence and the perception of the integrity of the securities markets. Consequently, a quick

and administratively simple procedure for such transfers should be facilitated by securities laws and regulations.⁶³ If the nature of an investment would limit the ability to make a quick transfer, such as the illiquidity of an investment, this should be fully disclosed to clients prior to entering into the contract and making the investment.

C5: SEGREGATION OF FUNDS

- a. Assets of a CIU should be held by a custodian and segregated from the assets of all other entities that deal with the CIU.
- b. To the extent permitted by law, assets of an intermediary or adviser should be segregated pursuant to the law applicable to the safekeeping of assets.

Explanatory Notes

A consensus has developed that the assets of a CIU should be held by a custodian and segregated from the assets of all entities that deal with the CIU, including the asset manager; any other CIUs managed by the asset manager; the custodian, intermediary, and adviser for the CIU; and all other service providers for the CIU.⁶⁴ The safekeeping of customer assets is one of the most important aspects of financial consumer protection. Proper segregation means that the assets will be used only for the purposes intended by the consumer. Segregation can help prevent misappropriation and the use of client assets for proprietary trading or the financing of an asset manager's or custodian's operations. It can also facilitate the transfer of client assets in cases of severe market disruption. More-

over, in order to protect customer assets in the event of insolvency of a CIU or its asset manager, custodian, investment adviser, intermediary and any other service provider for the CIU, customer assets should be segregated from the assets of such entities in such a manner that the assets are excluded from being a part of their estate in the event of insolvency or receivership.

Customer assets held by intermediaries and advisers are segregated based on the nature of the security or instrument. Fully owned securities, margin securities, derivatives, and cash are all handled differently based on the law related to such financial instruments in the jurisdiction in which they are held. Intermediaries and advisers should hold and segregate assets in the manner described, and to the full extent permitted, by local law.⁶⁵

C6: MISUSE AND MISAPPROPRIATION OF CUSTOMER ASSETS

- a. Intermediaries, advisers, and CIUs should be liable to customers for any misuse or misappropriation of their assets, including misuse or misappropriation by employees, agents, contractors, and service providers.
 - b. An intermediary, adviser, or CIU should be required to put in place internal controls and supervisory procedures to prevent misuse or misappropriation of customer assets.
-

Explanatory Notes

Intermediaries, advisers, and CIUs have the highest moral and legal duty to hold and safeguard their clients' assets securely. The misuse or misappropriation of client assets can result in devastating financial consequences for clients and their ability to fund their families' current necessities and retirement. The safekeeping of these assets is critical not just to the clients, but also to the health of the securities market. Large losses of assets due to misappropriation can result in a loss of confidence in the securities market and reduced participation. As stated in IOSCO Methodology for Assessing Principles, one of the basic purposes of the oversight and supervision of intermediaries is to prevent this possible misuse.⁶⁶

Safekeeping can be done by placing the client assets with a custodian or other entity authorized by local law, but it is also important that internal controls be put in

place at intermediaries, advisers, and CIUs to monitor client funds and detect any misuse. Internal controls should be the first mechanism to detect misuse and provide the quickest way to prevent, stop, and remedy violations.

Another method of preventing misuse and misappropriation is to give customers electronic access to their accounts, so that they can verify the contents of the accounts. Different countries have developed ways for clients to monitor their accounts for evidence of misuse. In countries with Internet accounts, customers can verify their account status on a daily basis. For example, in Indonesia, clients are able to monitor the status of their accounts through the use of the Central Depository's AKSes facility on the Internet and through the use of a magnetic card that can be used at specified terminals around the country.⁶⁷

C7: AGENTS AND INTERMEDIARIES

- a. Intermediaries, advisers, and CIUs should be required under the regulatory system to have a compliance function in place to supervise, monitor, and provide training for persons acting as their agents, representatives, intermediaries, or contractors.
 - b. Intermediaries should be subject to regulatory administrative sanctions for failure to carry out their supervisory duties.
 - c. Intermediaries, advisers, and CIUs should be liable, as provided for under the civil and securities law, in judicial and non-judicial dispute resolution proceedings, to their clients for any loss or damage caused by their actions or the actions of persons acting on their behalf as their agents, representatives, intermediaries, or contractors, regardless of the legal character of their relationship.
 - d. Persons acting on behalf of intermediaries, advisers, and CIUs as their agents, representatives, intermediaries, or contractors, regardless of the legal character of their relationship, should be separately liable, as provided for under the civil and securities law, in judicial and non-judicial dispute resolution proceedings, to clients for any loss or damage caused by their actions.
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Explanatory Notes

Securities laws should require an intermediary, adviser, or CIU to put in place a compliance function that effectively supervises all of the salespersons employed by it or by its agents, representatives, intermediaries, or contractors, no matter the nature of the legal relationship between the intermediary, adviser, or CIU and the salespersons of the agents, representatives, intermediaries, or contractors. Principle 31 of the IOSCO Methodology for Assessing Principles recognizes that this is a particular problem for derivatives markets intermediaries.⁶⁸ The supervisory system should provide for training in the operation of the securities markets, in all relevant government regulations and SRO rules, and in the characteristics of the financial instruments and investment advice being given, so that the salespeople can competently handle client accounts. In addition, intermediaries, advisers, and CIUs should monitor the activity of salespeople and conduct periodic reviews of each salesperson's activities. The authority should be able to bring administrative sanctions for the failure to conduct such supervision.

In order for the consumer protection provisions of securities laws and regulations to be effective, they should provide for the liability of intermediaries, advisers, and

CIUs in actions brought by a client against them in civil courts and alternative dispute venues for any losses suffered by the clients for their own misconduct. Such actions could be based on breach of fiduciary duty, tortious conduct, breach of contract, violation of the securities laws, or any other causes of action provided for in the law.

In addition, intermediaries, advisers, and CIUs should be liable, in regulatory proceedings, civil proceedings, and alternative dispute venues, for the misconduct of their sales agents, since the intermediaries, advisers, and CIUs are responsible for supervising them. The relationship between an intermediary, adviser, or CIU and its salespeople is frequently structured to avoid such liability by making salespeople independent contractors, representatives, or agents. However, liability should exist irrespective of their legal relationship.

The sales agents themselves should also be liable in their own capacity to clients, as provided for in the law, for their conduct resulting in losses to clients. This would be particularly important in instances where the intermediary, adviser, or CIU becomes insolvent or is placed into receivership as a result of its conduct in violation of the law.

C8: COMPENSATION OF STAFF, AGENTS, AND INTERMEDIARIES

- a. **The authority should require that an intermediary, adviser, or CIU put in place a general remuneration structure that encourages compliance with the consumer protection legal regime. The compensation system should ensure that compensation is aligned effectively with prudent risk-taking.**
- b. **Intermediaries, advisers, and CIUs should establish and implement a remuneration policy that specifically encourages salespersons to comply with the consumer protection provisions set out in their internal compliance system and in the law.**

Explanatory Notes

A basic principle of consumer protection is that the incentives for salespeople of intermediaries, advisers, and CIUs should be aligned with the interest of the clients. One of the key reasons for misconduct by salespeople is that the remuneration structure encourages mis-selling in order to obtain higher pay. Compensation systems in which the payout is short-term (that is, based on volume of sales) can result in a situation in which the salesperson does not have to suffer the consequences of improper or high-risk sales and therefore has an incentive to sell high-risk financial instruments that are unsuitable for, or detrimental to,

the interests of the consumer in the long run.⁶⁹ Principle 8 of the IOSCO Methodology for Assessing Principles emphasizes that this is a particular problem where there is an active securitization market.⁷⁰

In order to create proper alignment, the incentives for salespeople should be balanced with the risks that are related to the financial products. For example, the use of claw-back provisions and deferred compensation, as well as limiting bonuses, can reduce the incentive to sell risky products, since future difficulties with the products can result in reduced compensation.

C9: CUSTOMER RECORDS

- a. An intermediary, adviser, or CIU should maintain up-to-date client records that are complete and readily accessible.
- b. The records should contain at least the following:
 - i. A copy of all documents required for client identification, contact, and profile
 - ii. All contract notices and periodic statements provided to each client
 - iii. Details of all information provided to each client in relation to the advice, products, and services provided to the client
 - iv. All correspondence with each client
 - v. Copies of all original documents submitted by each client in support of an application for the provision of advice, products, or services
 - vi. All other information concerning each client that the intermediary or CIU is required to keep by law
 - vii. All other information that the intermediary or CIU obtains regarding clients
- c. All records should be readily accessible to the authority and the client on request.
- d. Details of individual transactions should be retained for a reasonable number of years after the date of the transaction, but no less than five years. Similarly, all other records required under clauses C9(b)i–vii, above, should also be retained for a reasonable number of years from the date on which the relationship with the client ends, but no less than five years.

Explanatory Notes

The maintenance of books and records is vital to the proper regulation of intermediaries, advisers, and CIUs, since they facilitate the authority's review of their propriety accounts, in addition to the review of activity in individual customer accounts.⁷¹ The authority depends on the records when conducting its on-site and off-site audits of licensed persons. Without these records, the regulatory system would be ineffective and customer protection would be minimized. In addition, intermediaries, advisers, and CIUs depend on the records for their business management. Similarly, clients depend on these records to

verify transactions in their accounts for tax purposes, dispute resolution, and personal financial planning.

The amount of time that the records are kept varies from country to country. Latvia has a minimum period of 10 years, Croatia and Indonesia have a minimum of five years, while the United States breaks down the retention period depending on the type of document: confirmations and statements need to be kept for only three years, while blotters and ledgers of transactions must be kept six years.

D: DATA PROTECTION AND PRIVACY⁷²

D1: LAWFUL COLLECTION AND USAGE OF CUSTOMER DATA

- a. Intermediaries, advisers, and CIUs should be allowed to collect customers' data within the limits established by law or regulation and, where applicable, with the customer's consent.
- b. The law or regulation should ensure that intermediaries, advisers, and CIUs use data legally, within the limit legally established in relation to the consumers' consent, and should, at a minimum, establish clearly
 - i. How data can be lawfully collected by intermediaries, advisers, and CIUs;
 - ii. How data can be lawfully retained;
 - iii. For which purposes data can be collected; and
 - iv. Which types of data can be collected.

- c. **The law or regulation should provide the minimum period for retaining all customer records and, throughout this period, the customer should be provided ready access to such records for a reasonable cost.**
- d. **For data collected and retained by intermediaries, advisers, and CIUs, intermediaries, advisers, and CIUs should be required to comply with data privacy and confidentiality requirements that limit the use of consumer data exclusively to the purposes specified at the time the data was collected, or as permitted by law or otherwise specifically agreed with the consumer.**

Explanatory Notes

Consumers have a right to financial privacy and to be free from unwarranted intrusions into their privacy.⁷³ Because intermediaries, advisers, and CIUs are required to know their customers, securities markets professionals often have some of the largest sources of information regarding the financial situation of their customers, including personal information, contact details, consumer agreements, transaction logs, passwords, and so forth. Given the potential for abuse and misuse of such information, it is essential that this type of collection be regulated to avoid the risk of potential harm for consumers. For example, intermediaries, advisers, and CIUs may otherwise collect sensitive data and use it for unfit purposes that may harm consumers—for example, selling them products at higher prices. The various reasons for ensuring privacy and data protection include:

- The sensitivity of the personal information held and used in securities products
- The extensive information flows that take place, such as between providers and intermediaries and between members of a corporate group that includes one or more financial service providers
- The ever-increasing likelihood of information being received and held electronically, with a corresponding increase in the risk of remote, unauthorized access
- The fact that privacy is a fundamental human right deserving of protection, as indicated in various international instruments to which many countries are signatories⁷⁴

Securities markets professionals should be allowed to legally obtain, retain, and use personal data after obtaining lawful and informed consent from the consumer or on some other legitimate basis, including when related to the provision of the specific financial product or service the consumer acquired. International guidance is clear in establishing that “the collection of personal data and any

such data should be obtained by lawful and fair means and, where appropriate, with the knowledge or consent of the data subject.”⁷⁵ While the policies and practices regarding what constitutes lawful collection of data differ both across jurisdictions and among international guidance and principles, lawful and informed consent represents an underlying and cross-cutting theme.

Further, following the approach of treating data privacy as a human right, Convention 108 of the Council of Europe (COE Convention) establishes that data shall undergo automatic processing only for a legitimate purpose and that certain categories of sensitive data cannot be processed automatically, unless national legislation provides appropriate safeguards.⁷⁶

Securities markets professionals may also have incentives to store personal information for longer than necessary. Therefore, the major international instruments also require limitations to be placed on data retention.⁷⁷ For example, the COE Convention states that data must be “preserved in a form which permits identification of the data subjects for no longer than is required for the purpose for which those data are stored.”⁷⁸

The lawful collection of data is strictly connected to the purpose for which it was collected, and securities markets professionals should be able to use the data only for these purposes. Data should be considered legally used only if it is processed for the purpose for which it was collected. If this issue is not regulated by law or regulation, there is a risk that securities markets professionals may collect information for certain purposes for which customers’ may be willing to give consent but then use that same information for other purposes that may be detrimental to customers’ interests and for which the customer may not otherwise have given consent. Securities markets professionals should also be prohibited from disclosing consumer information to third parties for unauthorized uses—that is, without the consumer’s prior consent—such as for marketing purposes.

D2: CONFIDENTIALITY AND SECURITY OF CUSTOMER INFORMATION

- a. Intermediaries, advisers, and CIUs should be required to implement policies and procedures to ensure confidentiality, security, and integrity of all customer data stored in their different databases.
 - b. Intermediaries, advisers, and CIUs should take sufficient steps to protect the confidentiality and security of a customer's information against any anticipated threats or hazards to the security or integrity of such information, and against unauthorized access to, or use of, such information.
 - c. When establishing such procedures, intermediaries, advisers, and CIUs should also establish different levels of access to customers' data for employees, depending on the role they play within the organization and the different needs they may have to access such data.
 - d. The legal regime should have a protocol for cyber security that must be followed by intermediaries, advisers, or CIUs to protect customer information and assets.
-

Explanatory Notes

Once information has been lawfully collected, it is very important that intermediaries, advisers, and CIUs have an obligation to keep the financial information of their clients secure from unwarranted access by persons inside and outside their organization, as well as from any threats or hazards to data security or integrity. Over the last several years, the vulnerability of financial institutions to cyber

attacks on electronically held data and operations of intermediaries, advisers and CIUs has become a paramount problem.⁷⁹ Intermediaries, advisers, and CIUs must have in place sufficient safeguards to ensure that customer funds and activity are safe and secure. The authority, in cooperation with the securities industry, should develop effective protocols and procedures to protect against cyber attacks.

D3: SHARING CUSTOMERS' INFORMATION

- a. The law should prevent intermediaries, advisers, and CIUs from sharing customer account or personal information with any unaffiliated party for marketing purposes, such as telemarketing or direct mail marketing, without the customer's prior written consent.
 - b. The law should also prevent intermediaries, advisers, and CIUs from sharing customer account or personal information with any affiliated party for marketing purposes, such as telemarketing or direct mail marketing, without the customer's prior written consent.
 - c. Intermediaries, advisers, and CIUs should
 - i. Unless the law provides otherwise, inform a client of the situations in which they are required to share information regarding the client's account with third parties, such as legal enquiries by a credit bureau;
 - ii. Explain how they use and share a client's personal information;
 - iii. Explain to a client that the law prevents sharing customer account or personal information with any affiliated or unaffiliated party for marketing purposes, such as telemarketing or direct mail marketing, without the client's prior written consent;
 - iv. Allow a client to stop or opt out of sharing any other non-account information and inform the client of this option before the information is transferred; and
 - v. Explain to clients that if they agree to opt in to information sharing, the consent is limited to the specific purpose to which they consented.
 - d. Specific procedures and exceptions concerning the release of customer financial records to government authorities should be stated in the law.
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Explanatory Notes

Customers should be aware of how information can be shared with third parties and within the various units or subsidiaries of a financial conglomerate.⁶⁰ Many of these shared uses can be beneficial for customers, but they should have the right to affirmatively state that they consent to such information sharing, and that the sharing is limited to the specific uses to which the customers consent. A customer should be able to opt out of sharing

non-account related information if the customer does not find such information sharing to be useful or beneficial.

Governmental regulatory authorities have the need to obtain customer information for regulatory and law enforcement purposes. The instances in which this is permitted should be clearly stated in the law, as well as procedures for notification or situations in which notification is not required.

E: DISPUTE RESOLUTION MECHANISMS

E1: INTERNAL COMPLAINTS HANDLING

- a. Intermediaries, advisers, and CIUs should be required to have an adequate structure in place as well as written policies regarding their complaints handling procedures and systems—that is, a complaints handling function or unit, with a designated member of senior management responsible for this area, to resolve complaints registered by consumers against the entity effectively, promptly, and justly.
- b. Intermediaries, advisers, and CIUs should be required to comply with minimum standards with respect to their complaints handling function and procedures. These include the following:
 - i. Resolve a complaint within a maximum number of days, which should not be longer than the maximum period applicable to a third-party external dispute resolution mechanism. (See E2.)
 - ii. Make available a range of channels—telephone, fax, email, web—for submitting consumer complaints appropriate to the type of consumers served and their physical location, including offering a toll-free telephone number to the extent possible, depending on the size and complexity of the intermediary’s, adviser’s, or CIU’s operations.
 - iii. Widely publicize clear information on how a consumer may submit a complaint and the channels made available for that purpose, including on intermediaries’, advisers’, and CIUs’ websites, marketing and sales materials, KFSs, standard agreements, and locations where their products and services are sold, such as branches, agents, and alternative distribution channels. (See B1.)
 - iv. Publicize and inform consumers throughout the complaints handling process, and particularly in the final response to the consumer, regarding the availability of any existing ADR schemes. (See E2.)
 - v. Adequately train staff and agents who handle consumer complaints.
 - vi. Keep the complaints handling function independent from business units such as marketing, sales, and product design, to ensure fair and unbiased handling of the complaints, to the extent possible, depending on the size and complexity of the intermediary, adviser, or CIU.
 - vii. Within a short period following the date the provider receives a complaint, acknowledge receipt of the complaint in a durable medium—that is, in writing or in another form or manner that the consumer can store—and inform the consumer about the maximum period within which the provider will give a final response and by what means.
 - viii. Within the maximum number of days, inform the consumer in a durable medium of the intermediary’s, adviser’s, or CIU’s decision with respect to the complaint and, where applicable, explain the terms of any settlement being offered to the consumer.
 - ix. Keep written records of all complaints, while not requiring that the complaint itself be submitted in writing—that is, allow for oral submission.
- c. Intermediaries, advisers, and CIUs should be required to maintain and make available to the supervisory authority up-to-date and detailed records of all individual complaints.

- d. **The complaints handling and database systems of intermediaries, advisers, and CIUs should allow the entity to report complaints statistics to the supervisory authority.**
- e. **Intermediaries, advisers, and CIUs should be encouraged to use analysis of complaints information to continuously improve their policies, procedures, and products.**

Explanatory Notes

Efficient internal procedures should be in place to handle customer complaints fairly and quickly.⁸¹ Many customer complaints come from misunderstandings or a lack of information about their accounts and can be quickly resolved within the intermediary, adviser, and CIU. Consultation conducted in good will with the customer can help the customer understand the account and result in actions that satisfy the customer.

Even contested matters can be resolved within the intermediary, adviser, or CIU. An objective internal review

can verify events and facts related to an account. It is important that personnel who possess specialized training and are independent of management handle such matters. Trades incorrectly attributed to or taken from an account can be verified and corrected. Fees charged against the account can be recalculated for accuracy. Good-faith efforts by both parties can reach a quick conclusion.

For further details, [see the explanatory notes for E1 in chapter 1, "Deposit and Credit Products and Services."](#)

E2: OUT-OF-COURT FORMAL DISPUTE RESOLUTION MECHANISMS

- a. **If consumers are unsatisfied with the decision resulting from the internal complaints handling at the level of the securities market professional, they should have the right to appeal, within a reasonable timeframe (for example, 90 to 180 days), to an out-of-court ADR mechanism that**
 - i. **Has powers to issue decisions on each case that are binding on the securities market professional (but not binding on the consumer);**
 - ii. **Is independent of both parties and discharges its functions impartially;**
 - iii. **Is staffed by professionals trained in the subject(s) they deal with;**
 - iv. **Has an adequate oversight structure that ensures efficient operations;**
 - v. **Is financed adequately and on a sustainable basis;**
 - vi. **Is free of charge to the consumer; and**
 - vii. **Is accessible to consumers.**
- b. **The existence of the ADR, its contact details, and basic information relating to its procedures should be made known to consumers through a wide range of means, including when a complaint is finalized at the securities market professional's level.**
- c. **If the ADR has a member-based structure, all securities market professionals should be required to be members.**

Explanatory Notes

In addition to the judicial system, there should be an independent and impartial ADR system for resolving disputes between clients and their intermediaries, advisers, and CIUs. Retail consumers frequently invest only small sums of money, which makes recourse to the judicial system impractical. The expense of judicial processes can render any successful claim meaningless, and judicial proceedings frequently take long periods of time before a resolution is reached. Consequently, the judicial system does

not provide a practical venue for pursuing small securities market disputes.

As emphasized in the IOSCO Methodology for Assessing Principles of Securities, it is important for the legal system to provide investors with a "fair and efficient judicial system (including the alternative of arbitration or other alternative dispute resolution mechanisms)."⁸² In order for a method of ADR to be a respected venue for dispute resolution, it needs to be financed in a sustainable manner and staffed with experts able to evaluate cases inde-

pendently. The ADR decisions must be binding on intermediaries, advisers, and CIUs and enforceable by law, to encourage consumers to use the ADR for dispute resolution and to encourage the intermediaries, advisers, and CIUs to change the behavior that is the basis for the com-

plaint. All decisions by the ADR should be appealable to an appropriate tribunal, based on the law of the jurisdiction in which the ADR takes place.

For further details, [see the explanatory notes for E2 in chapter 1, “Deposit and Credit Products and Services.”](#)

F: GUARANTEE SCHEMES AND INSOLVENCY

F1: CLIENT PROTECTION WHEN A LICENSED PERSON FAILS

- a. **The law on an investors’ guarantee fund, if there is one, should require that the fund be**
 - i. Adequately capitalized;
 - ii. Clear regarding the persons, funds, and financial instruments that are covered under the law;
 - iii. Disclosed to clients;
 - iv. Subject to rigorous public reporting requirements and external audits; and
 - v. Subject to supervision and oversight.
- b. **Clear provisions in the law should ensure that the authority is able to effectively supervise and take prompt corrective action on a timely basis in the event of distress at an intermediary, adviser, or CIU.**
- c. **The legal provisions on the insolvency of intermediaries, advisers, and CIUs should provide for expeditious and equitable provisions to enable the timely payment of funds and transfer of financial instruments to clients by the insolvency trustee of an intermediary or CIU.**

Explanatory Notes

Client funds should be protected in the event of the insolvency of intermediaries, advisers, and CIUs that hold client funds. The segregation of assets set forth in C5 will facilitate the identification and prompt transfer of client funds. The insolvency proceedings should provide for a fair and rapid mechanism for winding up a licensed person and making the transfer.

IOSCO Principles of Securities Regulation, Principle 32⁸³ emphasizes that an authority must have a “clear plan for dealing with the eventuality of the failure of market intermediaries.” This would apply to advisers and CIUs as well. These provisions can include restricting activity of the intermediary or moving assets to another intermediary. When the authority becomes aware of an ongoing fraud or immediate stress in an intermediary, adviser, or CIU that puts client funds at risk, a trustee may immediately need to be placed in charge of the assets held by and under the control of the intermediary, adviser, or CIU to ensure that client assets are not dissipated. The law should give to the authority the power to take this action on its own decision or on order of a competent court.

Where permitted by law, an investor guarantee fund can provide an independent, effective mechanism for ensuring that client assets are protected.⁸⁴ However, in

order for clients to make alternative arrangements for non-covered instruments, they must be aware what instruments the fund covers and the circumstances in which it will make a payout. In addition, clients must be informed that the fund does not pay for lost profits and—depending on the scope of the fund—bad advice. To avoid giving a false sense of security to clients, it is critical that the fund be sufficiently funded to handle the failure of several large intermediaries or advisers that hold client assets. Due to the large amount of assets handled by the guarantee fund, the authority must have the power to supervise and audit the fund regularly, to ensure that its actions are in compliance with applicable laws and regulations. It is good practice that the fund publishes an annual report that includes accounts and financial condition.

It should be noted that not all financial markets are ready for a guarantee fund, due the high cost that is born by the market participants. A relatively small amount of activity on the markets would result in insufficient fees from which the participants could support the fund. In the past, this has created underfunded schemes that were not able to fulfill their mandate and were forced to rely on a government bailout. Even if established, a fund will take some time to build up sufficient resources to be effective. Nonetheless, guarantee funds are used in Canada, China,

the European Union, and the United States. In countries where deposit guarantee funds also exist, merit can be found in having both funds under the same administrative body. In addition, guarantee funds do not generally cover CIUs, since the assets of the CIU are held by a custodian

and are segregated from the asset manager and other related parties, including the custodian itself. Consequently, the winding up of a CIU is done pursuant to the authority's regulations and procedures that should be in place to handle such an event.

NOTES

- For purposes of this chapter, the term *consumer* is used to refer to potential or existing customers or clients of intermediaries, advisers, and CIUs or other potential or existing retail investors who are purchasers and/or sellers of securities markets products and services. The term *securities* is used to refer to shares in a company and other financial instruments equivalent to shares or other interests in business entities, such as partnerships, bonds, or other forms of securitized debt, or any other financial instruments, such as derivatives, giving the right to acquire or sell such securities. Following the International Organization of Securities Commission's (IOSCO) Objectives and Principles of Securities Regulation, published in June 2010 (IOSCO Principles of Securities Regulation), the words *securities markets* are used, where the context permits, to refer compendiously to the various market sectors, including reference to the derivatives markets.
- The term *intermediary* generally includes persons who are in the business of managing individual portfolios, executing orders as brokers, dealing in, and distributing securities, and it can include other registered entities that are authorized to engage in such activities, such as banks. A jurisdiction could give an intermediary the authority to conduct other activities, such as securities underwriting. See "Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation," FR08/11 (IOSCO, September 2011), revised August 2013 (IOSCO Methodology for Assessing Principles). An issuer of securities would be an intermediary for the purposes of these GPs if it distributes its own securities.
- Advisers are principally engaged in the business of advising others regarding the value of securities or the advisability of investing in, purchasing, or selling securities. A jurisdiction can permit an adviser to engage in other activities, such as holding client assets. In some jurisdictions, advisers may be required to obtain a license as an intermediary. See IOSCO Methodology for Assessing Principles.
- Collective investment undertaking* (CIU) means an entity that is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities. The CIU can take different legal forms, such as a corporation, partnership, trust, or legally recognized corpus of assets. Units or shares in a CIU are considered to be securities for the purpose of these GPs. CIUs are both self-managed and managed by asset managers. For the purposes of these GPs, the term *CIU* will encompass both the CIU in whatever legal form it takes and its asset manager. Many jurisdictions also permit the creation of CIUs for the investment in other assets, such as real estate and commodities.
- For purposes of this chapter, the term *authority* is used to refer generally to the primary institutions that are given the responsibility of regulating consumer protection in the securities sector. If the regulation is split between a market conduct supervisor, prudential supervisor, SRO, or other governmental entity, then, unless otherwise noted, *authority* refers to the activities of the regulatory authorities as a group.
- "Responsible Finance: Financial Capability and Consumer Protection," <http://responsiblefinance.worldbank.org>.
- Good Practices for Financial Consumer Protection* (Washington, DC: World Bank, 2012), available at <http://responsiblefinance.worldbank.org/~media/GIAWB/FL/Documents/Misc/Good-practices-for-financial-consumer-protection.pdf>.
- For purposes of this section, unless otherwise specified, *person* means a natural or legal person.
- G20 High-Level Principles on Financial Consumer Protection (OECD, 2011), Principle 1.
- Emerging Markets Committee, "Guidelines to Emerging Market Regulators Regarding Requirements for Minimum Entry and Continuous Risk-Based Supervision of Market Intermediaries, Final Report" (IOSCO, December 2009); Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on Markets in Financial Instruments Amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and Repealing Council Directive 93/22/EEC (EU MiFID I), Article 5; Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Directive 2002/92/EC and Directive 2011/61/EU (EU MiFID II), Article 5; and the US FINRA Manual (Financial Industry Regulatory Authority), maintaining NASD Rules 1030–1032.
- EU MiFID II, Paragraph 70.
- IOSCO Methodology for Assessing Principles, Principle 29.
- Principle 2 states that independence implies (a) a regulator that operates independently of sectoral interest and (b) the ability to undertake regulatory measures and enforcement actions without external (political or commercial) interference.
- G20 High-Level Principles on Financial Consumer Protection, Principle 2.
- G20 High-Level Principles on Financial Consumer Protection, Principle 1.
- Pascal Franz and Norvald Instefjord, "Rules v. Principles Based Financial Regulation" (SSRN, November 25, 2014).
- "Principles-Based Regulation: Focusing on the Outcomes That Matter" (UK Financial Services Authority, April 2007).
- IOSCO Methodology for Assessing Principles, Principle 10.
- Emerging Markets Committee, "Guidelines to Emerging Market Regulators."

20. IOSCO Methodology for Assessing Principles, Principle 10.
21. IOSCO Methodology for Assessing Principles, Principle 11, and "Credible Deterrence in the Enforcement of Securities Regulation" (IOSCO, June 2015), 29.
22. Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on Insider Dealing and Market Manipulation (Market Abuse), Article 23, and Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on Criminal Sanctions for Market Abuse (Market Abuse Directive).
23. SRO Consultative Committee, "Model Code of Ethics" (IOSCO, June 2006).
24. "Report on Investor Education Initiatives Relating to Investment Services" (IOSCO, February 2013) and "Study Regarding Financial Literacy among Investors as Required by Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act" (US Securities and Exchange Commission, August 2012).
25. "Principles on Point of Sale Disclosure, Final Report" (IOSCO, February 2011), chapter 5A, 22.
26. "Principles on Point of Sale Disclosure," chapter 4E, 19, and IOSCO Methodology for Assessing Principles, Principle 31, Key Issue 11(h), and Principle 26, Key Issue 6.
27. "Principles on Point of Sale Disclosure," Principle 5.
28. US FINRA, Rule 2210.
29. "Master Circular for Mutual Funds" (Securities and Exchange Board of India, 2011), chapter 13, "Advertisements."
30. For example, Latvian Law on Advertising, as amended, 2014.
31. IOSCO Methodology for Assessing Principles, Principle 31 Key Issue 11(c).
32. G20 High-Level Principles on Financial Consumer Protection, Principle 4; IOSCO Methodology for Assessing Principles, Principle 31 for Intermediaries, Key Issues 8(e).
33. "OTC Markets and Derivatives Trading in Emerging Markets, Final Report" (IOSCO, July 2010).
34. "Suitability Requirements with Respect to the Distribution of Complex Financial Products, Final Report" (IOSCO, January 2013), where complex financial instruments are broadly defined and include, among other instruments, credit-linked notes, asset-backed securities, and swap contracts; and "Report on the IOSCO Survey on Retail OTC Leveraged Products," FR14/2016, (IOSCO, December 2016). See also G20 High-Level Principles on Financial Consumer Protection, Principle 4.
35. Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and Amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, and "Regulatory and Investor Protection Issues Arising from the Participation by Retail Investors in (Funds-of) Hedge Funds" (IOSCO, February 2003).
36. Eleanor Kirby and Shane Worner, "Crowd-Funding, An Infant Industry Growing Fast," Staff Working Paper SEP3/2014 (IOSCO, 2014). This paper does not necessarily reflect the views of IOSCO or its members.
37. The determination of which conflicts are material and in need of disclosure will depend on the circumstances of the relationship and the nature of the local securities markets.
38. IOSCO Methodology for Assessing Principles, Principle 8, Key Issue 2, and Principle 31, Key Question 6.
39. "Guidelines for the Regulation of Conflicts of Interest Facing Market Intermediaries, Final Report" (IOSCO, November 2010), 12.
40. "Guidelines for the Regulation of Conflicts of Interest," 15.
41. "IOSCO Statement of Principles for Addressing Sell-Side Securities Analyst Conflicts of Interest" (IOSCO, September 2003), 5 and 9.
42. "Conflicts of Interests of CIS Operators" (IOSCO, May 2000), 3 and 13.
43. "Survey Results on Outsourcing of Financial Services" (IOSCO, February 2005), 7.
44. "Principles on Outsourcing of Financial Services for Market Intermediaries" (IOSCO, February 2005), 11.
45. "Principles on Point of Sale Disclosure," and Commission Regulation (EU) No 583/2010 of 1 July 2010 Implementing Directive 2009/65/EC of the European Parliament and of the Council as Regards Key Investor Information and Conditions to Be Met When Providing Key Investor Information or the Prospectus in a Durable Medium Other Than Paper or by Means of a Website. The discussion regarding use of KFSs in this chapter is limited to CIUs, since there is no consensus about their use for all issuers.
46. Circular 4/2013 (WA) (Federal Financial Supervisory Authority [BaFin], Germany, 2013): Interpretation of statutory requirements for preparation of information sheets pursuant to sections 31(3a) WpHG, 5a WpDVerOV.
47. "Regulation (EU) No. 1286/2014 of the European Parliament and of the Council of 26 November 2014 on Key Information Documents for Packaged Retail and Insurance-Based Investment Products (PRIIPs)."
48. See also The Joint Forum, "Customer Suitability in the Retail Sale of Financial Products and Services" (Bank for International Settlements, April 2008) and other sources in section B8 in appendix 1.
49. IOSCO Methodology for Assessing Principles, Principle 31, Key Issue 11(f).
50. IOSCO Methodology for Assessing Principles, Principle 31, Key Question 16.
51. "Recommendations Regarding the Protection of Client Assets, Final Report" (IOSCO, January 2014).
52. G20 High-Level Principles on Financial Consumer Protection, Principle 3.
53. "Survey on Anti-Fraud Messaging, Final Report" (IOSCO, May 2015).
54. Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 Concerning the Distance Marketing of Consumer Financial Services and Amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC.
55. For example, Latvian Law on Advertising, as amended, 2014.
56. "Survey on Anti-Fraud Messaging."
57. IOSCO Methodology for Assessing Principles, Principle 26, regarding suitability for CIUs, and Principle 31 for intermediaries, Key Issue 8(b); G20 High-Level Principles on Financial Consumer Protection, Principle 4; US FINRA, Rule 2111; EU MiFID I, Article 19; and EU MiFID II, Article 25.
58. The Joint Forum, "Customer Suitability in the Retail Sale of Financial Products and Services."

59. EU MiFID I, Article 19, and EU MiFID, Article 25.
60. For example, US FINRA, Rule 2111.
61. The Joint Forum, "Customer Suitability in the Retail Sale of Financial Products and Services," 12, paragraph 66.
62. "Suitability Requirements with Respect to the Distribution of Complex Financial Products," wherein complex financial instruments are broadly defined and include, among other instruments, credit-linked notes, asset-backed securities, and swap contracts.
63. US FINRA, Rule 11870.
64. IOSCO Methodology for Assessing Principles, Principle 25.
65. "Recommendations Regarding the Protection of Client Assets" and "Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets, Final Report" (IOSCO, March 2011).
66. IOSCO Methodology for Assessing Principles, 10.
67. Annual Report (Indonesian Central Securities Depository, 2014), 86.
68. IOSCO Methodology for Assessing Principles, Principle 31, Key Issue 4; Key Question 6(c).
69. "FSF Principles for Sound Compensation Practices" (Financial Stability Forum, April 2009).
70. IOSCO Methodology for Assessing Principles, Principle 8, Key Issues 3 and 4, Key Questions 4 and 5.
71. IOSCO Methodology for Assessing Principles, Principle 10, Key Questions 4 and 5; Principle 29, Key Issue 10; and Principle 31, Key Issue 8(d) and Key Questions 4 and 5.
72. Intermediaries, advisers, and CIUs gather vast amounts of data, including personal information, in order to conduct their daily tasks. This information is sensitive to misuse or breaches, which has the potential to cause harm to consumers. This section touches on only a few select issues with respect to data protection and privacy that are most relevant to financial consumer protection.
73. Directive 2002/58/EC of the European Parliament and of the Council of 12 July 2002 Concerning the Processing of Personal Data and the Protection of Privacy in the Electronic Communication Sector, and the US Securities and Exchange Act of 1934 and Regulation S-P thereunder.
74. See, for example, (a) Universal Declaration of Human Rights, Article 12 (United Nations, 1948), (b) Convention for the Protection of Human Rights and Fundamental Freedoms, Article 8 (European Court of Human Rights, 1950), available at <http://www.coe.fr/eng/legaltxt/5e.htm>, (c) Convention for the Protection of Individuals with Regard to the Automatic Processing of Personal Data, ETS No. 108 (Council of Europe, 1981), available at <http://www.coe.fr/eng/legaltxt/108e.htm>, and (d) International Covenant on Civil and Political Rights (United Nations, 1966), available at <http://www.hrweb.org/legal/cpr.html>.
75. Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data (OECD, 2013), section 7.
76. Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data.
77. See, for example, the OECD Guidelines on the Protection of Privacy and Transborder Flows of Personal Data, Principle 10; the UN Guidelines, Article 3; the APEC Privacy Framework, Principle III, "Collection Limitation"; and the COE Convention.
79. Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data.
79. Committee on Payments and Market Infrastructures, "Cyber Resilience in Financial Market Infrastructures" (Bank for International Settlements, November 2014).
80. Directive 2002/58/EC Concerning the Processing of Personal Data and the Protection of Privacy in the Electronic Communication Sector, and the US Securities and Exchange Act of 1934 and Regulation S-P thereunder; Committee on Payments and Market Infrastructures, "Cyber Resilience in Financial Market Infrastructures."
81. IOSCO Principles of Securities Regulation, Principle 31, Key Issue 10; G20 High-Level Principles on Financial Consumer Protection, Principle 9.
82. IOSCO Methodology for Assessing Principles, appendix 1, Item 7.
83. IOSCO Methodology for Assessing Principles, Principle 32, Key Issue 1.
84. Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on Investor-Compensation Schemes, and the US Securities Investor Protection Act of 1970.

APPENDIX 1: SOURCES

A1: Consumer Protection Legal Framework

(a) *Legal framework*: IOSCO Methodology for Assessing Principles, Appendix 1; G20 High-Level Principles on Financial Consumer Protection, Principle 1. (b) *Licensing sales people and managers*: EU MiFID I, Article 9 (requires only managers of investment firms to be qualified); EU MiFID II, Article 5, and US FINRA Manual maintaining NASD Rules 1030–1032. (c) Emerging Markets Committee, “Guidelines to Emerging Market Regulators Regarding Requirements for Minimum Entry and Continuous Risk-Based Supervision of Market Intermediaries, Final Report” (IOSCO, December 2009). (d) *Licensing advisers*: IOSCO Principles of Securities Regulation 24 and 29.

A2: Institutional Arrangements and Mandates

(a) IOSCO Methodology For Assessing Principles, Principles 1–8. (b) G20 High-Level Principles on Financial Consumer Protection, Principle 2.

A3: Regulatory Framework

(a) IOSCO Methodology for Assessing Principles, Principles 4, 10–12. (b) G20 High-Level Principles on Financial Consumer Protection, Principle 1. (c) Franz and Instefjord, “Rules v. Principles Based Financial Regulation,” November 25, 2014. (d) “Principles-Based Regulation: Focusing on the Outcomes That Matter” (UK Financial Sector Authority, April 2007).

A4: Supervisory Activities

(a) IOSCO Methodology for Assessing Principles, Principle 10. (b) “Guidelines to Emerging Market Regulators Regarding Requirements for Minimum Entry and Continuous Risk-Based Supervision of Market Intermediaries.”

A5: Enforcement

(a) IOSCO Methodology for Assessing Principles, Principles 11 and 12. (b) “Credible Deterrence in the Enforcement of Securities Regulation” (IOSCO, June 2015), 29. (c) Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on Insider Dealing and Market Manipulation (Market Abuse), Article 23; Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on Criminal Sanctions for Market Abuse (Market Abuse Directive).

A6: Codes of Conduct and Other Self-Regulation

SRO Consultative Committee, “Model Code of Ethics” (IOSCO, June 2006); US FINRA Manual incorporating NASD Rules, Section 2000, “Business Conduct”; “Code of Ethics and Standards of Professional Conduct for the

Unit Trust Industry” (Federation of Malaysian Unit Trust Managers, September 2001); and Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS), as Amended, Article 14.

A7: Dissemination of Information by Authorities

“Report on Investor Education Initiatives Relating to Investment Services” (IOSCO, February 2013); “Study Regarding Financial Literacy among Investors as Required by Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act” (US Securities and Exchange Commission, August 2012).

B1: Format and Manner of Disclosure

(a) “Principles on Point of Sale Disclosure, Final Report” (IOSCO, February 2011), chapter 4, subsections C and E; Principle 5. (b) IOSCO Methodology for Assessing Principles, Principle 31, Key Issues 8(e). (c) US FINRA, Rule 2210. (d) “Master Circular for Mutual Funds” (Securities and Exchange Board of India, 2011), chapter 13, “Advertisements.” (e) EU MiFID I, Article 19, subsections 2 and 3.

B2: Advertising and Sales Materials

(a) “Principles on Point of Sale Disclosure,” Principle 5. (b) US FINRA, Rule 2210. (c) “Master Circular for Mutual Funds,” chapter 13. (d) EU MiFID I, Article 19(2); EU MiFID II, Article 24(3). (d) Latvian Law on Advertising, as amended, 2014.

B3: Disclosure of Terms and Conditions

(a) IOSCO Methodology for Assessing Principles, Principle 31. (b) EU MiFID I, Article 19; EU MiFID II, Article 24.

B4: Disclosure of Product Risk

(a) “Suitability Requirements with Respect to the Distribution of Complex Financial Products, Final Report” (IOSCO, January 2013). (b) “OTC Markets and Derivatives Trading in Emerging Markets, Final Report” (IOSCO, July 2010). (c) G20 High-Level Principles on Financial Consumer Protection, Principle 4. (d) Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and Amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010. (e) “Regulatory and Investor Protection Issues Arising from the Participation by Retail Investors in (Funds-of) Hedge Funds” (IOSCO, February 2003). (f) Kirby and Worner, “Crowd-Funding: An Infant Industry Growing Fast,” Staff Working Paper SEP3/2014 (IOSCO, 2014).

B5: Disclosure of Conflicts of Interest

(a) IOSCO Methodology for Assessing Principles, Principles 8, Key Issues 2 and 31, Key Question 6. (b) "Guidelines for the Regulation of Conflicts of Interest Facing Market Intermediaries, Final Report" (IOSCO, November 2010), 12. (c) "IOSCO Statement of Principles for Addressing Sell-Side Securities Analyst Conflicts of Interest" (IOSCO, September 2003), 5 and 9. (d) "Conflicts of Interests of CIS Operators" (IOSCO, May 2000), 3 and 13. (e) "Survey Results on Outsourcing of Financial Services" (IOSCO, February 2005), 7. (f) "Principles on Outsourcing of Financial Services for Market Intermediaries" (IOSCO, February 2005), 11. (g) Investment Advisers Act, Section 206(3). (h) Investment Advisers Act, Rule 204-3. (i) Directive 2009/65/EC, Article 14. (j) EU MiFID I, Article 18; EU MiFID II, Article 23.

B6: Key Facts Statements for CIUs

Contents: (a) "Principles on Point of Sale Disclosure." (b) The Joint Forum, "Customer Suitability in the Retail Sale of Financial Products and Services" (Bank for International Settlements, April 2008). (c) Directive 2009/65/EC, Article 78. (d) Regulation (EU) No. 1286/2014 of the European Parliament and of the Council of 26 November 2014 on Key Information Documents for Packaged Retail and Insurance-Based Investment Products (PRIIPs). (e) Form N-1A (US Securities and Exchange Commission) and *SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products* (Hong Kong: Securities and Futures Commission, 2013), chapter 6. (f) Circular 4/2013 (WA) (Federal Financial Supervisory Authority, Germany, 2013). *Performance:* (a) Form N-1A. (b) Securities Act of 1933, Rule 482. *Frequent trading:* (a) Form N-1A. (b) "Best Practices Standards on Anti Market Timing and Associated Issues for CIS, Final Report" (IOSCO, October 2005). *Disclosure:* Investment Advisers Act of 1940, Rule 204-3.

B9: Contract Notes

(a) US FINRA, Rule 2232. (b) Investment Advisers Act, Rule 206(3)-2.

B10: Statements

(a) IOSCO Principles of Securities Regulation, Principle 31. (b) "Recommendations Regarding the Protection of Client Assets, Final Report" (IOSCO, January 2014). (c) US FINRA, Rule 2340. (d) "Electronic Delivery of Information between Members and Their Customers," Notice to Members 98-3 (NASD, January 1998); Investment Advisers Act of 1940, Rule 206(4)-2.

C1: Unfair Terms and Conditions

G20 High-Level Principles on Financial Consumer Protection, Principle 3.

C2: Sales Practices and Duty of Care

(a) "Survey on Anti-Fraud Messaging, Final Report" (IOSCO, May 2015). (b) Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 Concerning the Distance Marketing of Financial Services. (c) Latvian Law on Advertising, as amended, 2014.

C3: Product Suitability

(a) IOSCO Principles of Securities Regulation, Principle 26, regarding suitability for CIUs, and Principle 31 for intermediaries. (b) "Customer Suitability in the Retail Sale of Financial Products and Services." (c) "Suitability Requirements with Respect to the Distribution of Complex Financial Products." (d) G20 High-Level Principles on Financial Consumer Protection, Principle 4. (e) EU MiFID I, Article 19; EU MiFID II, Article 25; and US FINRA, Rule 2111.

C4: Customer Mobility

US FINRA, Rule 11870.

C5: Segregation of Funds

(a) "Recommendations Regarding the Protection of Client Assets." (b) "Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets, Final Report" (IOSCO, March 2011). (c) IOSCO Methodology for Assessing Principles, Principle 25. (d) EU MiFID I, Article 13(7) and (8) and MiFID II, Article 16(9), which provide arrangements to safeguard client funds but no statement of segregation. (e) Securities and Exchange Act of 1934, and Rule 15c3-3 promulgated thereunder.

C6: Misuse and Misappropriation of Customer Assets

(a) "Recommendations Regarding the Protection of Client Assets." (b) IOSCO Methodology for Assessing Principles, page 10. (c) G20 High-Level Principles on Financial Consumer Protection, Principle 7. (d) Annual Report (Indonesian Central Securities Depository, 2014), 86.

C7: Agents and Intermediaries

(a) IOSCO Methodology for Assessing Principles, Principle 31, Key Issue 4, Key Question 6(c). (b) Securities Exchange Act of 1934, Section 15(b)(4)(E). (c) US FINRA, Rule 3110. C8, Compensation of Staff, Agents, and Intermediaries: (a) "FSP Principles for Sound Compensation Practices (Financial Stability Forum, April 2009). (b) G20 High-Level Principles on Financial Consumer Protection, Principle 6.

(c) IOSCO Methodology for Assessing Principles, Principle 8, Key Issues 3 and 4, Key Questions 4 and 5.

C9: Customer Records

(a) "Recommendations Regarding the Protection of Client Assets." (b) IOSCO Methodology for Assessing Principles, Principles 10, 29, and 31. (c) Securities and Exchange Act of 1934, and Rule 17a-3 thereunder. (d) US FINRA, Rule 4511; Latvian Law on Financial Market Instruments, Article 124 (9) and (10); Croatia Ordinance on Operating Conditions for Authorized Companies, Article 13; Rule No. V.D.3 (13) (Financial Services Authority of Indonesia [OJK]).

D1: Lawful Collection and Usage of Customer Data

(a) Directive 2002/58/EC Concerning the Processing of Personal Data and the Protection of Privacy in the Electronic Communication Sector. (b) Securities and Exchange Act of 1934 and Regulation S-P thereunder. (c) Universal Declaration of Human Rights (United Nations, 1948). (d) Convention for the Protection of Human Rights and Fundamental Freedoms (European Court of Human Rights, 1950). (e) Convention for the Protection of Individuals with Regard to the Automatic Processing of Personal Data, ETS No. 108 (Council of Europe, 1981). (f) Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data (OECD, 2013). (g) APEC Privacy Framework (Asia-Pacific Economic Cooperation, 2005).

D2: Confidentiality and Security of Customer Information

(a) Directive 2002/58/EC. (b) Securities and Exchange Act of 1934 and Regulation S-P thereunder. (c) Committee on Payments and Market Infrastructures, "Cyber Resilience in Financial Market Infrastructures" (Bank for International Settlements, 2014).

D3: Sharing Customer's Information

(a) Directive 2002/58/EC. (b) Securities and Exchange Act of 1934 and Regulation S-P thereunder. (c) "Cyber Resilience in Financial Market Infrastructures."

E1: Internal Complaints Handling

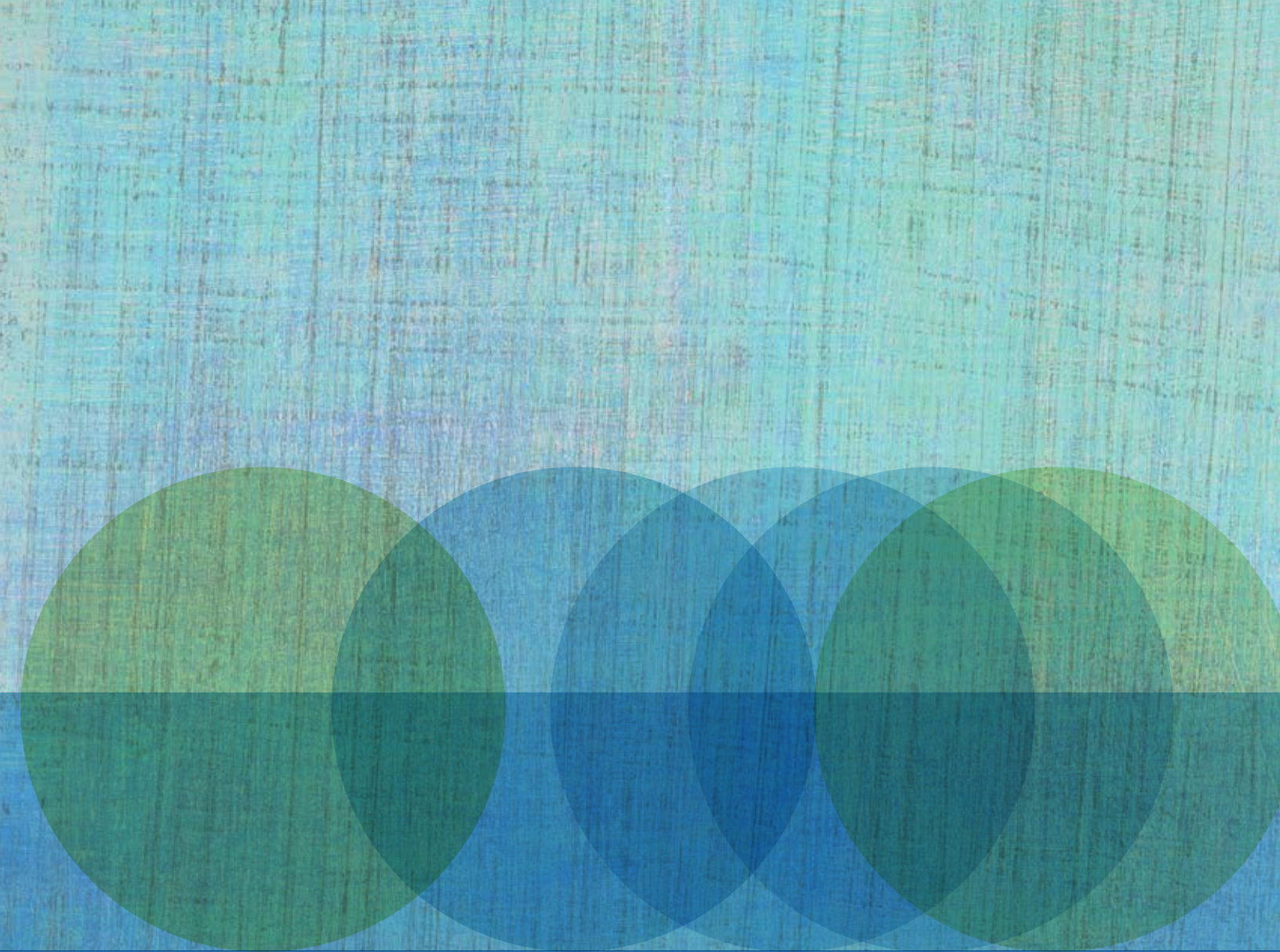
(a) IOSCO Methodology for Assessing Principles, Principle 31, Key Issue 10. (b) G20 High-Level Principles on Financial Consumer Protection, Principle 9.

E2: Out-of-Court Formal Dispute Resolution Mechanisms

(a) IOSCO Methodology for Assessing Principles, annex I, Item 7. (b) EU MiFID I, Article 53, and EU MiFID II, Article 75. (c) US FINRA, Rule IM-12000, "Code of Arbitration Procedure for Customer Disputes."

F1: Client Protection When a Licensed Person Fails

(a) IOSCO Methodology for Assessing Principles, Principle 32, Key Issue 1. (b) "Recommendations Regarding the Protection of Client Assets." (c) "Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets." (d) Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on Investor-Compensation Schemes. (e) Securities Investor Protection Act of 1970.



ANNEXES

RETAIL PAYMENT SERVICES

This annex covers good practices for financial consumer protection with respect to payment services in general and retail payment services in particular. Given their nature, large-value payments are not in the scope of this document. International standard-setting bodies as well as country-level policy makers have increasingly recognized consumer protection as an important issue for payment services—particularly with regard to electronic retail payments, such as mobile phone-based services. The examples and background for this annex are drawn from a range of countries to reflect the diversity of markets and approaches, including those that aim to balance financial inclusion and consumer protection goals. Specific emphasis has been placed on experience from the developing countries where the World Bank Group has had active engagements in recent years.

WHAT IS A RETAIL PAYMENT?¹

A retail payment is often defined indirectly as anything that is not a large-value payment. Large-value payments are typically defined as payments of a relatively high value and between banks and/or participants in a financial market.² Based on this definition, retail payments are also commonly referred to as low-value payments. However, retail payments can also be for relatively large amounts. For purposes of the Good Practices, a retail payment is defined as a payment whose

- settlement is not time-critical;³
- the payer, the payee, or both are individuals or non-financial institutions; and
- parties are not direct participants in the payments system that is processing the payment.

A retail payment instrument is defined as an instrument mainly intended to permit execution of retail payments

and serve consumers or small business. A related term is an *electronic payment instrument*, which is defined here as a payment instrument that uses electronic means for initiation, authentication, and authorization of a payment transaction. Even though a transaction might be initiated electronically, the subsequent processes of clearing and settlement might involve a combination of manual and electronic procedures. A payment may also be initiated on paper but subsequently processed electronically. Despite the various possible combinations of means of transfer—either paper-based or non-paper-based—retail payment instruments can be broadly classified into (i) paper-based instruments; (ii) electronic funds transfer (EFT)-based instruments; (iii) payment card-based instruments; and (iv) e-money-based instruments.⁴ The overall retail payment product packaging is referred to in this annex as a *payment service*. All payments involving the intermediation of a financial service provider are usually referred to as *non-cash retail payments*.

DIFFERENT ENTITIES INVOLVED IN A NON-CASH RETAIL PAYMENT

Broadly speaking, a non-cash retail payment involves the following parties:

- Issuer:** The institution that issues the payment instrument. Typically refers to the institution issuing a payment card or e-money instrument.
- Acquirer:** The entity or entities that provide services to the card acceptors (merchants) related to clearing and settlement of the accepted transactions. In general, the services include receiving and processing the data relating to the transaction for authorization, clearing, and settlement, though some provide only clearing and settlement services. Some acquirers also hold deposit accounts for card acceptors (merchants).

- iii. **Clearinghouse:** A central location or central processing mechanism through which financial service providers agree to exchange payment instructions or other financial obligations (for example, securities). The providers settle for items exchanged at a designated time based on the rules and procedures of the clearinghouse. In some cases, the clearinghouse may assume significant counterparty, financial, or risk-management responsibilities for the clearing system.
- iv. **Third-party service providers:** Entities that can provide services to one or more of the three entities described above and also, in some cases, to payers and payees.⁵

In the case of a person-to-person EFT, the same process holds true, but an acquirer could be referred to as an originating institution and the issuer as the receiving institution.

In this annex, the term *payment service provider (PSP)* refers to an entity that provides payment services, including remittances. A PSP could be a bank, nonbank financial institution, or nonfinancial institution. For example, in some jurisdictions, nonfinancial institutions such as mobile network operators (MNOs) are allowed to issue e-money-based instruments under a specific regulatory framework. Further, a PSP can provide the payment service to either a payee, a payer, or both.

A payment transaction in which the PSP for the payer and payee are different will need a clearing and settlement arrangement such as a clearinghouse, with its associated rules, guidelines, and pricing arrangements. Such an arrangement is referred to in this annex as a *payment infrastructure*, and the entity operating it is referred to as a *payment system operator (PSO)*. A PSO is an entity that operates a payment network and/or other payment infrastructures.

The PSPs and also the PSO might engage third parties to offer specific services on their behalf. For example:

- An issuer of an e-money service might engage shops and other entities to function as agents to meet cash-in and cash-out needs of its customers.
- A PSP could engage specialized entities to sign up and service its merchants.
- A PSO could engage a third party to operate its underlying information technology systems.

SCOPE OF THIS ANNEX

In a single payment transaction, there are multiple user-provider relationships. A payment transaction involves a payer and a payee, both of which are using the

services offered by their respective PSP. In turn, such PSPs might be engaging third-party service providers. Hence, in the broader context of retail payments, the term *consumer* can be used to cover all these user-provider relationships. For example, in card payments, the cardholder and the merchant are both users (of the issuer and acquirer, respectively). Furthermore, the issuer can be considered a user of a PSO. However, service arrangements between PSPs and PSOs or third-party service providers are typically handled adequately on a bilateral basis, as all parties are institutional users who are sophisticated and have the necessary skills to protect their respective interests.

In line with the rest of the Good Practices, this annex therefore focuses on the relationships where one of the parties is an individual, as imbalances of information, resources, and power generally disfavor such users of payment services. As noted in the introduction to the Good Practices, the term *consumer* is used throughout this document to refer primarily to individuals, although the GPs can also be applied to microentrepreneurs and small enterprises. Also, the Good Practices are generally focused on consumers as payers, though issues with respect to consumers as payees are also discussed where relevant.

As with other chapters of the Good Practices, the focus of this annex is on common retail payment services most relevant to individuals (as well as microentrepreneurs and small business). Large-value payments are not in the scope of this annex. All four types of retail payment instruments are covered except cash, which is a specific type of paper-based instrument. The reason for this is that cash payments, while being the most used payment instrument in the world,⁶ do not involve a user-provider relationship.⁷ However, remittances originated with and received in cash are covered, as these involve a user-provider relationship.

This annex generally does not cover issues specific to the payment system infrastructure. Nevertheless, some of the GPs described in this annex touch upon the payment system infrastructure where there is a direct and imminent causal link between the payment system infrastructure and consumer protection (for example, **C5, “Competition and Interoperability”**). More specifically, the rules of the payment system infrastructure have a bearing on the design of payment services and supporting mechanisms, in particular its dispute resolution processes, as such rules usually cover (i) information that needs to be contained in the payment instructions; (ii) timelines for processing a payment instruction; (iii) pricing and fees for PSPs, which could be passed on to consumers; (iv) processes for handling errors and associated

timelines; (v) which entity takes responsibility for any fraud or error; and (vi) adoption of specific standards, risk-management arrangements, and certain customer service requirements.

RELATIONSHIP TO OTHER CHAPTERS OF THE GOOD PRACTICES

This annex complements and should be read in conjunction with chapter 1, “Deposit and Credit Products and Services” (as well as other chapters). For example, the disclosure requirements referenced in chapter 1 for current accounts are complementary to the disclosure requirements listed for e-money services in this annex.

However, while many of the good practices in this annex are similar to those discussed in chapter 1, their implementation to PSPs and retail payment services may entail different policy considerations and require tailored approaches, which are highlighted in this annex. For instance, this annex emphasizes specific aspects of disclosure requirements (for example, timing, content, and format about transactional fees and exchange rates for remittances). There are also GPs that are unique to payment services, such as **interoperability (C5)**, **liability in the case of mistaken or unauthorized transactions (C9)**, and **operational reliability (C10)**.

CONSUMER PROTECTION ISSUES RELEVANT TO RETAIL PAYMENT SERVICES

Retail payment services have a number of features that differ from the products and services covered in other chapters, particularly in terms of the operation of payment instruments and the involvement of nonfinancial providers. Hence, consumer protection concerns can differ accordingly. The consumer protection aspects for payment services span both the sale/purchase of the service as well as its ongoing usage. Further, consumer protection issues may differ between the payment service and the underlying financial service. In some cases, the sale/purchase and also usage of a payment service is integral to another financial service, such as a current account (for example, checks and debit cards), while in other cases, these services are designed and sold as separate and distinct services (such as prepaid cards and other e-money services). In other cases, payment services are provided without an underlying transaction account—for example, remittances and bill payments. The good practices in this annex are intended to cover both the specific transaction

and the usage of the payment instrument (with or without an underlying financial service). Where applicable, issues specifically relating to the underlying transaction accounts or services (for example, deposit accounts, credit and insurance products) are covered in the other chapters of the Good Practices.

A variety of specific consumer protection issues can arise in the sale, provision, and usage of retail payment services. These issues can be categorized into the following areas:

- Effective disclosure of terms and conditions (for example, disclosure of fees/charges levied before the payment is effected, remittance is withdrawn, or money is cashed out; notices about transactions; and so forth)
- Fairness of terms and conditions of the service (such as level of fees/charges levied and rules pertaining to adherence/cancellation of recurring payments)
- Security standards (for example, authentication rules)
- Resolution of errors, including reversals (such as incorrect processing of payment instructions in terms of the amount or recipient or timing)
- Liability in case of errors and frauds (for example, unauthorized transactions in a transaction account)
- Operational service standards and reliability (for example, timeliness of settlement, system uptime)
- Data protection issues (for example, compromised non-payment account related consumer data)

ISSUES SPECIFIC TO PAYMENT CARDS

Payment cards are associated with a range of fees that are charged to the cardholder (payer) and to the merchant (payee). A card issuer may charge cardholders an annual fee, penalty fees, and other transaction-specific fees. In addition, the merchant is also subject to a range of fees by the acquiring bank, such as merchant service fees (MSF), account maintenance fees, penalty fees, and other transaction-specific fees.⁸ While merchants can also be small businesses and vulnerable to unfair practices by card issuers and acquirers,⁹ in general the Good Practices do not cover the relationship between merchants and these actors. Similarly, the Good Practices do not focus on the many other interactions in payment cards, such as issuer-acquirer, issuer-payment network,¹⁰ and acquirer-payment network. Certain aspects of these interactions, such as interchange fees and “honor all cards” requirements,¹¹ are widely believed to influence fees and other aspects relevant to cardholders.

Additionally, several emerging payment mechanisms that build on existing payment instruments, in particular cards, are relevant to the Good Practices. For example, Apple Pay, Android Pay, and Samsung Pay are all based on cards and are effectively a card payment conducted via mobile devices. But there are important differences in how one signs up for these services, and how transactions are initiated and processed. These mechanisms could entail additional risks for consumers to those linked to the underlying payment instrument.

ISSUES SPECIFIC TO EFT-BASED SERVICES

EFTs can be credit or debit payments. EFT credit payments can be deferred or instantaneous payments, while EFT debit payments are often deferred and also often used as recurring payments (for example, monthly utility bill payments). Additionally, EFTs require providing information about the recipient's account number, details of the PSP with whom the account is maintained, and details of the payment, such as the amount, when it is to be paid, and so forth. These characteristics require attention to certain disclosure requirements, such as timely notifications and alerts about payment requests and any related problems with the payment, as well as fair practices and solid operational standards, such as providing means for easy and timely cancellation of recurring payments and minimizing the likelihood of incorrect information in payment instructions. Moreover, EFTs require particularly clear and fair processes for resolution of incorrect or unsuccessful payments. Such issues are discussed further in the Good Practices.

ISSUES SPECIFIC TO CHECKS

Checks are traditionally conceived as negotiable instruments. In addition to consumer protection issues connected with disclosure of risks in case a check is drawn on an account with insufficient funds or on time limits within which a check can be cashed, or information on costs, there are specific issues connected to the validity of endorsement and the risk of misuse of the instrument as a form of security. However, the current trend is to limit negotiability and, in particular, to truncate a paper check (that is, to transform it into electronic inputs) at the time of presentation. Once a check is truncated, for clearing purposes and execution it is treated as a debit transfer. Consequently, it is subject to the same kind of risks as an EFT.

ISSUES SPECIFIC TO E-MONEY SERVICES

E-money instruments, which include prepaid cards and other instruments such as mobile money products, can have a range of costs associated with them: initial sign-up fee, account maintenance fee, cash load fee, cash withdrawal fee, balance inquiry fee, and other transaction- and event-specific fees, particularly for redemption. The sign-up process for prepaid instruments is often handled remotely (for example, over the Internet or via mobile phones) or at locations of an agent of the PSP.¹² Ensuring that all the details about these fees are communicated clearly and in a timely manner to consumers who use remote channels is a challenge. Extensive use of agents may also bring the challenge of ensuring uniform quality and reliability of service.

In addition, prepaid instruments that allow consumers to keep funds in their accounts for an indefinite period of time and reload the accounts as desired (as is the case for most mobile money services currently offered by nonbank institutions such as MNOs) could be considered a hybrid of payment and deposit services, raising many consumer issues that are characteristic of both types of services. In that vein, certain Good Practices applicable to current accounts are also relevant to e-money services, although their application may vary. (For example, the issuance of periodic statements in traditional format may not be appropriate for mobile money services.)

THE GOOD PRACTICES AND INTERNATIONAL STANDARDS FOR PAYMENT SYSTEMS

This annex relies on, builds off, and expands on existing guidance and standards issued by international standard-setting bodies, such as the Basel Committee for Banking Supervision, the Committee on Payments and Market Infrastructures (CPMI), and the International Organization of Securities Commissions (IOSCO), and relevant organizations, such as the World Bank Group, the International Telecommunications Union Telecommunications Standardization Section (ITU-T), and the Organisation for Economic Co-operation and Development (OECD). It does so by drawing from country examples and making specific considerations regarding the relationship between such standards and guidance and consumer protection, including how such standards and guidance can be put into practice.

A: LEGAL AND SUPERVISORY FRAMEWORK

A1: CONSUMER PROTECTION LEGAL FRAMEWORK

- a. There should be a clear legal framework that establishes an effective regime for the protection of consumers of retail payment services.
- b. In the event that the legal framework takes an institution-based approach (that is, respective laws cover specific types of PSPs), efforts should be made to ensure that the overall legal framework provides sufficiently comprehensive coverage, avoids conflicts or lack of clarity, and provides for a level playing field for providers of similar services.
- c. The legal framework should be proportional, technology-neutral, risk-based, and predictable.
- d. Efforts should be made by the authority or authorities responsible for the implementation of the consumer protection legal framework (“authority”) to authorize/license or register PSPs offering retail payment services.
- e. The PSPs that effectively handle consumers’ funds should be subject to a mechanism of authorization/licensing to enter the market and be subject to appropriate supervision and oversight.
- f. If not authorized/licensed, all PSPs should at a minimum be subject to registering with the authority.
- g. Where PSPs are required to be authorized/licensed by the authority, the authority should have the power to establish minimum entry criteria, which should include the following:
 - i. The applicant’s beneficial owners, board members, senior management, and people in control functions demonstrate integrity and competence.
 - ii. Appropriate governance and internal controls are in place, including specific controls to mitigate consumer protection risks.
 - iii. Measures to protect consumer funds, interests, and privacy are adequate.
- h. The legal framework should include provisions establishing an effective supervisory authority with power to use a range of supervisory tools to ensure compliance with the laws relating to consumer protection.
- i. The legal framework should be developed via a consultative process that encourages input from affected markets, relevant authorities, collaborative arrangements such as national payment councils (NPCs), and consumer associations.

Explanatory Notes

A sound and appropriate legal framework is the basis for an efficient payments system. In light of the current rapid transformation of the market based mainly on innovation in technologies, legislation on the legal validity of electronic contracts and signatures is required, to also cover electronic (that is, non-paper-based) money transfers and procedures for authorization. These rules would not only ensure legal enforceability of new payment instruments, but also guarantee adequate protection of consumers where technology requires new forms of protection (such as in protection and correct use of codes of access).

Other relevant pieces of legislation that affect the soundness of the legal framework of the payments system include laws on the security of payment instruments and telecommunication networks, legislation on free competi-

tion for the supply of payment services, and laws on the efficiency of the national payment system as a whole.

PSPs should be duly supervised and overseen by the relevant authority. One of the tools used for supervision and oversight of payment systems and services is requiring PSOs, issuers of payment instruments, and other PSPs to obtain a license from a designated regulator. This is indeed common practice in all countries with new legislation on retail payments. However, due to the wide range of payments services and the varying roles played by different PSPs, various methods of granting approval to enter the market may be allowed—ranging from full-fledged licensing mechanisms to less burdensome mechanisms for authorization to registration only—all combined with a certain range of supervisory/oversight discretion to ensure that the same risks are treated the same way across all PSPs.

For example, in cases where PSPs are providing activities with low risk, a mechanism for basic registration can be put in place. Registration implies that the PSP does not need a prior approval by the regulator (through either a full-fledged licensing mechanism or another less burdensome method, such as obtaining an authorization). The PSP simply informs the authority of its existence and the kinds of activities performed. It may be required to provide information on such activities on a regular basis. Registration should be the minimum criterion required to permit authorities to monitor the correct application of minimum standards in the market, including for consumer protection.

Although this is currently much less frequent than in the past, in some countries, PSPs may not be fully subject to regulation or enforcement procedures, even though they are effectively providing a payment service that is subject to financial consumer protection requirements. This issue is usually due to lack of adequate legislation on the provision of payment services, and should be effectively addressed by taking a functional approach that brings all PSPs under the scope of the relevant authority depending on the type of payment service provided.

The application of the financial consumer protection legal framework in the case of e-money may be less clear when compared to traditional payment services managed by banks, in which the services are usually closely associated with the banking business and the opening of accounts. In this case, the consumer protection legal framework covering banking services is often extended to traditional payment services used to move money from accounts (as in the case of checks). However, e-money and other innovative payment services emerging in a wide range of countries are often offered by nonbank providers, or when offered by banks, they may be kept separate from the banking business (that is, run separately from the core banking account system). As a result, existing consumer protection legal frameworks (whether for banking products or payment services) are often less likely to be directly applicable to nonbank PSPs, resulting in a gap in the legal framework.

In order to mitigate these shortcomings, comprehensive legislation on the national payment system is recommended. At the same time, a functional approach may be used for financial consumer protection—that is, a set of similar provisions applying to users of retail payment services irrespective of the institutional qualities of the provider.

A2: INSTITUTIONAL ARRANGEMENTS AND MANDATES

- a. **The authority (or authorities) in charge of implementing the financial consumer protection legal framework should have an explicit and clear legal mandate for consumer protection with respect to retail payments.**
 - b. **The authority should have legal powers to**
 - i. **Issue binding regulations for financial consumer protection in relation to retail payment services and PSPs, as well as guidelines or other instruments under these regulations; and**
 - ii. **Implement and enforce the application of the financial consumer protection legal and regulatory framework.**
 - c. **The payment system overseer, if different from the authority, should have a role in the formulation of the consumer protection framework for retail payment services and include these topics in the scope of its oversight activities, as appropriate. The two authorities should coordinate and cooperate.**
 - d. **The authority should have an adequate allocation of resources and be operationally independent from external interference from political, commercial, and other sectoral interests.**
 - e. **Appropriate legal protection should be established to protect the authority and supervisory staff members from personal litigation in the good-faith exercise of their supervisory duties.**
 - f. **Any overlap between the legal mandates of different authorities implementing the financial consumer protection legal framework, as well as between such authorities and the payment system overseer, prudential, competition, and other authorities, should be minimized.**
 - g. **The authority should collaborate with payment system overseers to study and analyze trends in consumer protection issues, with a view to instituting appropriate policy and regulatory changes to payment systems and payment services and also operating rules, procedures, and risk-management measures for the underlying payment systems infrastructure.**
 - h. **The authority should coordinate with consumer and industry associations, the NPC or its equivalent, and the media, to ensure that they play an active role in promoting financial consumer protection.**
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Explanatory Notes

See the explanatory notes for A2 in chapter 1, “Deposit and Credit Products and Services,” which generally apply to retail payment services.

A number of regulators and other entities may be involved in the protection of consumers of retail payment services, resulting in potential fragmentation and the risk of regulatory arbitrage. The following entities may be involved to varying degrees with the implementation of consumer protection laws and regulations with respect to retail payment services: (i) the central bank, as the overseer of the national payment system; (ii) the banking/financial services supervisory authority; (iii) the telecommunication regulatory agency (for usage of telecom services incidental to payment services); (iv) a dedicated financial consumer protection or market conduct authority; (v) the competition agency (from the perspective of impact on consumers from uncompetitive market conditions); and (vi) general consumer protection agencies (which are not focused on financial sector).

When multiple authorities exist, cooperation and coordination mechanisms are strongly needed to implement the legal framework for consumer protection in retail payment services effectively. Coordination should be ensured by way of clarity in the mandate of each relevant authority and by institutional arrangements between authorities. It is currently good practice for central banks and supervisors in the sector to stipulate memorandums of understanding, which should be extended in scope to also cover issues of protection of consumers.

In some countries, such as in Australia, Mexico, Peru, and the United Kingdom, a separate authority independent of the central bank is responsible for financial consumer protection or market conduct, including retail payment services. In such cases, the functions of consumer protection are concentrated into a single authority.

The payment system oversight function exercised by the central bank is fundamental for guaranteeing the adequate and proper functioning of the national payment system, including the protection of consumers of retail payment services. In this instance, supervision and oversight are distinct. Whereas supervision traditionally focuses on prudential standards and is centered on the soundness of individual operators, oversight focuses on their activities and their relations within the various payment systems and is mainly concerned with the risks inherent to each activity and the efficiency of the payment system as a whole. These two functions, although sharing a number of objectives and tools, are clearly distinguished and are often performed by different authorities. How-

ever, whereas supervision can be the competence of a number of different authorities, oversight is usually carried out by the central bank. The overseer also has an overarching function of coordination—to ensure that different policies and objectives within the national payment system are kept consistent—and has a holistic understanding of the sector.

Overseers often have an explicit objective to maintain trust and confidence in money. In fact, the General Guidance on National Payment Systems Development recognizes that, where there is no dedicated institutional arrangement for consumer protection related to payment services, this could be part of the payment systems oversight function. Accordingly, in many jurisdictions, payment system overseers maintain an interest in and actively study consumer protection related to payment services. Where overseers do not have a full mandate to regulate this topic, they should collaborate and cooperate with other relevant authorities.

Even in the presence of a dedicated authority covering financial consumer protection issues with respect to retail payments, a potentially effective approach to achieve interagency collaboration and coordination is including consumer protection in the agenda of existing NPCs. NPCs can either be created with a legal personality or set up as advisory bodies by the central bank or other relevant authorities. The membership of NPCs is usually broad, encompassing various regulatory bodies, PSPs, PSOs, and, potentially, consumer rights associations. NPCs usually create working groups/task forces to study specific areas, such as risk management, legal and regulatory framework, marketing, technology and operations. While work streams dedicated to consumer protection issues are an option, these can also focus on specific consumer protection issues, such as fraud-related aspects in risk management, redress, and other requirements related to consumer protection.

Finally, in some countries, more than one of the functions related to payment systems, including the implementation of the consumer framework for retail payments, could be handled by different organizational units/entities within the same institution, most commonly the central bank. Therefore, intra-organization collaboration and coordination will be important, especially where the primary responsibility for consumer protection is placed outside the payments oversight function at the central bank. This could be facilitated, for instance, through designated committees/standing groups on consumer protection with respect to retail payment services.

A3: REGULATORY FRAMEWORK

- a. There should be a comprehensive regulatory framework that elaborates on the law to protect consumers of retail payment services.
 - b. At a minimum, the regulatory framework should include
 - i. Transparency and disclosure requirements;
 - ii. Fair treatment and business conduct, including:
 - 1. Protection and availability of customer funds;
 - 2. Authorization, authentication, and data security requirements;
 - 3. Liability for errors, fraud, and unauthorized transactions; and
 - 4. Operational reliability;
 - iii. Data protection and privacy; and
 - iv. Dispute resolution mechanisms.
 - c. Such regulations should be legally enforceable and binding on PSPs.
 - d. The regulatory framework can use a principles-based approach, a rules-based approach, or a hybrid approach.
 - e. The regulatory framework should be consistent, including across regulations issued by different authorities with respect to similar retail payment services that may be provided by different types of PSPs.
 - f. Regulations should be written in a manner that minimizes ambiguity and the possibility of differing interpretations.
 - g. The formulation of regulation should involve consultation with a range of relevant parties, including affected industries, government authorities, and consumer associations. A good mechanism to ensure such consultation is the NPC.
 - h. Regulation should take into account international guidance and standards and benefit from research regarding the regulatory practices of other countries and consumer research and behavioral economics. However, model laws and other countries' regulations should not be transplanted without customization to a country's particular context.
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Explanatory Notes

See the explanatory notes for A3 in chapter 1, "Deposit and Credit Products and Services," which generally apply to retail payment services.

As noted in chapter 1, specific rules should be established for outsourcing and agents, since a number of risks related to the use of third parties can adversely

affect consumers (such as strategic, reputational, operational, and compliance risks). It is also important that the regulatory framework pertaining to retail payment services includes protection against fraud and misuse of the instrument, since these issues strongly affect the trust of consumers in non-cash payments, in particular non-paper-based instruments.

A4: SUPERVISORY ACTIVITIES

- a. Consumer protection supervision should be risk-based, with the purpose of focusing on riskier areas and PSPs while optimizing the use of supervisory resources.
- b. Supervision should be comprehensive, proactive, and mostly forward-looking, aimed at identifying emergence of poor practices.
- c. The authority should collect and use quality and timely data, including data reported by PSPs in a standardized, electronic format.
- d. The planning of consumer protection supervisory activities should be conducted on a regular basis within a documented framework and following a set process.
- e. Supervisory procedures should be based on specialized supervision manuals, to ensure standardization and consistency.
- f. The authority should deploy an adequate range of supervisory tools and techniques (for example, market monitoring, off-site and on-site inspections, thematic reviews).
- g. Although it may play a role in facilitating the resolution of individual consumer complaints, the authority should focus primarily on regulatory and supervisory activities.
- h. The authority should evaluate its supervisory approach, tools, and techniques, as well as supporting information systems, on a regular basis, to enable its staff to effectively assess institution-specific and market-wide risks.
- i. Supervisory staff should meet high professional standards and have sufficient knowledge and appropriate expertise and training to carry out financial consumer protection supervisory activities.

Explanatory Notes

Payment services are very heterogeneous, ranging from traditional paper-based products linked to bank accounts (for example, checks) to e-money services provided by nonbanks. Many of these payment services involve innovative technologies, delivery channels, and business models. Identifying and keeping track of consumer protection issues in fast-paced markets such as electronic retail payments require sufficient resources and capacity and a well-designed, effective, forward-looking supervisory approach. Leveraging skills and resources across different departments or authorities (for example, between the financial consumer protection authority and the payment systems overseer) and involving external experts (such as survey companies, to conduct payment costs surveys) could help bridge gaps in resources and capacity.

If no specialized authority or unit is dedicated to monitoring of compliance with financial consumer protection rules, consumer issues would need to be included in the existing functions of institution-focused supervisors or the overseer. For instance, where banks offer retail payment services, their consumer protection issues could be covered in the ongoing supervision pertaining to banking services. The responsibility for supervising nonbank PSPs varies more widely across countries, as the payment overseer may focus on oversight and on large-value payment

systems, and may not be actively engaged in direct supervision of retail PSPs (as in El Salvador, Mexico, and the United Kingdom). In some countries, such as Ghana, Kenya, and Tanzania, the payments oversight unit at the central bank may be more engaged in monitoring, and, hence, consumer protection could be added to their supervisory activities in the absence of a specialized team dedicated to consumer protection for retail payment services.

Since consumer protection issues are not necessarily covered in traditional prudential supervisory activities, it is important that a specific supervisory program is created for this area, based on a risk-based approach, with criteria that identify the most relevant consumer issues and institutions and the most appropriate supervisory activities for each of them. Such program should exist irrespective of whether consumer protection in retail payment services is dealt with by a specialized unit/authority, or by prudential/ payments supervisors/overseers. Detailed supervisory guidance for on-site and off-site procedures covering the key consumer issues in bank and nonbank PSPs should be developed as well. While a product-cycle approach may be adequate for services such as credit and insurance, it may be less useful for most retail payments, given the lower level of complexity in consumer interactions and shorter duration of product life (with the possible exception of e-money services).

The supervisory program for consumer protection in retail payments should comprise a mix of supervisory tools, including on-site and off-site supervision. Tools that are less often used for prudential supervision should be considered. Mystery shopping, for instance, is a useful tool for checking on regulatory requirements that contain a timing element (for example, disclosure of price information before a transaction is performed) or an element of human behavior (such as non-discrimination and high-quality service). Also, it is useful and cost-effective to conduct thematic reviews (which combine on-site and off-site analyses) on key consumer issues, to assess the level of risk across different providers. For example, thematic reviews of the contractual terms of prepaid cards, mobile money fees, or processing times in international remittances could be conducted. The Financial Conduct Authority in the United Kingdom reviewed how PSPs dealt with unauthorized transactions and also conducted a thematic review of mobile banking and payments. With respect to the latter, one of the key findings was that smaller screens and keypad sizes increased the risk of consumer error, although the measures put in place by PSPs to mitigate such risk were considered satisfactory.¹³

Supervision should, at a minimum, and at least with respect to selected PSPs and services, perform the following:

- Assess the business practices and their relationship with the PSP's governance structure, corporate culture, revenue and growth model, and risk-management structure, internal controls, as well as staff and executive compensation policies
- Scrutinize the main services throughout the product cycle (research, design, marketing, sales and distribution, contracting, post-sales)
- Assess the effectiveness of internal complaints handling mechanisms, including how the analysis of complaints statistics is used at the corporate level to improve practices, products, and services on an ongoing basis
- Assess the level of compliance with legal and regulatory requirements
- Assess compliance with the PSP's own policies and possibly industry self-regulation and codes of conduct (COCs)
- Assess the role and impact of the most relevant third parties involved in service design and delivery or consumer interaction functions, such as agents and merchants
- Monitor relevant market developments and the emergence of new or increased consumer issues across various PSPs

In some contexts, payment services involve extensive use of agents, notably for e-money services in many developing economies such as Bangladesh, El Salvador, Ghana, Kenya, Paraguay, Rwanda, and Tanzania, but also for cash-based bill payments (for example, across Latin America). The number of agent locations can be several multiples that of traditional physical bank branches. For example, in China, there are over 900,000 agent locations and around 89,000 bank branches.¹⁴ Such agents should also be required to maintain standard practices with respect to financial consumer protection. In such cases, supervisors should focus on the risk-management practices of the PSP (the principal), such as for signing up new agents, their training, ongoing monitoring, and other risk-management procedures—including transaction monitoring, anti-money laundering and combatting the financing of terrorism (AML/CFT) efforts, and agent dismissal—in order to ensure that PSPs are adequately managing agents for financial consumer protection purposes. While supervision would be focused primarily on the headquarters of the PSP, certain issues that may be subject to mystery shopping or in-person observation by supervisors do require sampling agents for on-site visits.¹⁵ In addition, specific categories could be created for agents with the largest share of transactions, agents who have been on-boarded recently, or agents about whom the most complaints have been raised, for which direct monitoring by supervisors (whether on-site or off-site) may be warranted. The ITU-T Focus Group Digital Financial Services gives specific recommendations for supervising digital financial services with respect to consumer protection and experience, such as taking a harmonized approach to agents of banks and other PSPs.¹⁶

As in other sectors (such as banking and insurance), there is a very close relationship between strong risk-management practices and governance at PSPs and ensuring an adequate level of consumer protection. Operational and risk-management aspects—in particular, the existence of robust arrangements that result in safety, security, and reliability of retail payments—should be subject to effective ongoing supervision, regardless of the framework for covering supervision of consumer protection issues. In order to ensure optimal use of supervisory capacity and get the most out of specialization of supervisors without ineffective overlaps, coordination between the supervision of these two aspects should be close. For instance, in Mexico, many consumer issues, such as the incidence of fraud and the handling of complaints related to unsuccessful banking transactions, are addressed within the scope of the operational and technology risk supervision conducted by the banking supervisory authority, and there is constant coordination and information sharing with the dedicated financial consumer protection authority.

A5: ENFORCEMENT

- a. The authority should have clear powers to negotiate and impose preemptive and corrective measures in the course of its supervision, to address non-compliance and instances of misconduct.
- b. The authority's enforcement powers and tools, and the actions taken against PSPs, should create a credible threat of enforcement against lack of compliance with the legal and regulatory framework.
- c. The authority should have an adequate range of enforcement powers and tools to allow it to investigate and address various situations adequately (for example, reprimands, withdrawal of products, fines, suspension of management, or compensation to affected customers).
- d. The authority should strive to be gradual, proportionate, timely, and consistent in the application of its enforcement powers.
- e. There should be effective coordination between the areas or authorities responsible for supervision and those responsible for enforcement, including relevant enforcement agencies. In particular, the supervisory authority should have functional coordination mechanisms with overseers and regulatory authorities, to address any interventions required at the level of a PSO, to enforce its actions, and also to communicate any of its enforcement actions that might have a bearing on them.
- f. The authority should have the power to refer cases to the judiciary as well as other agencies for civil or criminal action.

Explanatory Notes

See the explanatory notes for A5 in chapter 1, "Deposit and Credit Products and Services."

A6: CODES OF CONDUCT AND OTHER SELF-REGULATION

- a. The legal and the regulatory framework should allow for the emergence of self-regulatory organizations, including industry associations.
 - b. PSPs that are unregulated with respect to consumer protection should be encouraged to design, adopt, disseminate, and enforce COCs or other types of self-regulation (although this should not be viewed as a substitute for regulation).
 - c. Self-regulation related to consumer protection to be adopted by regulated entities should be created in consultation with the relevant authority and other relevant stakeholders (for example, payment system overseers).
 - d. COCs and other self-regulation should be written in plain language and without industry jargon to ensure that consumers and providers can easily understand them.
 - e. COCs and other self-regulation should be publicized and disseminated so that they are known to consumers.
 - f. To the extent possible, the authority should take actions to encourage or check compliance with self-regulation by PSPs and should use self-regulation when evaluating a PSP's conduct.
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Explanatory Notes

The industry itself may develop COCs or self-regulatory regimes. Provided that they are properly designed with appropriate governance arrangements and sanction powers, they may be a useful complement to formal regulation.

In many countries, COCs for banking products and services often include references to payment services. In India, the Code of Bank's Commitment to Customer, administered by the Banking Codes and Standards Board of India, is an example of a general code for banking products that also covers specific payment services and instruments often offered by banks—debit cards, remittances, and funds transfers.¹⁷ This board also monitors compliance of its members with COCs and publishes a compliance rating index annually. Further examples of COCs specific to payments services include the Australia ePayments Code, which applies to payments, funds transfers, and cash withdrawal transactions that are initiated using electronic equipment, and the Hong Kong Banking Code of Conduct, which was approved by the Hong Kong Monetary Authority and covers electronic banking services (chapter 6) and stored value cards and devices (chapter 7).

There are also model COCs for particular payment products and services advocated at the global level—for example, the Code of Conduct for Mobile Money Providers issued by the GSM Association in 2014,¹⁸ the code of conduct for remittances advocated by the World Bank in a publication in 2010,¹⁹ and the Better Than Cash Alliance Responsible Digital Payments Guidelines, which also include guidelines for developing a national COC.²⁰

It is also good practice for payment systems to have their own operating rules and procedures that are contractually binding on PSPs. These rules and procedures often provide the PSO with powers to levy penalties and also to allocate responsibility for frauds and errors. These rules and procedures include, among other things, the following elements of consumer protection:

- What information should be provided to customers
- Eligibility requirements for some products (for example, income requirements for premium payment cards)
- Minimum standards for customer service
- Dispute resolution framework
- Processing timelines
- Requirements regarding transparency on pricing (for example, card networks often require the acquirer to display any specific fees charged for withdrawing cash from automated-teller machines [ATMs]).

PSOs implement specific programs to monitor compliance through data collection, self-reporting, and on-site inspections. An example is the Zero Liability Program of Visa and MasterCard,²¹ which requires the PSPs using the Visa and MasterCard network to communicate to cardholders that, subject to certain conditions, customers have zero liability for any unauthorized transaction. Visa and MasterCard also have global communication campaigns about this program and have internal compliance mechanisms in place to ensure their PSPs honor this requirement.

A7: DISSEMINATION OF INFORMATION BY THE AUTHORITY

- a. **The authority should make readily available to the general public, at no cost, at least through its website, minimum relevant information to help it achieve its statutory goals and increase its transparency and accountability. This information should ideally include**
 - i. **A clear and thorough description of its regulatory and supervisory mandate and remit and the role of other authorities, if applicable, as well as whether any PSPs are not covered by any authority with regard to consumer protection;**
 - ii. **Its annual reports, with general statistics about retail payment services and a description of supervisory objectives and activities undertaken in the past year;**
 - iii. **A list or database with all licensed/authorized/registered PSPs and their regulatory/supervisory status; and**
 - iv. **Laws and a compilation of all regulations on financial consumer protection pertaining to PSPs.**
- b. **Resources permitting, the authority should strive to publish additional information that can help to achieve its objectives, such as aggregated statistics on consumer complaints or examples of supervisory findings and enforcement actions.**

- c. **To the extent possible, the authority should coordinate with a variety of stakeholders, such as industry and consumer associations, the media, and other government agencies, to increase the reach of the information it disseminates.**

Explanatory Notes

As noted in A7 of chapter 1, “Deposit and Credit Products and Services,” disseminating information is important to increase supervisory effectiveness in financial consumer protection. Publicizing information about the regulatory status of PSPs is important, given that this is a very diverse sector where the use of third parties is commonplace, and also given that environment is changing fast, making it difficult for the public to access updated information. Dissemination can also facilitate the coordination across relevant authorities, or across different departments of the same authority.

The range, depth, and complexity of information to be published by the authority in charge of consumer protection in retail payment services, and the channels and materials used, will depend on the resources available to the authority and on the priority given to different consumer issues, although the authority should strive to disseminate on its website at least the four items listed under clause A7(a), above. For the benefit of consumers and the general public, and in line with international standards set for prudential supervisors, the financial consumer protection authority should publish a list of all registered and authorized/licensed PSPs and keep the list updated. Resources permitting, the list should have links to the websites of each PSP.

Dissemination of information should be done at least through the authority’s institutional website, although

other channels (such as newspapers) may be used as well. The Internet is usually a less costly medium than printed dissemination. For example, the United Kingdom’s Payment System Regulator (operating under the Financial Conduct Authority) puts on its website the regulatory framework and approach, interagency-coordination mechanisms, its annual plan, a statement of its focus, explanations about the payments system and the card industry in particular, market reviews, and guidance about complaints against PSPs, as well as other useful information. Several jurisdictions require reporting of customer disputes/complaints to relevant authorities, which are then consolidated and disseminated widely. [See A7 in chapter 1, “Deposit and Credit Products and Services,”](#) for further details.

In addition, efforts have been made by national payment overseers to disseminate price comparisons in certain key retail markets. For instance, numerous countries have joined a global effort to collect and disseminate, through a single web portal managed by the World Bank Group, price information on international remittances contained in national databases, with the ultimate objective of reducing overall costs to consumers.²² Another example is the central bank in Mexico, which disseminates periodic information about ATM fees and payment card fees (including the MSF and the interchange fees),²³ which are usually further disseminated by major newspapers.

B: DISCLOSURE AND TRANSPARENCY

B1: FORMAT AND MANNER OF DISCLOSURE

- a. **Any advertisement, sales material, or other form of communication or disclosure by a PSP to a consumer (whether written, oral, or visual) should be in plain and easily understandable terms, not misleading, and should use at least the language that is prevalent in the geographic area in question.**
- b. **Any written communication (including in electronic formats) should use a font size, spacing, and placement of content that makes the communication easy to read for the average person.**
- c. **Key documents, such as consumer agreements, forms, receipts, and statements (including those provided in electronic format), should be provided in a written form that can be kept or saved by the consumer.**
- d. **Written, oral, and visual communications should contain and highlight key features of a given product or service (for example, price and risks) prominently.**
- e. **The regulatory framework should establish the timing of key disclosures to the consumer, particularly during the shopping, pre-contractual, and contractual stages.**

- f. **Standard indicators for total comprehensive cost of a product or service and standard methodologies for the calculation of such indicators should be established by the authority, in order to ensure consistency across PSPs and enable consumers to compare products properly.**
- g. **Adaptations to regulatory requirements should be considered to allow for innovation in product design and delivery with respect to electronic payments, while mitigating potential risks to consumers due to disclosures that may be less comprehensive, more difficult to read, or harder to store.**
- h. **In addition to key product/service features, communication materials should disclose**
 - i. **The regulatory status of a PSP;**
 - ii. **Contact information for the internal complaints handling mechanism of the PSP; and**
 - iii. **Contact information for the relevant external dispute resolution mechanism, if any.**

Explanatory Notes

See the explanatory notes for B1 in chapter 1, “Deposit and Credit Products and Services,” which generally apply to retail payment services as well.

In the case of retail payment services, in addition to the interactions between the consumer and PSP at the time of sign-up for the account or the initial service, there could be additional services to which the consumer subscribes over a period of time. An example of this is a customer who at the time of opening a bank account did not sign up for a debit card or Internet banking services, because those services were not offered at the time. Subsequently, when the bank introduced debit cards or Internet banking, it required additional subscriptions with their own specific terms and conditions. In general, good practices with respect to the format and manner of disclosure should apply to all subsequent interactions as well. However, some specific considerations need to be taken into account. Requiring physical interaction and a physically signed acknowledgement of terms and conditions can be onerous and could, in fact, affect the adoption of addi-

tional services. It is usually more cost-effective for the PSP, and more convenient for consumers, to leverage some authenticated interaction, such as an ATM transaction, to handle additional sign-up processes and the disclosure of information related to such additional services.

PSPs may use their website, call centers, ATMs, and other physical points of presence to communicate standard terms and conditions and any changes to them. Pre-recorded calls, SMS text messages, and social media mechanisms are other channels that are used by some PSPs. These practices should be taken into consideration when designing flexible rules on the format and manner of disclosure for retail payment services. In principle, usage of these mechanisms could be encouraged, provided, however, that PSPs clearly inform customers of the channels being used for such important communications and ensure that consumers understand the information provided. As emphasized by the ITU-T Focus Group Digital Financial Services, it is important that consumers clearly understand the information provided, even when this is done through digital means.²⁴

B2: ADVERTISING AND SALES MATERIALS

- a. **In addition to the general requirements in B1, PSPs should be required to ensure that its advertising and sales materials**
 - i. **Do not contain misleading or false information; and**
 - ii. **Do not omit information that is important to a consumer’s decision to purchase any of their products or services.**
 - b. **A PSP, if applicable, should be required to disclose its regulatory status in its advertising materials.**
 - c. **A PSP should be legally responsible for all statements made in advertising and sales materials.**
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Explanatory Notes

See the explanatory notes for B2 in chapter 1, “Deposit and Credit Products and Services,” which generally apply to retail payment services as well, but note that for many simpler types of payment services, PSPs make very little marketing effort.

Sales and marketing are more often found with respect to international remittances and prepaid instruments, including mobile money and other e-money services. Regarding remittances, advertisements usually focus on cost and speed (in addition to distribution network). Regarding mobile money in developing countries (particularly in Africa), the focus of advertising has been shifting from highlighting how much more convenient it is to send money to friends and family via mobile money transfers than over traditional methods (such as couriers) to the costs (for example, fee comparison) and rewards of such services. For example, payment of interest in the prepaid funds is an emerging practice.

These main elements that are the focus of advertising by PSPs should be aligned with the good practices described above in order to avoid misleading customers, in particular when they are urged to shift from one PSP to another. For instance, if multiple providers of mobile money in a country pay interest, it may be useful if marketing materials use a standard manner to disclose the effective rate of return relative to a common reference account balance, discounting such fees as maintenance fees, and perhaps even to provide the cost of a set of common monthly transactions.

In the case of an international remittance transfer, relevant information to disclose in marketing materials should include

- Fees;
- Exchange rate applied;
- Base exchange rate;
- Fees to be paid by the recipient; and
- Locations where the recipient can receive the funds.

B3: DISCLOSURE OF TERMS AND CONDITIONS

- a. Before entering into a formal agreement with a consumer on the basis of which a payment service may be provided on a regular basis (as compared to ad hoc services), a PSP should be required to inform the consumer in writing (including in electronic form) about the following:
 - i. Identification of the PSP, at a minimum by its full name and address and, where applicable, also by its identification number and contact details
 - ii. Key service features (including risks) and terms and conditions of the agreement
 - iii. All costs, fees, and charges (including from third parties, particularly if related to the use of a payment instrument) that arise or may arise from the agreement, when they can be applied, and how they are calculated
 - iv. How and when the terms and conditions may be altered unilaterally by the PSP, and if, how, and when the consumer will be warned about changes to the agreement (see B7)
 - v. Key rights and responsibilities of the consumer
 - vi. Penalties and any other remedies the PSP may seek to impose in the event of a perceived breach of the agreement by the consumer
 - vii. How disputes with the PSP can be solved, with contact and process information about internal and external dispute resolution mechanisms available (see E1 and E2)
 - viii. A summary of procedures in the event of suspicious, unauthorized, or mistaken transactions, fraud, system malfunctions, or lost or stolen payment instruments and/or authentication information, including contact information, relevant fees and charges, and the parties’ liability in such cases
 - ix. Any transaction restrictions (such as limits on the value of daily transactions or number of withdrawals per month) and balance limits
- b. The PSP should provide a printed or electronic copy of the final agreement containing at least the information listed in clause B3(a) to the consumer at signing.
- c. In addition to the information listed in clause B3(a), the regulatory framework should require specific disclosures in product or service agreements according to the type of product or service being contracted.
- d. If applicable, a COC to which the PSP underwrites should be provided or made available by the PSP to the consumer at signing of the agreement.

- e. Before placing an order for an individual payment transaction, a PSP should inform a consumer in writing (including electronic format) about the following items. Such information should be provided at the first instance, with the option to review again before subsequent transactions.
 - i. Unique information necessary to be provided by the consumer for proper use of the payment instrument concerned (for example, the sender's details, an account number, a telephone number that identifies an e-money or other mobile-based account, PINs/passwords, recipient details, and so forth)
 - ii. Information about time limits relevant for execution of the transaction (including internal, external, debit, and credit transactions), and the point of time from which the time limits count, including the instant of finality and irrevocability of the order
 - iii. All fees and charges charged by the PSP to the consumer and, where applicable, fees imposed by third parties
 - iv. The applicable exchange rate
- f. Separate from the disclosure of terms and conditions for a product or service, a PSP should make consumer guidebooks or similar guidelines available—free of charge on the PSP's website, via other electronic channels where feasible, at branches and agent's outlets, and on request—that cover, at a minimum, the following:
 - i. The proper usage of electronic devices used for making transactions and access codes
 - ii. Security risks involved with devices and abuse of access codes (for example, malware, identity theft)
 - iii. Details of the required security measures to be followed by the consumer
 - iv. Circumstances in which the consumer will be liable for losses (such as certain unauthorized and mistaken transactions)
 - v. Contact details to notify the PSP of any lost or stolen payment instrument or access code, or unauthorized transaction (for example, a customer service hotline)

Explanatory Notes

General principles

Effective disclosure and transparency not only promote greater use of cost-effective payment instruments, but also promote consumer confidence and trust in those instruments and related products. PSPs should always be transparent in stating actual fees and use methods of disclosure that make it easy for the user to compare products and services.²⁵ However, consumers of retail payment instruments and services often are not certain about the real cost of a particular payment instrument. When they rightly or wrongly attribute a higher-than-expected cost to the payment instrument, they tend to reduce its usage.

Lack of full understanding is due in part to the complexity of pricing. Retail payments often involve using another financial service, such as a current account, which could have various levels and types of fees (for example, periodic maintenance fees), and even ancillary services not directly related to the payment function, such as life or non-life insurance coverage, that might result in costs to the consumer. Payment instruments also often involve an element of subscription. For example, to pay using a credit transfer, payers need to sign up for that specific service even though they may already have bank accounts. With respect to costs directly associated with the payment service, consumers might incur different per-transaction fees²⁶ or may be rewarded for using the financial product

and/or associated payment instruments. These additional services and benefits could have a specific price, though a bundled price structure is most often created. All of these scenarios illustrate the difficulties consumers face in determining the unitary cost of their payment services.

Good practice requirements for disclosing terms and conditions of payment services will vary based on whether it is an ad hoc transaction (such as a remittance) or a contract-based relationship on which payment services are provided repeatedly (for example, a mobile money account). Further, specific disclosure requirements are needed for specific services and for suspicious, mistaken, unauthorized, or fraudulent transactions. (See below.) Different types of users of a retail payments service (for example, a payer versus a payee) will require different types of disclosure. Different disclosure requirements may also need to be applied to different types of PSPs (for example, a payer's PSP versus a payee's PSP).

Specific disclosures for transaction accounts

The requirements for transaction accounts are similar to the requirements listed in **B3 in chapter 1, "Deposit and Credit Products and Services."** Specifically, before entering into a contract for payment, current, savings, or prepaid/e-money accounts, the PSP should, in addition to the information listed in B3(a), above, inform the consumer of the following:

- Charges or fees for account opening or minimum balances
- Account maintenance fees
- Applicable interest yield
- Ability to check account balance
- Responsibility of the consumer to keep their personal information confidential, including PINs and passwords linked to the account
- Whether an overdraft facility is included, and the fees and costs in case this facility is used
- Where applicable, charges for issuing and clearing a check, and whether charges vary according to the value of the check
- Where applicable, consequences and costs to the consumer of drawing a check/processing of a direct debit instruction with insufficient funds
- Procedures to countermand or stop a payment on a check/processing of a direct debit instruction/mandate issued by a consumer
- Duration of the contract (particularly if a prepaid account has an expiration date), procedures and fees (if any) for closing the account, and the ability to withdraw the remaining balance
- The rights of the PSP to unilaterally close the account
- What constitutes an inactive account and the rights of the PSP if the account becomes inactive, including applicable charges
- Any guarantee schemes covering the payment service or the absence thereof

Specific disclosures for underlying payment instruments

In addition to the aforementioned disclosure of terms and conditions for transaction accounts and specific individual payment orders, PSPs should also make the following specific disclosures for the continuous usage of certain underlying payment instruments (for example, EFTs; cards, including virtual cards; and e-money):²⁷

- Limits and restrictions in the usage of the instrument (for example, transaction limits, whether it works nationwide, and so forth)
- Responsibility for securing personal information such as passwords and PINs related to the payment instrument and the obligation to protect the security of the payment instrument
- Instructions on how to use the payment instrument (for example, how to make a payment order), including technical requirements in the case they are relevant for

use of the specific payment instrument (for example, specific software needed)

- Rights of the consumer to disable a payment instrument
- Summary of procedures in the event of lost or forgotten information necessary for the authorized usage of the payment instrument (such as a login, password, or PIN), or lost payment instrument, including contact information, and applicable fees and charges
- Expiration date of the payment instrument, if any
- Basis for calculating the exchange rate applied to each transaction in the case of a payment instrument that can be used in foreign countries

Direct debit and direct credit transfers

With respect to direct credit transfers, the consumer (payer) needs to receive confirmation of the receipt of the payment request, confirmation that it will be processed as per a defined timeline, and notification if there are any problems. The consumer also needs information pertaining to when the payee would be paid, the exact amount that will be paid to the payee, and the process for addressing any delays in processing the payment request. In many systems, the consumer increasingly has a choice of receiving confirmations through various channels. In the absence of a confirmation being received, the consumer would have to use other less convenient means, such as contacting the payee to confirm receipt of payments.

In direct debit transfers, the consumer (payer) should receive both a confirmation that an attempt would be made to collect the payment from his/her account on a specified date and also the status of the debit.

Specific disclosure for remittance agreements

A remittance agreement requires many specific disclosures as well. The PSP and the underlying agreement should inform a consumer of the following:

- Total amount in an originating currency that will be paid by a sender
- Total amount in a disbursing currency that will be paid to a receiver
- Fees paid by both the sender and the receiver (and any relevant costs, such as taxes) and the exchange rate
- Time within which the remittance will be available for the receiver
- Whether the above varies according to how the receiver is paid or how much information the sender is able to provide about the receiver
- What documentary proof the recipient is required to provide

- Whether and how the PSP will inform the receiver when the funds are available
- Responsibility for securing personal information, such as passwords and PINs, related to the payment instrument, and the obligation to protect the security of the payment instrument
- Points in a receiving country where the remittance can be disbursed
- Ability (if any) of the sender to revoke the transfer after it has been paid for
- Procedures for error resolution in case the transfer fails, and the contact information for the PSP in the sending and the receiving countries

For example, chapter B of the Australian ePayments Code requires institutions to disclose terms and conditions, ATM fees, and information about changes to terms and conditions (such as fee increases). Institutions are also required to disclose any fees or charges for issuing or replacing devices or passwords, fees and charges for transactions, limits on transactions, a description of trans-

actions that can be performed, and information on how to make a complaint (Article 4). In Hong Kong, Article 40 of the Banking Code of Conduct provides that institutions should make readily available to customers general information relating to the use of e-banking services, including information regarding (a) the customer's liability for unauthorized transactions; (b) all fees and charges that will apply to the e-banking service; (c) relevant statement(s) in relation to protection of customers' personal data; (d) customer obligations in relation to security for the e-banking service, including observing in a timely manner the relevant security measures specified from time to time by the institutions for the protection of customers; and (e) the means for reporting security incidents or complaints. Section 14 of the Reserve Bank of India's Prepaid Instruments Guidelines covers issues related to disclosure and redress mechanisms. It notes that "all pre-paid payment instrument issuers shall disclose all important terms and conditions in clear and simple language (preferably in English, Hindi and the local language) comprehensible to the holders while issuing the instruments" and further specifies what items need to be disclosed.

B4: KEY FACTS STATEMENTS

- A PSP should be required to produce key facts statements (KFSs) for major retail payment services on offer that summarize the main characteristics of the retail payment service.**
 - To increase effectiveness of disclosure, the regulator should set minimum standards for KFSs, including the following:**
 - Being concise and effectively written in plain, easy-to-understand language**
 - Standardized formula for disclosure of all-inclusive total cost or return**
 - Standardized formats deemed to be the most effective for a particular service and the average target clientele**
 - Standardized content, including at least**
 - The identity and regulatory status of the PSP;**
 - The identity of the agent (if applicable);**
 - Key product features, including specific mechanisms used for authentication and identification and risks;**
 - Potential consequences and penalties if consumers fail to meet their obligations in the contract; and**
 - Key contacts for the PSP's complaints handling service as well as for an external dispute resolution mechanism (if any).**
 - KFSs should be signed by the consumer and given prominent placement when attached to the agreement.**
 - PSPs should be required to provide and explain KFSs through convenient channels, including at least the channel through which the particular service is provided.**
 - PSPs should be required to retain copies of KFSs signed by the consumer for a reasonable number of years.**
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Explanatory Notes

See the explanatory notes for B4 in chapter 1, “Deposit and Credit Products and Services,” which generally apply to retail payment services as well.

As an example, the EU Directive 2014/92/EU from 2014, the Payment Accounts Directive, requires member states to ensure that during the pre-contractual stage, PSPs give a “fee information document” to consumers on paper or another durable medium containing the standardized terms in the final list of the most representative services linked to a payment account. Among other requirements, this document should be short, clear, and easy to understand and contain the title “fee information document.”²⁸ In line with the requirement included in the EU directive, the European Banking Authority has devel-

oped a standardized “fee information document” that all PSPs in the member states need to make available to consumers.²⁹ This document is intended to aid both comprehension and comparability. KFSs are also a good means to highlight key information to consumers in simple language and in local languages.³⁰

In the case of retail payment services, KFSs should highlight the potential consequences when consumers fail to meet their obligations. For example, if consumers do not take reasonable steps to protect their authorization code, it may be difficult to recover money from fraudulent transactions. Or if consumers do not report an unauthorized transaction within a certain time period after becoming aware of it (such period should be clearly disclosed), they may not be able to recover the funds.

B5: TRANSACTION RECEIPTS

- a. **Unless agreed otherwise, a PSP should be required to provide to a consumer a receipt in writing (including electronically) for any transaction executed by the PSP on the consumer’s account (for both debit and credit transactions) at the time when**
 - i. **The transaction order is placed by the payer to confirm that the specific order has been placed;**
 - ii. **The transaction order/initiation is received by the PSP to confirm that the specific transaction order/initiation has been received; and**
 - iii. **The transaction is executed.**
- b. **After a transaction is executed, both the payer’s and the payee’s PSP should issue a receipt that includes, at a minimum**
 - i. **The PSP’s name, address, and licensing/registration number, if one has been assigned;**
 - ii. **In cases where an agent has been involved, its details;**
 - iii. **The amount, date, time, and nature of each transaction;**
 - iv. **The transaction reference number;**
 - v. **All fees and charges for the transaction, on an itemized basis;**
 - vi. **Details of the relevant counterparty (payer or payee);**
 - vii. **The exchange rate, where relevant; and**
 - viii. **Identification details of the instrument and/or device used to perform the transaction.**
- c. **Notwithstanding clause B5(b), the transaction receipt should not allow a third party to identify the consumer.**

Explanatory Notes

Given the prevalence of electronic payments, transaction receipts are crucial, as they often present the only evidence readily available to consumers that proves their transactions. While PSPs usually carefully document transactions on their customers’ accounts, such records may not be available to consumers. These receipts may serve not only for consumers’ personal records, but also in disputes with PSPs, merchants, or other consumers (payers/payees). If not immediately available at the time a transac-

tion order is placed, an order/initiative is received, or a transaction is executed, receipts should be provided within a reasonably brief time period thereafter, in accordance with general good practice in the industry.

Examples of such requirements can be found in the European Union, where Article 64 of Directive 2015/2366, the revised Payment Systems Directive of 2015 (PSD2), states that PSPs should be required to provide a receipt for payments either at the time the payment is transmitted or when it is received by the payee.³¹ In Uganda, custom-

ers should immediately receive written confirmation of the execution of a transaction, including the fee charged.³² The Central Bank of West African States requires that for every e-money transaction, a receipt needs to be given to the client, indicating the transaction number, the type of transaction, the name of the e-money issuer, the identity of the sender and receiver, the amount of the transfer, and transaction fees.³³ In Australia, Article 5 of the ePayments

Code requires subscribers to take “reasonable steps” to offer users a receipt for all transactions at the time of the transaction. The code goes on to note that this requirement does not apply in certain cases, such as with respect to low-value facilities or direct debit arrangements, where transactions are clearly identifiable on a statement. In the case of low-value facilities, the subscriber must give consumers other means to check transaction histories.³⁴

B6: STATEMENTS

- a. A PSP should issue and provide a consumer, free of charge, periodic statements of every account the PSP operates for the consumer for which a balance can remain on the account.
- b. PSPs should be required to provide the consumer with a closing statement when an agreement is terminated or concluded.
- c. The PSPs should preferably make statements available using at least the channel through which the payment facility was sold (that is, aligned to the manner in which the agreement was initially signed).
- d. The frequency with which statements are provided should be commensurate with the type of service and its term, in particular to allow customers to become aware of any unauthorized transactions.
- e. In general, statements for transaction accounts, with regard to the period covered, and depending on the type of product, (i) list the opening and closing balances and any repayment made in the period; (ii) list all transactions in the period; (iii) indicate the counterpart of each transaction (for example, a retail establishment where a credit/debit card purchase was made); (iv) provide details of the interest rate applied to the account; (v) provide details of the fees, exchange rate and other charges incurred by the customer in each transaction; and (vi) indicate any changes applied to the interest rates or fees. (See B7.)
- f. Statements should also generally inform the consumer regarding
 - i. The regulatory status of the PSP and contact number for its customer service and complaints handling mechanism; and
 - ii. Contact information for the external dispute resolution mechanism.
- g. Regulation should impose specific requirements for statements linked to the most commonly used retail payment services, which may include standardization of minimum content, format, and terminology, as well as frequency, timing, and manner of delivery.
- h. For certain accounts such as prepaid cards and other e-money services, in lieu of a regular statement, PSPs should have the option of providing consumers with easy access to check the account balance and transaction history.

Explanatory Notes

See the explanatory notes for B5 in chapter 1, “Deposit and Credit Products and Services,” which generally apply to retail payment services as well.

For retail payment services, requirements regarding the regular provision of statements should be calibrated to the complexity of the payment service in question. Issuing statements represents a non-trivial cost to PSPs, and there is often an attempt to reduce the frequency and issue statements only when there is some activity.³⁵

Exemptions or more flexible approaches to the provision of statements may be warranted for certain prepaid

product categories, such as prepaid cards and e-money wallets, with a greater emphasis on providing easy access to check account balances instead. In some cases, PSPs do not issue statements for e-money products and basic bank accounts. In these cases, the customer might be notified for every transaction and offered some form of a limited statement—for example, an electronic summary of the last five transactions conducted, with additional information available upon request and also through automated interactive voice-recording mechanisms. For example, in Uganda, mobile money service providers are obliged to provide in writing the balance remaining in the

customer's mobile wallet, as well as a statement on previous transactions, including hard copies if requested by customers.³⁶ Article 7 of the ePayments Code in Australia requires subscribers to give statements of transactions to

consumers, though it includes an exception for low-value facilities, where subscribers alternatively must give consumers a process for checking the balance of their facility and their transaction history.

BOX 5

Statements for Mobile Money Accounts?

Mobile money—a transaction account opened and managed exclusively through mobile phones and mobile money agents—allows the account holder to make several types of debits and credits to the account. Despite its popularity in many developing countries, in particular in East Africa, South Asia, and some Pacific Islands, and despite usually providing free account balance enquiries, mobile money usually does not provide consumers with periodic account statements where they can check the current account balance, all transactions conducted, and fees charged, as well as the existence of any charges

related to other products attached to the account, such as mobile insurance and small loans.

Regulators should be careful to avoid excessive or inappropriate requirements for statements for products delivered electronically, which may have unintended negative impacts on financial inclusion. However, at a minimum, it should be easy for mobile money account holders to access, through their mobile phone, account balances and information about transactions performed in their mobile money accounts going back a certain time period (aligned with requirements for digital recordkeeping).

B7: NOTIFICATION OF CHANGES IN RATES, TERMS, AND CONDITIONS

- a. A PSP should be required to notify its consumers, at least in writing (including in electronic form) and also orally or through other channels or means if deemed necessary, prior to any change in
 - i. Any fees charged to the consumer (for example, transaction fees, or overdraft fees); and
 - ii. Any other key product feature or previously agreed term or condition (such as procedures for cancellation, liability, or contact information for notification of unauthorized transactions).
- b. A PSP should notify consumers in case their transaction accounts have become inactive or dormant, and state the related consequences, including applicable charges. The notice should be given within a reasonable period in advance of the effective date of the change.
- c. The nature and extent of the change, particularly its potential impact on the customer, should dictate the required format and the length of the notice, and whether personalized, individual notification to a customer is required.
- d. If the revised terms are not acceptable to the customer and were not foreseen in the customer's original agreement, the regulatory framework should guarantee the customer's right to exit the agreement without penalty, provided that such right is exercised within a reasonable period, as established in the original agreement.
- e. Along with the notice of the change, PSPs should inform customers of their foregoing rights and how they can be exercised.

Explanatory Notes

See the explanatory notes for B6 in chapter 1, "Deposit and Credit Products and Services."

With regard to transaction accounts, it is particularly important that PSPs have policies establishing when

accounts are considered dormant and how this should be dealt with, including giving notice to customers.³⁷

C: FAIR TREATMENT AND BUSINESS CONDUCT

C1: UNFAIR TERMS AND CONDITIONS

- a. A PSP should be prohibited from using any term or condition in a consumer agreement that is unfair. If used, such terms and conditions should be considered void and legally unenforceable.
- b. Except where expressly permitted by law, in any agreement with a consumer, a term should be deemed to be unfair if it excludes or restricts any legal requirement on the part of a PSP to act with skill, care, diligence, or professionalism in line with industry best practices toward the consumer in connection with the provision of any product or service and/or any liability for failing to do so.
- c. Product regulation and rules pertaining to product suitability should also play a role in shaping terms and conditions that are not harmful to consumers, in a balanced and flexible fashion that allows for innovation.

Explanatory Notes

The terms and conditions of service provision are typically documented in some form of an agreement between a consumer and its PSP. The terms and conditions need to be fair and to bind the PSP to good business conduct. For example, a term should be deemed to be unfair if it effectively deprives a consumer of access to justice in the case of a dispute with a PSP.

In some jurisdictions, PSPs are required to submit these terms and conditions to the authority for review or for information. The authority is then empowered to require the PSP to make changes to uphold consumers' interests and also to ensure for safety and efficiency of the national payment system. For example, Bank Negara Malaysia (BNM) has several powers in relation to the specific terms and conditions of a product. In fact, not only do payment instruments have to be approved by BNM, but BNM may also require a PSP to make modifications to a

payment instrument or any document related to it for various reasons, including in the interests of the public.³⁸

Over time, supervisors and regulators have discovered and addressed several critical issues with respect to transaction accounts. This often has involved aspects related to closing fees (the fee levied to close an account) and maintenance fees (the fees for keeping an account in operation). In cases where the customers have not fully understood these fees, they may be surprised to find that their account balances have been depleted and that they are unable to recover the full balance when they close their accounts. These fees by themselves are not abusive unless they limit customer mobility (see also C3), as at times these are integral to the way the payment product is designed and necessary to make the business model work. However, it is important to ensure that customers are fully aware of these fees not only up front but also when such fees are being incurred. (See also B3 and B7.)

C2: UNFAIR PRACTICES

- a. At all stages of the relationship, a PSP should be required to treat consumers fairly.
- b. PSPs should be required to consider the outcome for consumers of their products, services, procedures, strategies, and practices, to ensure compliance with clause C2(a).
- c. A PSP should be prohibited from, and held legally accountable for, employing any practice that could be considered unfair.
- d. The regulatory framework should also prohibit specific unfair practices related to particular retail payment products and services.
- e. Bundling and tying practices should not be permitted when such practices unduly limit consumer choice or hinder competition.

Explanatory Notes

Unfair, deceptive, or abusive acts and practices should be prohibited. These might include discrimination, violation of the consumer's right of privacy, or participation in corruption or kickbacks. In addition to blatantly abusive conduct, other behaviors might lead to unjust treatment of a customer.

Regarding transaction accounts:

- A PSP should be prohibited from charging maintenance fees on accounts that have reached zero or have a negative balance for an unreasonably prolonged period.
- A PSP should be prohibited from imposing fees and charges related to unsolicited automatic overdraft facilities.

Regarding credit cards and other payment cards:

- PSPs should be prohibited from sending an unsolicited pre-approved credit card, debit card, or prepaid card to a current or potential consumer and charging the consumer any fees related to the card that have not been accepted by the consumer.
- PSPs should be prohibited from charging up-front fees on sub-prime credit cards/overdraft products issued to individuals with bad credit histories.

Regarding money remittances, unless the service exclusively consists of account-to-account services, a PSP should be prohibited from

- Requiring a prospective consumer to use the services in order to be given cost information about a specific transfer; and
- Requiring a consumer to open an account simply in order to effect the transfer.

With respect to dormancy, banks and other PSPs increasingly face a per-account maintenance cost regardless of whether the account is active or not. In addition, in some jurisdictions, banks and PSPs are required to maintain the account for a particular period of time, even when the account is dormant. This can result in banks and other PSPs charging customers even when accounts are dormant and sometimes levying fees over a period, resulting in the remaining balance being consumed and, in some cases, even going negative.

In such cases, authorities should consider rules governing fees charged for dormant accounts in order to balance the negative impact on banks and PSPs with the impact on customers. In several jurisdictions, bank and PSPs are required to effectively disclose their rules and policies around this matter and to provide customers adequate notice. In addition, PSPs could be required to change the status of such accounts after a pre-announced period of inactivity and charge reasonable fees for reinstating an account. Accounts with inactivity beyond a particular period of time could be closed permanently.

For example, all prepaid payment instrument issuers in India are required to disclose all important terms and conditions in clear and simple language, including (i) all charges and fees associated with the use of the instrument and (ii) the expiration period and the terms and conditions pertaining to expiration of the instrument.³⁹ Additionally, given that pre-paid instruments expire, issuers are required to warn the holders at reasonable intervals during the 30-day period prior to expiration of the validity period before forfeiting outstanding balances. This requirement helps to remind consumers of the existence of prepaid accounts that they may have forgotten or have otherwise left dormant with unused balances.

In many instances, the bundling of retail payment services with other financial services (such as current accounts) is done as a means to achieve efficiencies. For example, banks often encourage customers to subscribe to debit cards to increase use of electronic transactions, rather than services rendered at bank branches, which are more costly to banks. These are situations in which there is usually a link between the two products sold. However, at other times, bundling can be sought purely as a profit-making tool, such as when credit or debit cards are pushed onto consumers applying for a loan. In this situation, the two products are not directly linked, and tying implies raising the risks to consumers. Authorities should try to differentiate between bundling practices that are standard and reasonable and those that are unfair.

If the acquisition of a product from a PSP requires a consumer to purchase a legitimate subsidiary product or service, the consumer should be granted the right to choose the provider of the subsidiary product (where feasible) and informed of this right in writing before the acquisition takes place.

C3: CUSTOMER MOBILITY

- a. PSPs should be prohibited from unduly limiting a customer’s ability to cancel or transfer a product or service to another provider, on the customer’s reasonable notice.
 - b. PSPs should be required to provide comprehensive information about its cancellation and portability procedures to consumers, including when products and services are delivered through agents or digital channels.
 - c. PSPs should only be allowed to charge reasonable cancellation fees and only where such fees are set out in the consumer agreement, which should also contain its method of calculation.
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Explanatory Notes

PSPs generally try to make their products sticky—that is, they encourage customers to continue using their services and, at times, make it difficult for customers to move to other PSPs. For example, PSPs invest significant efforts to make their customers use services such as direct debit, standing instructions, and bill payments, and they offer reward programs to increase customer loyalty. These efforts of PSPs are not against consumer interests by their basic nature, but PSPs should enable customers to terminate these arrangements in a quick and efficient way.

For example, when debit orders are used for recurring payments, payers should be able to cancel with reasonable ease the general mandate they gave to the payee to charge their account for the service. The ability to easily cancel a recurring payment instruction for a designated

future date is also an important consumer protection feature. In addition, regulators should consider approaches to enable easily shifting arrangements like mandates for direct debits from one PSP to another.

One approach that is gathering some attention is the account number portability initiative in the European Union. The EU Payment Accounts Directive of 2014 states that member states must make sure that PSPs allow for a switching service between payment accounts held in the same currency to any consumer who opens or holds a payment account with another PSP within the same member state.⁴⁰ The directive further provides details on how the switching service should function (for example, payments should be processed upon receipt of the authorization) and what information should be provided to consumers in relation to switching services.

C4: COMPLIANCE AND PROFESSIONAL COMPETENCE

- a. A PSP should be required to ensure that all relevant staff members and third parties acting on its behalf meet competency requirements, including familiarity with the products and services sold to consumers and financial consumer protection principles and rules.
 - b. A PSP’s board of directors should bear ultimate responsibility for ensuring effective implementation of training and competency requirements, and there should be an established system to ensure the board of directors is adequately informed and able to take corrective action when needed.
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Explanatory Notes

See the explanatory notes for C6 in chapter 1, “Deposit and Credit Products and Services.”

C5: COMPETITION AND INTEROPERABILITY

- a. A PSP should be prohibited from engaging in anti-competitive practices.
- b. Financial sector regulators, payment system overseers, and competition authorities should consult with each other for the purpose of developing, applying, and enforcing consistent policies in relation to the regulation of providers of payment services. In particular, cooperation could concern the following:
 - i. Monitoring competition in relevant markets
 - ii. Conducting and publishing periodic assessments of competition in relevant markets
 - iii. Making recommendations publicly available on enhancing competition in relevant markets
 - iv. Encouraging the use of online tools for comparing price and other terms and conditions in relevant markets, and monitoring such use
 - v. Encouraging interoperability
- c. PSOs should be required to institute fair, transparent, and risk-based participation requirements enabling a wide variety of PSPs to access their services and enable interoperability.
- d. A PSP should be encouraged to avoid exclusivity agreements with agents and merchants in a way that unduly limits the use of the agent network and infrastructure by other financial service providers.

Explanatory Notes

With respect to payment services, several competition aspects arise at the relevant payment system and overall national payment system levels. For a complete discussion on this topic, see the 2008 World Bank publication *Balancing Cooperation and Competition in Retail Payment Systems: Lessons from Latin America Case Studies* and the 2012 World Bank publication “Developing a Comprehensive National Retail Payments Strategy: Consultative Report.” In this annex, the focus is on specific aspects at the PSP level.

Interoperability

In general, fostering interoperability is a key policy action of payment system overseers. This stems from the positive impact interoperability has on efficiency for the overall national payment system and also for consumers. Achieving interoperability requires several different elements to be in place: an effective payment system infrastructure in which interested PSPs can participate; appropriate pricing and business rules, to make it commercially viable for the participants to participate; and effective oversight arrangements, to ensure that the payment system infrastructure remains safe, reliable, and efficient.

In the context of retail payment services, interoperability is often discussed regarding payment card systems. However, it is also relevant for EFT-based products—for example, co-existence of two or more automated clearinghouses (ACHs) for the same payment instruments that offer the same or very similar services to their respective participants.⁴¹ There is also the case of infrastructure-level

interoperability, whereby the same infrastructure can be used to support multiple payment mechanisms. This is especially relevant for innovative payment products, since without some basic interoperability with more traditional payment instruments and systems, their acceptance and/or usefulness for consumers might be very limited.

Access to payment systems

It has been a long-standing best practice advocated by payment system overseers to require payment systems to have a fair, transparent, and risk-based access criteria. This best practice has been in place in several international standards, including the CPMI Core Principles for Systemically Important Payment Systems, issued in 2001, and the CPMI-IOSCO Principles for Financial Markets Infrastructures, issued in 2012. While these standards are generally considered applicable only for systemically important payment systems, the specific principles have been widely adopted for retail payment systems as well and have also been included in payment systems-related legislation in several jurisdictions.

For example, the PSD2 requires member states to ensure that the rules on access for authorized or registered PSPs are objective, non-discriminatory, and proportionate, and that they do not inhibit access more than is necessary to safeguard against specific risks, such as settlement risk, operational risk, and business risk, and to protect the financial and operational stability of the payment system.⁴² In Bangladesh, regulation specifies that banks may link their mobile financial services with those of other banks for the convenience of users and that their mobile account may

be linked with a customer's bank account (if any).⁴³ In Jamaica, regulation requires that arrangements to ensure interoperability should be adequate.⁴⁴

Agent exclusivity

The participation of a PSP in an interoperability arrangement by itself does not address all anti-competitive aspects. There is the additional aspect of the contractual restrictions that PSPs can potentially place on their agents, merchants, and other service providers, restricting them from entering into similar service provision arrangements with other PSPs. The 2007 CPMI-World Bank General Principles for International Remittances discusses the negative impacts of agent exclusivity arrangements on the remittances market. This discussion is directly relevant also for agents often used in the provision of e-money services. Several jurisdictions now require non-exclusivity arrangements for agents for

remittances and e-money markets. For instance, to address the issue of agent exclusivity, the Reserve Bank of Zimbabwe has created a requirement in its Electronic Payment Systems Guidelines that provides: "[w]here a payment system provider requires entering into exclusive arrangements with an agent; the payment system provider shall apply to the Reserve Bank justifying why such an agreement is necessary."⁴⁵

In Bangladesh, for both mobile money and banking agents, prior approval of the agency agreement by the Bank of Bangladesh is required, and the regulation on banking agents specifies that they can be inter-operable as long as the agent ensures that there are no amalgamations, overlapping, and/or intermixing in the database of customers of different banks.⁴⁶ In India, regulation permits an agent to represent more than one bank, but a retail outlet or sub-agent can only represent one bank.⁴⁷

C6: AGENTS

- a. A PSP should be legally liable for the actions and omissions of its agents.**
 - b. A PSP should be required to perform appropriate due diligence before contracting with any agent or agent network manager.**
 - c. A PSP should be required to continuously monitor the performance of their agents, including adherence to regulatory requirements (including applicable consumer protection laws and regulations) and internal policies and procedures.**
 - d. The agency relationship should be governed by a formal agency agreement between the agent and the PSP.**
 - e. The authority should have legal or regulatory powers to review and require changes to agency agreements, assess the activities of agents and agent network managers, and take appropriate action upon any case of non-compliance with the consumer protection framework.**
-

Explanatory Notes

Several e-money products and remittance services use agents. In some jurisdictions, agent-based models are also allowed for traditional bank accounts. In agent-based models, in addition to the underlying acceptance infrastructure, the agent is the main point of contact for the customer. Agents could be used to facilitate account opening in terms of collecting documentation, deposit and withdraw cash, apply for additional products and services, and finally make in-person remittances and bill payments.

In large-scale agent networks, such as that used by FINO in India and M-Pesa in Kenya,⁴⁸ additional entities are involved to provide cash-management services to agents. These are often referred to as super-agents or agent network managers. The super-agents typically hold the accounts of the agents and facilitate conversion of the

agents' e-money balance to cash balance in their regular bank accounts and also, in certain cases, provide overdraft facilities to the agents. The agents in addition could also engage sub-agents.

The above model also applies to agent-based payment services using other mechanisms for transaction initiation, such as when the payer uses a smartcard at the agent's POS terminal to initiate a range of transactions, including remittances, cash deposits, and cash withdrawals.

The increasing reliance on agents to deliver innovative retail payment mechanisms raises the policy issue of how these entities need to be overseen and supervised. Authorities can choose either to authorize such entities themselves or to impose full liability for the behavior of the agent on the principal entity for which services are provided. The former implies a direct monitoring by the central bank of agents/branches. This may be too burdensome

operationally and disproportionate in respect to concrete risks. Authorities can also maintain a list of agents from which an agent can be withdrawn in cases of misconduct. Conditions could also be imposed to limit the use of agents and outsourcing to non-core activities and to ensure continuous control by the principal over the third party.

In general, in all jurisdictions, the PSP engaging the agent should be made responsible for compliance of the agent with prevailing regulatory requirements in the areas of consumer protection, AML/CFT, and other payment service provision-related aspects. Further, in line with Principle 6 of the G20 High-Level Principles on Consumer Financial Protection and the ITU-T Focus Group Digital Financial Services,⁴⁹ regulation should ensure that providers are legally liable for the actions and omissions of their agents, including when agent network managers are used to select and conduct on-boarding of individual agents.

Certain elements of agent-based models vary significantly across the world. These elements include:

- Which institutions can engage agents
- Types of entities
- Registration versus licensing
- Sub-agents and tiered arrangements
- Services permitted to be provided by agents
- Remuneration model for agents
- Qualification and training for agents
- Technology and operations
- Exclusivity requirements and interoperability

The choices made with respect to these elements have a bearing on consumer protection, in particular remunera-

tion models for agents. In general, best practice is to have the principal PSP, not the customer, pay all fees and commissions of an agent directly. The agent could, of course, collect fees for specific services on behalf of the principal. Risk management of agents has general implications for consumer protection. For example, the following items related to risk management for PSPs have a bearing on consumer protection:

- Offering customers an independent means of verifying completion of a transaction and not requiring customers to depend on the agent giving oral information. This could be in the form of a confirmation message delivered to a customer's phone from a pre-established number and in a pre-established format; delivery of a physical record of transaction completion; or an automated call-back from a pre-established number confirming completion of the transaction.
- Exercising adequate due diligence in signing up new agents.
- Establishing a compliance and awareness program for agents on specific issues, such as typical fraud typologies, AML/CFT, data security awareness, conveying messages on security to customers (such as the need to secure and safeguard their PINs), and so forth, and applying them rigorously through a combination of on-site audits and off-site validations.
- Establishing clear branding guidelines and educating customers about what transactions are allowed at agents and the process for the conduct of those.

C7: PROTECTION AND AVAILABILITY OF CUSTOMER FUNDS

- a. **A PSP should be required to have organizational, legal, and risk-management arrangements in order to segregate or otherwise protect the assets of consumers from the assets of the PSP, for any store of value product it may offer.**
- b. **PSPs should be required to ensure that customer funds are readily available, including by making convenient channels available for withdrawal. Specific liquidity requirements or limitations to the use of funds may be imposed for certain services, such as e-money offered by nonbank PSPs.**

Explanatory Notes

Electronic payment services need an underlying account against which transactions made by the user are recorded. The nature and type of account has an important bearing on the level of protection offered to consumers. One of the innovations underlying e-money services is the use of a particular type of account created specifically for the purposes of supporting prepaid instruments. Prepaid accounts are pre-funded accounts from which funds are then drawn

down through payment transactions. They are usually subject to different regulations and requirements than those applicable to regular deposit accounts. For instance, such accounts may allow simplified customer due-diligence procedures (including credit and documentation checks), easing the enrolling of customers (particularly low-income consumers). Nonbank institutions may be allowed to issue these accounts since they are usually limited in their functionalities, maximum balance, and transaction values.

Customer funds are broadly subject to two risk categories: (i) the risk of the issuer of the payment instrument or the bank holding the underlying funds going bankrupt and (ii) operational issues with the issuer's system that could result in unauthorized access, destruction, or corruption of records of the customer's account. For payment services based on a bank account, these risks are generally addressed as part of the overall prudential and operational requirements imposed on the bank, as well as by deposit insurance and/or other safety net arrangements. **(See section F.)**

Nonbank issuers or prepaid accounts might not be covered by such arrangements. In such cases, other mechanisms to mitigate risks should be imposed by regulation, such as a "ring-fencing requirement"—that is, a requirement for the PSP to deposit an amount equivalent to the total amount collected from e-money customers in one or more banks in accounts separate from the issuer's regular business account(s). This requirement should be coupled with requirements to ensure that access to these dedicated accounts is limited to a few designated staff and closely monitored by the PSPs, to ensure the safety of the funds. An additional layer of protection can be provided by guaranteeing the customers' legal ownership of the funds in the pooled account by establishing a trust (or similar) account that is managed on behalf of the customers either by the PSP itself or by a trustee. This arrangement protects customers against the PSP's creditors in the case of bankruptcy.

For the above to work in the case of PSP failures, adequate mechanisms for sound recordkeeping of individual customer accounts also need to be put in place by the PSP, and information about each consumer account balance needs to be constantly updated and available. In some jurisdictions, the nonbank e-money/prepaid instrument issuer is required to communicate periodically (for example, daily) the list of underlying account holders (along with their balances) to the bank maintaining the pooled funds. The banks maintaining non-traditional bank accounts are

required to record the details of such accounts on an ongoing basis in their main systems as well.

For example, in Paraguay, Article 15 of the Central Bank Regulation No. 18 of 2014 establishes that segregated funds corresponding to the total amount of funds held by e-money users must be deposited in one or more trust accounts in depository financial institutions licensed by the Central Bank of Paraguay. In Zimbabwe, Section 8.1.1 of the Reserve Bank of Zimbabwe's Electronic Payments Guidelines provides the following requirement relating to trustees and trust accounts: "approved electronic payment service providers and participants have a direct responsibility to ensure that electronic wallet or money (e-money) balances are ring fenced through the establishment of Trust Accounts." In the European Union, both the PSD2 (for nonbank PSPs) and the second Electronic Money Directive⁵⁰ (for e-money providers) establish analogous protections.

Closely related to the issue of ring-fencing customer funds is the need for these funds to be readily available as per the provisions of the product offering. In the case of retail payment products offered by banks, there usually are well-specified requirements, such as specific banking hours, operational hours for various services, and so forth. These also need to be considered for other payment services offered by nonbank PSPs as well. Additionally, many regulations on e-money services impose liquidity requirements on the pooled account, by limiting the types of investments that can be done using pooled funds (for example, liquid or semi-liquid assets, such as low-risk government bonds).

The above measures would still leave the customer exposed to the risk of destruction of records and fraud, which would need to be addressed by requiring appropriate operational reliability and business-continuity procedures for nonbank PSPs and non-traditional bank accounts **(see C10, "Operational Reliability")**, as well as strong authentication and fraud-prevention requirements. (See C8, below.)

C8: AUTHORIZATION, AUTHENTICATION, AND DATA SECURITY

- a. PSPs should be required to implement minimum security requirements for transactions and account opening, particularly transactions conducted remotely through electronic channels. The regulation should be technology-agnostic by not determining the specific types of security technologies and transaction devices that should be used by PSPs.**
- b. PSPs should be required to use trustworthy means for client identity verification regardless of the channels used for transaction.**
- c. PSPs should be required to use strong authentication methods, including means for renewal of expired, compromised, or forgotten authentication details, for consumers to effect payment transactions and use payment instruments and channels, including ATMs, branches, merchants, agents, internet, mobile phones, and so forth.**

- d. A PSP should be required to
 - i. Have policies and procedures to protect consumers' funds against internal fraud (that is, by staff, including senior management and board, or agents) and external fraud (by third parties such as hackers); and
 - ii. Have a governance structure, including clear policies and mechanisms to investigate and decide upon cases of staff involvement in fraud.
- e. A PSP should be required to train its staff and agents to conduct verification of a consumer's identity.
- f. PSPs should be required to have mechanisms to foster awareness of security measures that consumers need to adopt to protect their payment accounts against frauds (for example, hackers), including authentication methods.

Explanatory Notes

Authentication and authorization

Payment initiation and access to sensitive data should be secured by strong customer authentication, which may include a procedure based on the use of two or more authentication elements. Ideally, at least one of the elements should be non-reusable and non-replicable, and the two elements should not rely on the same media. (For example, both should not be stored or generated by one device, in order to minimize the risk if the device is accessed by a non-eligible party.) All payment transactions need to be authorized in the manner agreed between a consumer and a PSP.

PSPs (including banks) should be required to institute graded authorization⁵¹ requirements based on the strength of customer authentication, the nature of the transaction,⁵² transaction attributes, and other contextual information.⁵³ For example, technical standards in this area have been adopted in the European Union under the PSD2.⁵⁴

With respect to contextual information, different authentication mechanisms could be envisioned for different types of customers. For certain transactions of corporate customers, more sophisticated authentication/authorization mechanisms could be used, such as the ability to assess the risk profile of a transaction on the fly and multi-level approval. (That is, one transaction needs to be approved by several people.) For retail customers, PSPs may impose maximum transaction limits and, in turn, use simpler authentication mechanisms, such as through a one-time password/PIN sent to a customer's registered mobile phone.

Prevention of fraud

Even in the presence of authentication mechanisms, fraud can still happen, both internally and externally. A PSP should be required to have policies and procedures to prevent, detect, and deal with external and internal frauds, including a governance structure and clear policies to investigate and decide upon cases of staff involvement

in fraud. Transaction monitoring is one element that should complement authentication mechanisms to prevent, detect, and block fraudulent payment transactions as part of a broader risk-management framework at PSPs.

Specific minimum standards in this area that could be integrated in a country's regulatory framework include the following:

- Requiring express customer consent for enrollment in specific services like Internet banking, mobile banking, and debit cards
- Robust activation procedures for each of these services, potentially requiring an interaction with the customer through one of his or her registered phone numbers
- Requiring PSPs/PSOs to have an internal board-approved risk-management procedure for electronic payment mechanisms that should also include, in particular, ongoing fraud risk monitoring, having a specialized team to manage all these tasks, and an external review by an accredited information technology security auditor at least once a year or upon substantial changes
- Requiring all outsourced operations that involve sensitive account or personal information of customers to be subject to same stringent requirements as for internal systems
- Specifying minimum authentication requirements (for example, two-factor authentication)
- Requiring banks, PSOs, and PSPs to institute mechanisms to allow their participants and customers to report fraud and, in the case of PSOs, to institute mechanisms for transmitting the fraud information to other involved participants and mechanisms for monitoring the reported fraud and incorporating this analysis in their ongoing risk assessments
- Requiring banks, PSOs, and PSPs to report all frauds to PSOs and other relevant authorities and establishing ongoing monitoring of fraud trends as part of the oversight activities of the authorities

- Requiring all transactions to be authorized by both the user and the issuer of the payment product
- Submitting information technology security audit reports to the relevant authorities, and the authorities also conducting their own audits, if needed
- Adopting specific standards, such as ISO 270001 for all PSOs and PSPs, as well as Payment Card Industry Data Security Standards for card networks.

Storing of customers' information

Electronic payment transactions are underpinned by the creation and distribution of a set of data elements like PINs, the exchange of confidential information between the payer and payee, which could potentially flow through various entities, and the storage of a set of data elements.⁵⁵ The fundamental principle should be that only the necessary set of data elements should be exchanged and stored, and when exchanged or stored, information that can be directly used for conducting a fraudulent transaction or that can be re-purposed for conducting fraudulent transactions should be encrypted using a mechanism that achieves the best balance between transaction efficiency and safety considerations.

For example, in China, the Administrative Measures for Non-Bank Online Payment of 2015 require nonbank PSPs to take effective protective measures for the security of their clients' personal information and to adopt risk-control systems. The measures restrict the storage of clients' sensitive information, such as track information or chip information of their clients' bank cards, their verification codes, or passwords. In principle, PSPs are not allowed to store the effective term of the bank cards, unless they are stored for special business needs or pursuant to authorization by the clients and the banks opening the bank cards.

Further, this information must be encrypted prior to storage. PSPs are required to sign agreements with merchants prohibiting them from storing sensitive information of their clients and to adopt supervisory measures, such as periodic checks and technical monitoring. If the merchants store sensitive information in violation of the agreement, the PSPs are required to promptly suspend or terminate their provision of online payment services for these merchants and to adopt effective measures to delete the sensitive information and to prevent disclosure of it. The PSPs may also be liable for losses and liabilities caused by the disclosure of relevant information.

Consumer guidelines

With respect to engaging consumers in protecting their payment accounts, PSPs should be required to inform consumers about their obligations to protect their accounts and conduct transactions in a safe manner. PSPs should strive to provide clear and easy-to-understand information and the necessary tools and procedures for customers to exercise care in handling sensitive information (such as PINs), monitor their accounts regularly, and inform the PSP in a time-bound manner whenever they detect any problems. Good practices include providing detailed up-to-date information on common fraud patterns, such as phishing, and information on tools, such as anti-virus software.

This section draws inputs from the *Assessment Guide for the Security of Internet Payments* developed by the European Forum on the Security of Retail Payments⁵⁶ and published by the European Central Bank in February 2014,⁵⁷ as well as the various guidances on authentication standards published by the Federal Financial Institutions Examination Council.⁵⁸

C9: UNAUTHORIZED AND MISTAKEN TRANSACTIONS AND LIABILITY FOR LOSS

- PSPs should be required to effectively disclose to consumers the situations constituting fraud or unauthorized or mistaken transactions; a consumer's obligations in such situations; and limitations to consumer liability for losses in such situations.**
- In principle, PSPs should be held legally liable for breaches in data security that result in losses for a consumer.**
- A consumer's liability for losses from unauthorized transactions should be limited to a maximum amount specified by law, except in cases of consumer fraud or gross negligence.**
- PSPs should be required to provide evidence that the conditions for the consumer's liability for loss have been met.**
- A PSP should be required to provide timely and necessary assistance to consumers to recover mistakenly transferred funds.**

- f. PSPs should be required to have clear procedures to deal with security breaches and supposedly unauthorized transactions, including mechanisms to reimburse or compensate the consumer for losses.**

Explanatory Notes

The use of electronic means might generate mistakes or mismatches of data. In particular, in the case of EFTs, errors in the information provided about the recipient and the payment itself might result in either a misdirected payment or wrong processing of the payment.

In the case of EFTs, and in particular in the case of debit transfers, erroneous execution, an inadequate balance in the account due to some other unexpected payment from the account, and other operational issues could result in the payment being unsuccessful. The impact of such an unsuccessful payment could reach beyond the underlying transaction. For example, delays in paying a telephone bill could result in the suspension of phone service.

PSPs should be required to take steps to minimize the likelihood of errors and have clear processes for resolving such errors, and all other situations should be adequately prevented and rapidly corrected.⁵⁹ For example, the ITU-T

Focus Group Digital Financial Services states that PSPs should have in place transaction authentication procedures to minimize mistakes, as well as procedures, including specialized and adequately trained staff, to solve such errors and provide guidance to consumers.⁶⁰

In addition, a clear mechanism for allocating responsibilities should be in place. To this end, the tendency has been to allocate liability to the stakeholder that would be in the best position to avoid the wrongdoing, and a focus on the duty of the PSP to put a safety system in place that is able to detect mistakes. Moreover, in order to favor the use of electronic payments, the tendency has been to keep consumers free from liability under certain amounts or if they correctly and promptly report the wrongdoing. For example, PSD2 establishes that, except in cases of fraud or gross negligence by the consumer, the maximum amount that a consumer can be obliged to pay in the case of an unauthorized payment transaction is €50.

C10: OPERATIONAL RELIABILITY

- a. A PSP should be required to maintain reasonable technical measures in line with industry best practices, including a documented and audited business continuity plan, to protect the personal information and funds of consumers and to ensure continuous availability of the services.**
- b. A consumer should be given reasonable notice of any proposed system shutdowns.**

Explanatory Notes

Operational reliability is a very important requirement to protect the information of consumers as well as their funds and to allow for continuous service. Most payment system laws and regulation touch upon this. For instance, in Jamaica, issuers are required to have measures in place to ensure the safety, security, and operational reliability of the retail payment service, including contingency arrangements and disaster control procedures, to be applied to all relevant systems, whether internal or outsourced, including systems and platforms.⁶¹ The PSD2 asks member states to ensure that PSPs establish a framework with appropriate mitigation measures and control mechanisms to manage the operational and security risks relating to the payment services they provide.⁶² It provides clear rules on authentication procedures and reporting incidents to guarantee operational security and reliability.⁶³ In some cases, the PSO also imposes specific operational reliability guidelines on the PSPs. This is the case for international payment card brands in particular, and also for ACH networks.

Regulators should also monitor new technological innovations to keep up with evolving threats and risks to consumers. Ensuring that appropriate operational reliability requirements are imposed for nonbank providers is also critical, particularly in countries where these services have a very large penetration. As PSPs and the PSO are often dependent on critical service providers to keep their systems and services running, any impact on these critical service providers can affect several PSPs in a country at the same time.

For example, specific attention should be given to the issue of reliability of the mobile networks in connection with mobile money. For instance, some countries have reported that shutdowns may create conditions for agent fraud (when systems are down and an agent cashes in a customer's money without registering the deposit in the system). In the light of such situations, telecom regulators in some jurisdictions have imposed specific service-level requirements for telecom services as well.

D: DATA PROTECTION AND PRIVACY⁶⁴

D1: LAWFUL COLLECTION AND USAGE OF CUSTOMER DATA

- a. PSPs should be allowed to collect relevant customers' data within the limits established by law or regulation and, where applicable, with the customer's consent.
- b. The law or regulation should establish rules for the lawful collection and use of data by PSPs, including when consumer consent is required, and clearly establishing at a minimum
 - i. How data can be lawfully collected;
 - ii. How data can be lawfully retained;
 - iii. The purposes for which data can be collected; and
 - iv. The types of data that can be collected.
- c. The law or regulation should provide the minimum period for retaining customer records, and that, throughout this period, the customer should be provided ready access to such records for a reasonable cost or at no cost.
- d. For data collected and retained by PSPs, PSPs should be required to comply with data privacy and confidentiality requirements that limit the use of consumer data exclusively to the purposes specified at the time the data were collected or as permitted by law, or otherwise specifically agreed with the consumer.

Explanatory Notes

See the explanatory notes for D1 in chapter 1, "Deposit and Credit Products and Services," which generally apply to retail payment services.

Payments data reveal rich information for merchants, banks, nonbank PSPs, and others, with the potential to benefit financial inclusion. However, consumers can be very sensitive about financial service providers' use of payments data. If not properly regulated, the usage of such data could be subject to abuse. Global research by GSMA on more than 11,500 mobile users in Brazil, Colombia, Indonesia, Malaysia, Singapore, Spain, and the United Kingdom revealed that consumers have serious concerns about their mobile identity and personal data. One of their most significant worries consumers have with respect to payments data is the extent to which their privacy is secured and guaranteed. Consumers often do not know the extent to which their data is collected and what organizations are doing with their personal data.

Given the importance of the topic, in particular with the growing emergence of digital payments, it is important that rules limit the collection and processing of data. (For example, see PSD2.) Further, as recommended by the ITU-T Focus Group Digital Financial Services, authorities should strive to identify any gaps in the legal and regulatory framework for data protection and privacy with respect to the fast-paced evolution of digital financial services. One example is the European Union, where the General Data Protection Regulation⁶⁵ issued in 2016 aims to cover new issues raised by technology and "big data" by, among other things: introducing the concept of data

minimization (use only what is needed); embedding privacy in the product design phase; introducing the concept of extra-territorial applicability;⁶⁶ and making the data controller accountable for data processing.⁶⁷

In any event, providers should be obliged to disclose, at a minimum, what information is being maintained, for how long, and for what purposes. Informed consensus should be ensured, and providers should ensure that no abusive behavior occurs which could lead to discrimination or violation of privacy. Legislation should also address the issue of ownership of such data.

Big data

One unique and emerging issue with respect to retail payment services is the usage of "big data" or alternative data.⁶⁸ Since retail payments have an important position in the lives of all citizens, they form a rich source of information. In addition to the data on the underlying transaction, a payment transaction also has information on the location of the transaction, the time of day, and, in some cases, also the underlying economic interaction. Furthermore, with the integration of payment services and social networks and the emergence of large-scale ecommerce platforms, the type of information that can now be juxtaposed with payment information has increased significantly. Coupled with the reduction of data-storage costs, increased processing speed, and the development of smart algorithms, innovative businesses have realized the potential of turning raw data into useful information. They apply algorithms to extract information from transaction data with the aim of offering more products and services,

either by themselves or in association with other entities, and to detect fraud more effectively and efficiently.

The following applications of data analytics have gained prominence of late:

- *Emerging use of transaction data, social network, and other contextual information as alternative sources of information to assess creditworthiness:* Improved payment data can enable access to credit and other services, since (payment) data can provide valuable insights for financial institutions in assessing the creditworthiness of consumers, decreasing risk and helping more people qualify. Alternative information, such as utility bills, mobile phone bills, and online shopping transactions, helps to build relevant data on individuals, including those who are not captured by traditional credit scores. Data on consumer behavior also enable better predictions of willingness to repay borrowed money. Such behavioral information can, for instance, be obtained from social media sites, though the predictive power of such data has not been fully proven yet. Online lending platforms such as Lenddo in Colombia, Mexico, and the Philippines; Kabbage in the United States; and LendUp in the United Kingdom use the “online reputations” of consumers on social media to qualify them for loans. Another example is Cignify in the United Kingdom, which uses mobile phone usage data to assess the risk of lending money to consumers in emerging countries.⁶⁹
- *Offering personalized service:* One of the main purposes of the use of data is offering the customer a personalized approach. For merchants, payment data offer insights into shopping behavior, interests, and preferences. In physical stores, customers pay by card, which forms a rich source of data for card issuers and merchants. However, data are usually not tied to personal information, which restricts the leveraging of the data for post-sales activities. When shopping online,

customers are more often asked to log in (check in) before navigating to and selecting and purchasing products and services online. In this case, customer visits provide online merchants and authentication platforms with a rich source of data. By combining this information with collected and analyzed payments data, (financial) institutions can offer a unique user-tailored approach.⁷⁰

- *Payment systems and payment platforms commoditizing valuable information:* In 2011, Visa started selling retailers the ability to send text messages to consumers based on their recent credit card transactions. Consumers had to agree to this service beforehand and received discounts and other incentives in return. In 2012, MasterCard started offering marketers and advertisers aggregated and non-personalized information that is based on payments data, without explicit consent from consumers.⁷¹

The challenge for authorities is to foster innovation and set boundaries within which healthy economic conduct can proceed, while addressing data privacy and other consumer protection concerns at the same time. In particular, big data approaches raise questions with respect to data ownership and portability, the principle of specific usage of collected data, the feasibility of informed consent for collecting and using big data when collection is linked to basic services, inaccuracies or lack of transparency in credit information and scoring based on big data (without the clear ability for consumers to access and correct data), and the potential for abusive practices, such as discrimination, profiling, and aggressive marketing.⁷² Data protection and privacy issues should be taken into account by providers early in the design phase, so that resulting systems, applications, and platforms have the capability to address such issues.

D2: CONFIDENTIALITY AND SECURITY OF CUSTOMERS' INFORMATION

- PSPs should be required to have and implement policies and procedures to ensure the confidentiality, security, and integrity of all data stored in their databases that relate to their customers' personal information, accounts, deposits, deposited properties, and transactions.**
- In order to ensure confidentiality, when establishing policies and procedures, PSPs should also establish different levels of permissible access to customers' data for employees, depending on the role they play within in the organization and the different needs they may have to access such data.**
- In order to maintain the security of customers' data, PSPs should also be required to have and implement policies and procedures to ensure security related to networks and databases.**
- PSPs should be held legally liable for misuse of consumer data.**

- e. PSPs should be held legally liable for any breaches in data security that result in loss or other harm to the customer, and should put in place clear procedures to deal with security breaches, including mechanisms to reimburse or compensate consumers.

Explanatory Notes

See the explanatory notes for D2 in chapter 1, “Deposit and Credit Products and Services.”

D3: SHARING CUSTOMER INFORMATION

- a. The law should provide rules for the release to and use of customer information by certain third parties, such as government authorities, credit registries or credit bureaus, and collection agencies.
- b. Whenever a PSP is legally required to share a customer’s information with a third party, the PSP should be required to inform the customer in writing (including in an electronic form) in a timely manner of
 - i. The third party’s precise request;
 - ii. The specific information of the customer that has been or will be provided; and
 - iii. How and when that information has been or will be provided.
- c. Subject to the exceptions noted in clauses D3(a) and (b), above, without a consumer’s prior written consent as to the form and purpose for which the consumer’s data will be shared, the law should prevent a PSP from selling or sharing any of a consumer’s information with any third party for any purpose, including telemarketing or direct mailing, unless such third party is acting on behalf of the PSP and the information is being used for a purpose that is consistent with the purpose for which that information was originally obtained.
- d. Before any such sharing for the first time, the PSP should be required to inform consumers in writing of their data privacy rights in this respect.
- e. PSPs should be required to allow consumers to stop or opt out of any sharing by the PSP of information regarding the consumers that they previously authorized (unless such sharing is mandated by law).
- f. In the case of tied products, the consumer should be informed if a third party will have access to the consumer’s information.
- g. Unless it is a credit bureau or a credit registry, the third party should be prohibited from disclosing the shared information regarding a consumer.

Explanatory Notes

The explanatory notes for D3 in chapter 1, “Deposit and Credit Products and Services,” generally apply to retail payment services as well. For example, the Payment System Act in India establishes the principle that customers’ information cannot be shared with third parties, unless required by law and with the consent of the user.⁷³

In particular, in the specific case of innovative payment instruments, where a financial institution may link with a commercial entity, such as a telecom operator, for offering a product, exchanging information may require additional regulation, since the different entities may be subject to diverging legislation and different requirements. Consistent consumer protections should be put in place.

In addition, the collection of data by third parties may be used to provide value-added services, such as assessing creditworthiness and offering personalized services, raising potential concerns with data privacy, as noted in D1, above. Regulators should ensure that such data sharing follows strict rules on confidentiality, or else ensure that such data is shared in an aggregated, de-personalized format, in which case data privacy obligations would no longer apply. Furthermore, authorities should consider developing appropriate data privacy requirements for the actual recipients/users of third-party data.

E: DISPUTE RESOLUTION MECHANISMS

E1: INTERNAL COMPLAINTS HANDLING

- a. PSPs should be required to have an adequate structure in place as well as written policies regarding their complaints handling procedures and systems—that is, a complaints handling function or unit, with a designated member of senior management responsible for this area—to resolve complaints registered by consumers against the PSP effectively, timely, and justly.
 - b. PSPs should be required to comply with minimum standards with respect to their complaints handling function and procedures. These should include the following:
 - i. Resolve a complaint within a maximum number of days, which should not be longer than the maximum period applicable to a third-party external dispute resolution mechanism. (See E2.)
 - ii. Make available a range of channels (for example, telephone, fax, email, web) for submitting consumer complaints appropriate to the type of consumers served and their physical location, including offering a toll-free telephone number to the extent possible, depending on the size and complexity of the PSPs' operations.
 - iii. Widely publicize clear information on how a consumer may submit a complaint and the channels made available for that purpose, including on the PSP's website, in marketing and sales materials, in KFSs, in standard agreements, and at locations where products and services are sold, such as branches, agents, and other alternative distribution channels. (See B1.)
 - iv. Publicize and inform consumers throughout the complaints handling process, and particularly in the final response to the consumer, regarding the availability of any existing alternative dispute resolution (ADR) schemes. (See E2.)
 - v. Adequately train its staff and agents who handle consumer complaints.
 - vi. Keep the complaints handling function independent from business units such as marketing, sales, and product design, to ensure fair and unbiased handling of the complaints, to the extent possible, depending on the size and complexity of the PSP.
 - vii. Within a short period following the date the PSP receives a complaint, acknowledge receipt of the complaint in a durable medium (that is, in writing or another form or manner that the consumer can store), and inform the consumer about the maximum period within which the PSP will give a final response and by what means.
 - viii. Within the maximum number of days, inform the consumer in a durable medium of the PSP's decision with respect to the complaint and, where applicable, explain the terms of any settlement being offered to the consumer.
 - ix. Keep written records of all complaints, while not requiring that a complaint itself be submitted in writing (that is, allowing for oral submission).
 - c. PSPs should be required to maintain and make available to the supervisory authority up-to-date and detailed records of all individual complaints.
 - d. The PSP's complaints handling and database system should allow it to report complaints statistics to the supervisory authority.
 - e. PSPs should be encouraged to use the analysis of complaints information to continuously improve their policies, procedures, and products.
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Explanatory Notes

The explanatory notes for E1 in chapter 1, “Deposit and Credit Products and Services,” apply to retail payment services as well and should be extended to nonbank PSPs.

All PSPs should have in place an internal complaint handling mechanism, preferably by a specific handling unit. Procedures should be clear to the customer, known in advance, and rapidly address the claim. Electronic channels should be put in place to facilitate distant complaints, and the redress system should be available seven days a week and for 24 hours.

As PSPs increasingly leverage alternative distribution channels for product and service delivery, the role of such channels in internal complaints handling should be considered. For example, when PSPs serve consumers primarily through agents that are closer in physical proximity to the consumer, agents should be properly trained to receive and resolve simple complaints or to forward the complaint to the PSP’s complaints handling unit.

It should be easy for users to present evidence supporting their claims. For instance, for some types of disputes (for example, regarding a transaction amount), the payer could be required to submit a copy of the transaction

receipt. The customer could be asked to pay a fee to retrieve a copy of the receipt from the payer. These fees need to be set at a fair level or else they could deter the customers from raising disputes. Indirect costs could also be associated with how the dispute is to be raised and how the supporting information is to be submitted. Offering various options, including oft-used transaction channels (such as digital channels), could reduce these indirect costs.

In addition, depending on whether the transaction is an ONUS (that is, the same PSP is handling both the payer and the payee sides of a transaction) or an OFFUS (that is, different PSPs are handling the payer and payee sides of a transaction), and whether a transaction is domestic or international, different entities could be involved. In the case of an ONUS transaction, the entire dispute resolution process is within the same PSP. In the case of OFFUS transactions and international transactions, the underlying payment system would also get involved, and its operating rules and procedures for handling complaints would apply. It will be necessary to ensure that complaints handling requirements are harmonized across these transaction scenarios.

E2: OUT-OF-COURT FORMAL DISPUTE RESOLUTION MECHANISMS

- a. If consumers are unsatisfied with the decision resulting from the internal complaints handling at the PSP, they should be given the right to appeal, within a reasonable timeframe (for example, 90 to 180 days), to an out-of-court ADR mechanism that
 - i. Has powers to issue a decision in each case that is binding on the PSP (but not binding on the consumer);
 - ii. Is transparent and independent of both parties and discharges its functions impartially;
 - iii. Is staffed by professionals trained in the subject(s) they deal with;
 - iv. Has an adequate oversight structure that ensures efficient operations;
 - v. Is financed adequately and on a sustainable basis;
 - vi. Is free of charge to the consumer; and
 - vii. Is accessible to consumers.
- b. The existence of an ADR mechanism, its contact details, and basic information about its procedures should be made known to consumers through a wide range of means, including when a complaint is finalized at the PSP level.
- c. If an ADR mechanism has a member-based structure, all PSPs should be required to be members.

Explanatory Notes

The explanatory notes for E2 in chapter 1, “Deposit and Credit Products and Services,” generally apply to retail payment services as well.

In addition to a mechanism for claims internal to each PSP, a redress mechanism should exist to permit an unsatisfied customer to address an autonomous entity.

This may be an entity established by an association of financial institutions, a service provided by the supervisor or the overseer within its general functions, or an independent authority, such as a financial sector ombudsman. Whatever mechanism is chosen, this ADR mechanism must be impartial, permit the customer to ask for redress easily and inexpensively, and permit the

parties to confront each other openly to discuss the issue. The final decision should be either legally binding or accepted by the financial institution. It is also important to ensure that the ADR mechanism covers all PSPs, including nonbank PSPs. In Slovakia, an arbitration sys-

tem has been set up specifically for payments in addition to other types of ADR schemes already existing for other financial services and products. The arbitration chamber has competence over any dispute that arises between a PSP and a payment services user.⁷⁴

F: GUARANTEE SCHEMES AND INSOLVENCY

F1: DEPOSITOR PROTECTION

- a. The law should be clear on whether the financial safety net (that is, a deposit insurance system, if existing; the regulator or supervisor; and the resolution authority, if existing) covers customers' funds held by PSPs, when either the deposit-taking financial institution holding the funds (for example, commercial bank, financial cooperative) or the PSP is unable to meet its obligations, including the return of funds.
- b. If there is a law on deposit insurance, it should state the following clearly:
 - i. The mandate and powers of the deposit insurer(s)
 - ii. The scope of depositors who are insured (for example, natural persons, legal persons)
 - iii. The types of financial instruments that are insured
 - iv. The deposit insurance coverage-level limits
 - v. The mandatory membership of all deposit-taking financial institutions⁷⁵
 - vi. The creation of an ex ante financed fund for pay-out purposes
 - vii. The contributing institutions to this fund and clear back-up financing arrangements
 - viii. The events that will trigger a payout from this fund to insured depositors
 - ix. The mechanisms and the timeframe to ensure timely payout to insured depositors
- c. On an ongoing basis, the deposit insurer(s) should, directly and through insured institutions, promote public awareness of the deposit insurance system.
- d. The public should be informed of the scope of depositors and types of financial instruments that are insured (and those that are not), the institutions that are members of the deposit insurer(s) and how they can be identified, the coverage level, the mandate of the deposit insurer(s), the reimbursement process, and the benefits and limitations of the deposit insurance system.
- e. In the event of a failure of a member institution, the deposit insurer(s) must notify depositors where, how, and when insured depositors will be provided with access to their funds.
- f. The deposit insurer(s) should work closely with member institutions and other safety-net participants to ensure consistency and accuracy in the information provided to depositors and consumers and to maximize public awareness on an ongoing basis. Law or regulation should require member institutions to provide information about deposit insurance in a format/language prescribed by the deposit insurer(s).
- g. The deposit insurer(s) should have in place a comprehensive communication program and conduct a regular evaluation of the effectiveness of its public awareness program or activities.

Explanatory Notes

Further to the explanatory notes for F1 in chapter 1, “Deposit and Credit Products and Services,” for store-of-value payment products, authorities will need to consider whether such funds are considered deposits within the context of any deposit insurance system. Authorities should make efforts to stay abreast of financial inclusion initiatives and associated technological innovations occurring in their jurisdictions, particularly those regarding digital stored-value products and/or affecting unsophisticated small-scale depositors. For example, deposit insurers should be part of any dialogue among authorities, including financial regulators and supervisors and, for example, telecommunication authorities, regarding the authorization and regulation of digital stored-value products and providers.

Authorities should assess the opportunities and challenges associated with different approaches to deposit insurance treatment of digital stored-value products, such as (i) an exclusion approach, whereby such products are explicitly excluded from deposit insurance coverage, although other measures to protect customers’ stored

value are adopted; (ii) a direct approach, whereby such products are directly insured by a deposit insurer, and their providers must be or must become members of the deposit insurance system; or (iii) a pass-through approach, whereby deposit insurance coverage passes through a custodial account at an institution that is a deposit insurance member and holds customer funds from digital stored-value products, to the individual customer of the digital product provider (although this provider is not a deposit insurance member).⁷⁶ A conscious policy decision to adopt any of these approaches could help to address legal and customer uncertainty issues.

Regardless of the approach adopted, customers should be clearly informed about whether digital stored-value products are directly or indirectly insured or uninsured by the deposit insurance system. In jurisdictions where customers may promptly transfer their uninsured digitally stored value to insured accounts, they should also be clearly informed about the differences between both products.

NOTES

1. The discussion on retail payment services in the introduction to this annex is primarily derived from the World Bank publication "Developing a Comprehensive National Retail Payments Strategy: Consultative Report" (2012).
2. Committee on Payment Settlement Systems, "A Glossary of Terms Used in Payments and Settlement Systems" (Bank for International Settlements, 2003), 42.
3. It should be noted that "not time-critical" should not be interpreted as not real-time. Many retail payment transactions are processed on a near real-time basis, such as a person-to-person funds transfer. However, in such cases, the settlement agent is the same as the issuer or the settlement is completed at a later time, typically on a deferred net settlement basis—for example, as in the case of a card payment transaction.
4. E-money-based instruments involve the payer maintaining a pre-funded transaction account with a PSP, often a nonbank. Specific products include online money when the payment instruction is initiated via the Internet, mobile money when initiated via mobile phones, and prepaid cards. E-money can be offered by banks and authorized nonbanks. See Committee on Payments and Market Infrastructures (CPMI) and the World Bank Group, "Payment Aspects of Financial Inclusion" (Bank for International Settlements and the World Bank Group, 2016).
5. This term has acquired a very specific meaning in the European Union, where it refers specifically to payment initiation service providers and account information service providers. In the context of this document, the term has a broader meaning.
6. By some estimates, around 85 percent of transactions worldwide are in cash. See *Measuring Progress Toward a Cashless Society* (MasterCard Advisors, 2013).
7. Further, this annex does not cover "digital currencies" such as Bitcoin. These do not fall under any of the payment instrument categories. Moreover, currently there is not enough evidence to make conclusions about good consumer protection practices with regard to digital currencies, because they are still a recent innovation and there is only limited experience with their regulation and oversight. For an analysis of the features and implications of digital currencies, see CPMI, "Digital Currencies" (Bank for International Settlements, November 2015).
8. The *merchant service fee* is the fee paid per transaction by the merchant to the acquiring bank, usually structured as a combination of a fixed fee and a percentage of the transaction amount.
9. From a merchant's perspective, transparency and other consumer protection issues relate more to a clear understanding of when and how the merchant will get paid for the transaction, the schedule of fees, how the fees payable are calculated, the specific procedures the merchant needs to follow, and the records that must be kept to have guaranteed settlement for a transaction.
10. A *payment network* is a payments system that connects various member institutions, thereby enabling interoperability of payment instruments issued by one member at another member's acceptance infrastructure. The term is commonly used to refer to payment card systems such as Visa and Master Card.
11. The so-called "honor all cards" rule enforced by most payment networks typically requires acquirers to ensure that their merchants accept all cards affiliated with the payment network. The affiliation of a card to a payment network is typically visually represented by a logo of the payment network placed on the card.
12. A *PSP agent* is a local entity, such as a small shop, that provides basic payment and transaction account-related services on behalf of bank or nonbank payment service providers.
13. See "Mobile Banking and Payments," TR14/15 (Financial Conduct Authority, 2015) and "Fair Treatment for Consumers Who Suffer Unauthorized Transactions," TR15/10 (Financial Conduct Authority, 2015).
14. Annual Payment Systems Report (People's Bank of China, 2014); Financial Access Survey (International Monetary Fund, 2015); and Global Findex (World Bank, 2015).
15. Although not specific to consumer protection issues, guidance for supervision of agents used by banks and nonbanks is found at Denise Dias, Stefan Staschen, and Wameek Noor, "Supervision of Banks and Nonbanks Operating through Agents: Practice in Nine Countries and Insights for Supervisors" (Consultative Group to Assist the Poor [CGAP], 2015).
16. See ITU-T Focus Group Digital Financial Services, *Consumer Experience and Protection* (International Telecommunications Union [ITU], 2017).
17. Details available at <http://www.bcsbi.org.in/index.html>.
18. The GSMA's COC is available at www.gsma.com/mobilefordevelopment/wp-content/uploads/2014/11/Code-of-Conduct-for-Mobile-Money-Providers.pdf.
19. Global Remittances Working Group, *An International Remittances Customer Charter: A Toolkit For National Action* (World Bank, 2010), <http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/282044-1257537401267/customercharter.pdf>.
20. "Responsible Digital Payments Guidelines," <https://www.betterthancash.org/tools-research/case-studies/responsible-digital-payments-guidelines>.
21. See <https://www.visa.com/chip/personal/security/zero-liability.jsp> and <http://newsroom.mastercard.com/press-releases/mastercard-expands-consumer-protection-across-the-globe-2/>.
22. Remittance Prices Worldwide, <https://remittanceprices.worldbank.org/en/national-and-regional-databases-certified-by-the-world-bank>.
23. The *interchange fee* is the fee paid between by the merchant's bank (acquiring bank) to the issuer bank.
24. ITU-T Focus Group Digital Financial Services, *Consumer Experience and Protection* (ITU, 2017).
25. Statement of Fees Template and Fee Information Document as part of the technical standards of the EU payment account directive, EBA/ITS/2017/03 and EBA/ITS/2017/04 (European Banking Authority [EBA], May 2017).
26. The discussion on pricing is further elaborated under Guideline 4 of the General Guidance on National Payment Systems Development.
27. See CPMI and the World Bank Group, "Payment Aspects of Financial Inclusion," 12.

28. Directive 2014/92/EU of the European Parliament and of the Council of 23 July 2014 on the Comparability of Fees Related to Payment Accounts, Payment Account Switching and Access to Payment Accounts with Basic Features, Article 4.
29. "Final Report on Draft Implementing Technical Standards on the Standardised Presentation Format of the Fee Information Document and Its Common Symbol, under Article 4(6) of Directive 2014/92/EU [Payment Accounts Directive]," EBA/ITS/2017/03 (EBA, 2017).
30. ITU-T Focus Group Digital Financial Services, *Consumer Experience and Protection* (ITU, 2017).
31. Directive 2015/2366 of the European Parliament and the Council of 25 November 2015 on Payment Services in the Internal Market, Amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and Repealing Directive 2007/64/EC.
32. Mobile Money Guidelines (Bank of Uganda, 2013).
33. Instruction N°008-05-2015 regissant les conditions et modalités d'exercice des activités des émetteurs de monnaie électronique dans les états membres de l'Union Monétaire Ouest Africaine (UMOA) (La Banque Centrale des Etats de l'Afrique de l'Ouest, 2015).
34. The ePayments Code is a voluntary code of practice, although most relevant financial institutions have subscribed to it. However, there is also a legislative consumer protection overlay, including in relation to transaction receipts and statements, under chapter 7 of the Corporations Act 2001. Section 1017F mandates the provision of "confirmations of transactions," with some exceptions, including account direct debits and credits, and also provides—together with regulations made under it—a regime for confirmations (that is, receipts) to be made available through an electronic facility. See https://www.legislation.gov.au/Details/C2017C00129/Html/Volume_5#_Toc479592087.
35. See "Consumer Policy Guidance on Mobile and Online Payments," Digital Economy Papers 236 (OECD, 2014).
36. Mobile Money Guidelines (Bank of Uganda, 2013).
37. ITU-T Focus Group Digital Financial Services, *Consumer Experience and Protection* (ITU, 2017).
38. Laws of Malaysia, Act 627, Payment Systems Act 2003, Article 32.
39. "Master Circular: Policy Guidelines on Issuance and Operation of Pre-paid Payment Instruments in India," DPSS.CO.PD.PPI.No.3/02.14.006/2014-15 (Reserve Bank of India, 2014).
40. Directive 2014/92/EU of the European Parliament and of the Council of 23 July 2014 on the Comparability of Fees Related to Payment Accounts, Payment Account Switching and Access to Payment Accounts with Basic Features.
41. In the Global Payment Systems Survey 2015, 62 percent of central banks reported that the payment cards system in their country was fully interoperable for ATM transactions, while 59 percent reported full interoperability for POS transactions.
42. Directive 2015/2366 of the European Parliament and of the Council of 25 November 2015 on Payment Services in the Internal Market, Article 15.
43. Regulatory Guidelines for Mobile Financial Services in Bangladesh (Bangladesh Bank, 2015), Section 11.
44. Guidelines for Electronic Retail Payment Services (Bank of Jamaica, 2013), Section 8.
45. Electronic Payment Systems Guideline (Reserve Bank of Zimbabwe), Guideline 1.12.4.
46. Regulatory Guidelines for Mobile Financial Services in Bangladesh (Bangladesh Bank, 2015), Section 7, and Guidelines on Agent Banking for the Banks (Bangladesh Bank, n.d.), Sections 6, 7, 13, and 15.
47. Guidelines for Engaging of Business Correspondents, RBI/2010-11/217 DBOD.No.BL.BC.43 /22.01.009/2010-11 (Reserve Bank of India, 2010), Section 3.
48. For details on M-Pesa, refer to annex 7 in the 2012 World Bank publication "Developing a Comprehensive National Retail Payments Strategy: Consultative Report."
49. ITU-T Focus Group Digital Financial Services, *Consumer Experience and Protection* (ITU, 2017).
50. Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions.
51. *Authorization* is a procedure that checks whether a customer or PSP has the right to perform a certain action—for example, the right to transfer funds or to have access to sensitive data.
52. The nature of the transaction has an influence on the risk profile. Examples of high-risk transactions could include those at specific categories of merchants that are more prone to fraud, such as online ticketing and gambling, cash-out remittances, and interbank funds transfers. Transaction attributes, such as the amount of the transfers and the time of day when the transaction is initiated, also have a bearing on the risk profile of a transaction. (Transactions between midnight and early morning are often more suspicious than those during normal business hours or in the evening.)
53. Contextual information consists of circumstantial factors, such as the type of customer; interbank transfers to a new recipient and/or to a country for the first time; interbank transfers after a long period of dormancy; a change of authentication credentials immediately following other changes in customer/account attributes, such as address or phone information; a transaction from a device not usually used; and an abnormally high number of transactions in a given time window, such as a day or three-day period.
54. "Regulatory Technical Standards on Strong Customer Authentication and Secure Communication under PSD2," <https://www.eba.europa.eu/regulation-and-policy/payment-services-and-electronic-money/regulatory-technical-standards-on-strong-customer-authentication-and-secure-communication-under-psd2>.
55. For purposes of this GP, data security is differentiated from protection from misuse and sharing of customer data, although unauthorized access to and misuse of both types of data may result in both external and internal fraud.
56. The European Forum on the Security of Retail Payments is a voluntary cooperative initiative between relevant European authorities, in particular supervisors of payment service providers and overseers. It aims to promote knowledge and understanding of issues related to the security of electronic retail payment services and instruments. See <http://www.ecb.europa.eu/pub/pdf/other/assessmentguidesecurityinternetpayments201402en.pdf/>.

57. See also EBA guidelines based on such recommendations: <https://www.eba.europa.eu/regulation-and-policy/consumer-protection-and-financial-innovation/guidelines-on-the-security-of-internet-payments>.
58. The Federal Financial Institutions Examination Council is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Consumer Financial Protection Bureau, and to make recommendations to promote uniformity in the supervision of financial institutions. See <https://www.ffiec.gov/>.
59. "Online and Mobile Payments: Supervisory Challenges to Mitigate Security Risks" (International Financial Consumer Protection Organisation, September 2016).
60. ITU-T Focus Group Digital *Financial Services*, Consumer Experience and Protection (ITU, 2017).
61. Guidelines for Electronic Retail Payment Services (Bank of Jamaica, 2013), Section 8.
62. Directive 2015/2366 of the European Parliament and of the Council of 25 November 2015 on Payment Services in the Internal Market, Article 95.
63. Directive 2015/2366 of the European Parliament and of the Council of 25 November 2015 on Payment Services in the Internal Market, Articles 96 and 97.
64. PSPs gather vast amounts of data, including personal information, in order to conduct their daily tasks. This information is sensitive to misuse or breaches, which has the potential to cause harm to consumers. This section touches on only a few select issues with respect to data protection and privacy that are most relevant to financial consumer protection.
65. Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data.
66. In the context of big data, this is an essential principle as it ensures that the rules and obligations included in the General Data Protection Regulation are applicable to all controllers processing data of EU residents, regardless of their location.
67. Under this new concept, controllers will be required not only to have processes and procedures in place, but also be able to demonstrate that data processing is done in line with the requirements of the regulation.
68. The discussion in this section is based on joint work on innovations in retail payments conducted by InnoPay and the World Bank in 2014.
69. For example, see Christina Farr, "Kabbage Brings Its Quick Fix Loans to UK Merchants," *VentureBeat*, February 16, 2013, available at <https://venturebeat.com/2013/02/16/kabbage-brings-its-quick-fix-loans-to-uk-merchants/>.
70. For more information, see "EMC Digital Universe Study" (DELL EMC, 2014); Ben Rossi, "Big Data vs. Big Regulation: Will Changing the Rules Empower Consumers?," *Information Age*, January 13, 2014, available at <http://www.information-age.com/big-data-vs-big-regulation-will-changing-the-rules-empower-consumers-123457592/>; "Big Data: Seizing Opportunities, Preserving Values" (White House Office of Science and Technology, May 2014); "Leveraging Data and Analytics for Customer-Centricity and Innovation: Asian Banker Research Survey on Use of Data and Analytics in Banks in Asia Pacific 2013," (The Asian Banker, April 2013), available at http://www.theasianbanker.com/assets/media/dl/whitepaper/SAP_WP_2013_1.pdf; and "Big Data, Big Impact: New Possibilities for International Development," (World Economic Forum, 2012), available at http://www3.weforum.org/docs/WEF_TC_MFS_BigDataBigImpact_Briefing_2012.pdf.
71. For more information, see Mark Prigg, "Mastercard under Fire for Tracking Customer Credit Card Purchases to Sell to Advertisers," *The Daily Mail*, October 17, 2012, available at <http://www.dailymail.co.uk/sciencetech/article-2219069/Mastercard-tracking-purchases-sell-advertisers.html>; Emily Steel, "MasterCard Mines Data for Marketers," *Financial Times*, October 17, 2012, available at <https://www.ft.com/content/089f7cd0-16f2-11e2-b1df-00144feabdc0#axzz-34PvRhDQq>; and Emma Thomasson, "Mastercard: Real-Time Consumer Trend Data Is a Huge Growth Area for Us," *Business Insider*, June 11, 2014, available at <http://www.businessinsider.com/r-mastercard-expects-big-growth-from-big-data-insights-2014-11>.
72. For example, see "Joint Committee Discussion Paper on the Use of Big Data by Financial Institutions," JC/2016/86 (European Supervisory Authorities, 2016), which provides a high-level assessment of the potential benefits and risks of the use of big data by financial service providers.
73. Payment and Settlement Systems Act, 2007 (India), Section 22.
74. For more information, see the Permanent Arbitration Court of the Slovak Banking Association's website at <http://www.nbs.sk/en/payment-systems/other-information/permanent-arbitration-court>.
75. Deposit-taking financial institutions can be banks, credit unions, financial cooperatives (urban or rural), housing or building societies, MFIs, and so forth, which should be subject to sound prudential regulation and supervision on a regular basis.
76. See Juan Carlos Izaguirre, Timothy Lyman, Claire McGuire, and David Grace, "Deposit Insurance and Digital Financial Inclusion," *CGAP Brief*, October 2016.



CREDIT REPORTING SYSTEMS

Credit reporting is a crucial component of modern financial systems and a critical driver for efficiency in lending to consumers. Databases containing information relevant to making credit decisions, such as credit histories, personal data, and other information, represent a great concentration of power. For this reason, the impact of misuse, mishandling, or errors is potentially damaging to individuals. At the same time, the existence of such databases offers consumers who honor their obligations with the opportunity to distinguish themselves from those who do not, thereby establishing “reputation collateral.” As a result, consumers who have demonstrated their willingness to meet payment obligations—not only to financial service providers in respect of formal loans, but also to telecommunication companies, utility companies, and other providers from whom they obtain goods and services on credit—should enjoy greater access to credit at more favorable rates, terms, and conditions. Without ignoring the importance of a person’s capacity to repay (which is measured by income), the ability to build reputation collateral is especially important to consumers with lower incomes who may not own property that could serve as physical collateral for borrowing.

Achieving the optimal balance between protecting consumers and allowing information to be collected and distributed to assist them in their borrowing activities requires a combination of adequate legal and regulatory protections, enforcement, and properly aligned incentives for all participants in the financial system. Consumers should be able to understand what information is being collected about them and how the information is being used and by whom. Policies with respect to credit reporting systems (CRSs) should protect the rights of consumers and allow them to access their information, as well as to challenge any errors in data used for credit reports or scoring models.

In 2011, the World Bank, with the support of the Bank of International Settlements, published the *General Principles for Credit Reporting (General Principles)*,¹ which was the result of cooperative work by a task force of 25 members representing central banks, financial supervisors, multilateral organizations, data protection agencies, and the credit reporting industry. The General Principles were produced after literature review, extensive research conducted at the country level through the Western Hemisphere Credit Reporting Initiative, the Global Credit Bureau Program, the Arab Credit Reporting Initiative, and informed discussions in the International Credit Reporting Committee. In addition, the work conducted by the Expert Group on Credit Histories to identify barriers to the access to, and exchange of, credit information within the European Union under the coordination of the EU Commission was a relevant source of knowledge for the development of the General Principles.

The General Principles include five general principles on (1) data and its quality, (2) the security and efficiency of data processing, (3) governance and risk management, (4) the legal and regulatory environment, and (5) cross-border data flows. In addition, a set of “recommendations for effective oversight” is also included in the General Principles. General Principle 1 deals with the need of sharing complete, up-to-date, and accurate data that are collected from truthful sources. General Principle 2 deals with conditions to ensure participants’ confidence that information is properly stored and not being misused. The need for transparency and adequate accountability of CRSs is dealt with under General Principle 3. General Principle 4 provides guidance on how to meet the balance between accessing relevant data and protecting consumers’ rights.

The good practices (GPs) contained in this annex are consistent with the General Principles and with other international approaches regarding data protection policies. These include basic principles issued by the

United Nations (UN), the Organisation for Economic Co-operation and Development (OECD), the Asia-Pacific Economic Cooperation (APEC), the European Union (EU), and the Council of Europe (COE). Alternative regulatory models have also been taken into account through the comparison of credit reporting regulations in 100 countries.² Thus, the GPs have been developed based upon a broad range of policy and academic literature, comparative legal analysis, and practical experience from a number of country-based analyses.³

Until the adoption of the General Principles in 2011, a number of supranational frameworks included references to the protection of personal information included in databases such as CRSs. Table 4 shows the most relevant frameworks covering the protection of personal information.

The GPs described in this annex primarily focus on issues of consumer rights with respect to data and consumer awareness, which lie at the core of sound consumer protection in CRSs. It is fully recognized, however, that other issues not addressed in this annex due to time and space constraints are also important and should be considered to cover issues related to consumer protection and CRSs more comprehensively. These issues include adequate disclosure and transparency by CRSs and the role of creditors and CRS officers in explaining the content of credit reports to consumers. These GPs also do not directly cover the broader general principles, such as the principle for CRSs to have accurate, timely, and sufficient data. Such general principles also have direct impact on consumers.

TABLE 4: Overview of Consumer Protection Regulation for Credit Reporting Systems

INSTITUTION OR GOVERNMENT	LAWS, REGULATIONS, DIRECTIVES, AND GUIDELINES
UN	Universal Declaration of Human Rights, Article 12 International Covenant on Civil and Political Rights, Article 17 (December 16, 1966) United Nations Guidelines for the Regulation of Computerized Personal Data Files, adopted by General Assembly Resolution 45/95 of December 14, 1990 (UN Guidelines) "The Right to Privacy in the Digital Age" (United Nations Human Rights Council, March 2015)
OECD	"OECD Guidelines for the Security of Information Systems and Networks: Towards a Culture of Security" (2002) Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data (2013) Declaration on Transborder Data Flows (1985) "Ministerial Declaration on the Protection of Privacy on Global Networks" (1998) "Effective Approaches to Support the Implementation of the G20/OECD High-Level Principles on Financial Consumer Protection" (2014), Principle 8, "Protection of Consumer Data and Privacy"
World Bank and Inter-American Development Bank	Principles and Guidelines for Credit Reporting Systems (2004) Principles for Effective Insolvency and Creditor/Debtor Regimes, section B.1.4 (2011) General Principles for Credit Reporting (2011)
APEC	APEC Privacy Framework (2005)
EU	Directive 1995/46/EC, on the Protection of Individuals with Regard to the Processing of Personal Data and on the Free Movement of Such Data Directive 2008/48/EC, on Credit Agreements for Consumers and Repealing Directive 87/102/EEC (Consumer Credit Directive) Regulation (EU) 2016/679, on the Protection of Natural Persons with Regard to the Processing of Personal Data and on the Free Movement of Such Data, and Repealing Directive 95/46/EC (General Data Privacy Regulation)
COE	Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data (COE Convention), ETS No. 108 (January 28, 1981, entered into force on October 1, 1985) and Explanatory Report Amendments to the COE Convention, allowing the European Communities to accede (adopted June 15, 1999, entered into force after acceptance by all parties) and Explanatory Memorandum Additional Protocol to COE Convention, on Supervisory Authorities and Transborder Data Flows and Explanatory Report, ETS No. 181 (opened for signature on November 8, 2001) Recommendation R(2002) 9 on the Protection of Personal Data Collected and Processed for Insurance Purposes and Explanatory Memorandum (September 18, 2002) Recommendation R(90) 19 on the Protection of Personal Data Used for Payment and Other Operations and Explanatory Memorandum (September 13, 1990)
EU-US	Safe Harbor Framework (2000)

A: LEGAL AND SUPERVISORY FRAMEWORK

A1: CREDIT REPORTING LEGAL AND SUPERVISORY ARRANGEMENTS

- a. The overall legal and regulatory framework for the CRS should be (i) clear, predictable, nondiscriminatory, proportionate, and supportive of consumer rights; and (ii) supported by effective judicial or extrajudicial dispute resolution mechanisms.
- b. Aspects related to consumers' rights with respect to credit information shared in CRSs should be subject to appropriate oversight by an authority with sufficient enforcement capability.
- c. In facilitating the cross-border transfer of credit data, a CRS should provide appropriate levels of protection for the security and confidentiality of information.

Explanatory Notes

A borrower's payment behavior can have implications for the solvency of a financial system as a whole and for the safety and security of depositors' funds. As such, there is a public interest in having a CRS and data available on borrowers' payment histories. These data better enable lenders to evaluate risk and perform their function of intermediating financial resources in a society. These data are valuable not only for regulated financial institutions, but also for a variety of other financial service providers and nonfinancial businesses that need to evaluate risk as part of their business.

A legal and regulatory framework on credit reporting must protect consumer rights while allowing credit information to be collected, distributed, and used to assist consumers in their borrowing activities. The framework should establish standards and controls for the circulation of credit and other information for specified permitted uses, such as credit risk prediction. It should also establish conditions and limits (such as consent) for the use of credit information for purposes other than credit risk evaluation, such as assessing the suitability of a job candidate. Specific aspects related to consumer complaints and the effective handling of disputes should also be included within the oversight framework and entrusted to the adequate authority, taking into consideration the context and legal framework of the country.

Countries vary in their approach to enacting laws on credit reporting. In some cases, provisions governing credit reporting form part of a general financial services

law. In others cases, there may be a separate law on credit reporting. In some instances, a comprehensive data protection law exists. Any of these approaches can provide an adequate legal framework for credit reporting. However, it is important that the unique nature of credit information be expressly recognized if credit reporting laws form part of a general law that covers other types of personal information—that is, medical, tax, criminal, and so forth.

Financial liberalization has significantly reduced restrictions on the operations of financial institutions in foreign markets. At the same time, small businesses initiating activities in a new country, and individuals who have changed their country of residence will most likely need to establish a relationship with a local financial entity. New challenges have thus emerged in recent years, including the need to monitor the credit exposure of important borrowers outside a financial institution's home markets, or providing credit and other financial products or services on a sound basis to consumers who do not have a credit history in the country where they are applying for credit.

When there is a direct link between credit reporting service providers in different jurisdictions, the cross-border mechanism is subject to practically the same operational, legal, and reputational risks as is the case domestically. Hence, the parties involved in the cross-border transfer of credit information should adopt governance and control measures and mechanisms for protecting consumers' rights that are equivalent to those applicable to a domestic credit reporting service provider.

B: DATA PROTECTION AND PRIVACY

B1: CONSUMER RIGHTS IN CREDIT REPORTING

Laws and regulations on credit reporting should specify basic consumer rights with respect to credit information. These rights should include the following:

- a. **The right to be informed about the collection, processing, and distribution of credit information.**
- b. **Where consent is used to provide the legal basis for the collection, processing, and distribution of credit information, such consent should be informed, freely given, and specific as to its scope.**
- c. **The right of a consumer to access one's own credit report and other relevant data, free of charge at least once a year, subject to the consumer being properly identified. Such information should include the data provider's name and any previous requests for access to the consumer's credit report from at least the past six months.**
- d. **The right to know about any adverse action in connection with a credit decision, or any offers for less-than-optimal conditions or prices, that have been based on the individual's credit report. In this process, consumers should be provided with the name and address of the credit reporting service provider.**
- e. **The right to correct factually incorrect information or to have information that has been unlawfully collected or processed deleted.**
- f. **The right to place a red flag on information that is in dispute without adversely affecting the consumer's credit score.**
- g. **The right to consent to the use of the consumer's credit information for marketing, employment, or other purposes other than the evaluation of creditworthiness for credit-related purposes.**
- h. **The right to have information kept confidential and with sufficient security measures in place to prevent unauthorized access, misuse of data, or loss or destruction of data.**

Explanatory Notes

The right to be informed (B1[a]) refers to the right of consumers to know about the collection, processing, and distribution of their personal information, including the identity of the entity controlling such information. Where consent provides the legal basis for the collection, processing, and distribution of credit information, such consent should be freely given by the individual, on the basis of information provided about how their credit information will be handled and the purposes for which it will be handled, which is specific as to the scope of the individual's consent. The General Principles differentiate between the consent to collect data and share it with the CRS provider, the consent to report data, and the consent to access data.

Article 3 of the UN Guidelines regarding files states that "the purpose which a file is to serve and its utilization in terms of that purpose should be specified, legitimate and, when it is established, receive a certain amount of publicity or be brought to the attention of the person concerned." This ensures that all processed personal data are relevant to the purpose stated, there are no secret databases, and no data are used without the consent of the consumer.

The right to be informed may be waived in the context of sharing information with a credit registry for supervisory purposes. However, the consumer should be informed at least about the type of information that is being collected, the purpose for its collection and further distribution, and the process to correct any errors in the data.

Throughout the world, this right is reflected in most data protection laws, such as the EU Data Protection

Directive (implemented in the 27 EU Member States and replicated by some countries in South America), many non-European laws,⁴ the COE Convention, as well as in the Openness Principle 12 of the OECD Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data.

The right to access personal information (B1[b])—in this context, the individual's credit report and other key data items used to build credit scores—is based on Article 4 of the UN Guidelines. Article 4 establishes the "principle of interested-person access," which provides that upon providing proper proof of identity, every person has the right to know whether information about him or her is being processed and "to obtain in an intelligible form, without undue delay or expense, and to have appropriate rectifications or erasures made in the case of unlawful, unnecessary or inaccurate entries and, when it is being communicated, to be informed of the addressees." The OECD Guidelines provide that the individual has the right to obtain confirmation as to whether information has been stored from the data controller and to have such confirmation communicated within a reasonable manner and time-frame. Access is also mentioned in the World Bank's Principles for Effective Insolvency and Creditor/Debtor Regimes (Principle B1.4).⁵

The right to access enables individuals to check the quality of their personal data and the lawfulness of its processing. It is also a precondition to other rights, such as the right to rectify incorrect data or to erase unlawfully processed data. The right to access in the CRS environ-

ment also requires CRS providers to ensure that consumers are informed about the users that accessed their data, at least in the past six months—that is, “previous enquiries”—as well as the full name of the creditor or data provider that submitted the data to the CRS provider.

In the United States, financial institutions have a duty to inform consumers of any adverse action in connection with credit decisions that is based on their credit report or score (B1[c]). Such a duty is partly due to the fact that consumers in the United States are not informed *ex ante* about their credit information being collected and processed, and the purpose for its collection and processing. The additional duty to inform consumers about less-than-optimal conditions also forms part of US regulations.⁶ Although only a few countries have taken the same approach as the United States in establishing a duty to inform of adverse actions, it can also be found in Article 9 of the EU’s Consumer Credit Directive. Article 9(3) provides that, if a credit application is rejected on the basis of consultation of a credit database, the creditor should inform the consumer immediately and without charge about the result of the database consultation and of the particulars of the databases consulted.

The right to access and rectify or erase data (B1[d]) is established in all major international instruments on data protection, such as the UN Guidelines (Articles 2 and 4) and the OECD Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data (Individual Participation Principle 13). The right to have information corrected is established in more than 40 countries.⁷ In addition, Article 4 of the UN Guidelines provides that the data controller should bear the cost of correcting incorrect data. This right also encompasses the right to erase information that has been unlawfully collected or processed, such as sensitive information. (See below.)

The right to place a red flag on information the accuracy of which is under dispute (B1[e]) is common in credit reporting regimes. This practice allows consumers to correct any erroneous data in their reports before any decision is made based on inaccurate data, and it alerts users of the potential inaccuracy in that specific data.

In many credit reporting regulatory frameworks, the consent principle also encapsulates the notion that indi-

viduals can stop their credit information from being processed for purposes unrelated to the extension of credit, such as marketing or employment (B1[f]). In a number of countries, individuals may opt either in or out to having their credit information used for marketing purposes, with the opt-out approach tending to increase the use of credit information for marketing purposes.⁸ APEC’s Principle IV (Uses of Personal Information) requires information to be used only for the stated purposes of collection, except where the individual has given consent.

The right to have sensitive information specifically protected (B1[g]) appears in most major international instruments on data privacy, such as OECD reports (Comment to Guidelines on the Protection of Privacy), the UN Guidelines (Article 5), the COE Convention (Article 6), the EU Data Protection Directive (Article 8), and the EU-US Safe Harbor Framework. Legal controls against the discriminatory use of sensitive information are also discussed in the World Bank’s General Principles (Principle 15). Only the APEC Privacy Framework does not require additional protection for sensitive information.

The major international instruments—including the OECD Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data (Principle 10), UN Guidelines (Article 3), APEC Privacy Framework (Principle III, “Collection Limitation”), and COE Convention—also require limitations to be placed on information collection and distribution. The COE Convention, for instance, states in Article 5e that data must be “preserved in a form which permits identification of the data subjects for no longer than is required for the purpose for which those data are stored.” Companies may have incentives to store personal information for longer than necessary, which can lead to suboptimal market results.⁹ Therefore, it is good practice to place time limitations on data retention.

Care should also be taken to ensure that public sector and private sector CRSs provide the same levels of consumer protection on the use of personal data. Both types of CRS provide data that allow individuals to be identified, and both should therefore provide the same high standard of protection for consumers.

C: DISCLOSURE AND TRANSPARENCY

C1: UNBIASED INFORMATION FOR CONSUMERS

- a. **Via the Internet, printed publications, radio, and TV, financial regulators should provide independent information for consumers to improve their knowledge on credit reporting and to proactively manage how their personal information appears in credit reports.**

Explanatory Notes

Education on credit reporting may comprise several activities, such as a key information brochure that explains to consumers their privacy choices and their impacts, as well as rights and obligations. Depending on the country context, the type of services provided by CRS providers may vary. At minimum, consumers should be aware of the following: (i) the name of all CRS providers operating in the country; (ii) the type of sources that submit data to each of the CRS providers; (iii) the permitted purposes for data collection and access; (iv) the impact of a good or bad credit history on the consumer, such as access to credit, employment, insurance, and others; (v) the methods and protocols for ensuring data accuracy; (vi) consumers' rights and the channels available to exercise such rights; and (vii) the role of the regulator.

It is important to help consumers understand that financing costs could be reduced if their credit report or other value-added products, such as their credit score, were improved, and to help them see how this can be achieved. Education on credit reporting should include

information about the main factors that contribute to the formulation of an individual's credit score. Regulators should ensure proper collaboration between data providers, CRS providers, and users in order to ensure that such educational materials are made available to consumers.

Regulators should ensure that this information is easy to understand and provided to all consumers through accessible channels. Examples of consumer education publications on credit reporting include the following:

- The US Federal Trade Commission's Privacy Choices for Your Personal Financial Information;¹⁰ Building a Better Credit Report;¹¹ Credit Repair: Self Help May Be Best;¹² and Disposing of Consumer Report Information? New Rule Tells How¹³
- The United Kingdom's Information Commissioner's Office's Credit Explained¹⁴
- The Australian Securities and Investments Commission's Factsheet: Your Credit Report¹⁵ and Credit Reports¹⁶

NOTES

1. See *General Principles for Credit Reporting* (World Bank, 2011). The General Principles are part of the FSB compendium of financial sector standards.
2. See, for example, Nicola Jentzsch, *Financial Privacy: An International Comparison of Credit Reporting Systems* (Berlin: Springer, 2007). Jentzsch found that 80 of 100 countries in the sample had constitutional privacy-protection clauses, 35 had general data protection laws, 7 had credit reporting laws, 6 had statutory codes, and 22 had industry COCs.
3. See also Margaret Miller, "Credit Reporting Systems around the Globe: The State of the Art in Public and Private Credit Registries" (World Bank, 2000).
4. For example, the Fair Credit Reporting Act (1970) and the Consumer Reporting Employment Clarification Act (1998).
5. See http://siteresources.worldbank.org/INTGILD/Resources/ICRPrinciples_Jan2011.pdf.
6. See "Risk-Based Pricing Notice," section 311(a) of the Fair and Accurate Credit Transactions Act of 2003, and notice of proposed rulemaking for correction of this act (Fair Credit Reporting Risk-Based Pricing Regulations, 2008).
7. Nicola Jentzsch, *Financial Privacy: An International Comparison of Credit Reporting Systems* (Berlin: Springer, 2007).
8. See Eric J. Johnson, Steven Bellman, and Gerald L. Lohse, "Defaults, Framing and Privacy: Why Opting In-Opting Out," *Marketing Letters* 13, no. 1 (2002), 5–15. Available at https://www0.gsb.columbia.edu/mygsb/faculty/research/pubfiles/1173/defaults_framing_and_privacy.pdf.
9. See Curtis R. Taylor, "Consumer Privacy and the Market for Customer Information," *RAND Journal of Economics* 35, no. 4 (winter 2004), 631–651.
10. <https://www.consumer.ftc.gov/articles/0222-privacy-choices-your-personal-financial-information>.
11. *Building a Better Credit Report* (Federal Trade Commission, May 2014), available at <https://www.consumer.ftc.gov/articles/pdf-0032-building-a-better-credit-report.pdf>.
12. <https://www.consumer.ftc.gov/articles/0058-credit-repair-how-help-yourself>.
13. <https://www.ftc.gov/tips-advice/business-center/guidance/disposing-consumer-report-information-rule-tells-how>.
14. *Credit Explained* (Information Commissioner's Office, October 2015), available at <https://ico.org.uk/media/for-the-public/documents/1282/credit-explained-dp-guidance.pdf>.
15. <https://www.moneysmart.gov.au/tools-and-resources/publications/factsheet-your-credit-report>.
16. <https://www.moneysmart.gov.au/borrowing-and-credit/borrowing-basics/credit-reports>.



FINANCIAL CAPABILITY

It is becoming increasingly important that people are able to manage their personal finances well—in other words, to be financially capable. However, surveys from a number of countries have shown that many people lack the knowledge, skills, attitudes, and motivation to do so. Many countries are therefore taking steps to increase their population's level of financial capability.

There is widespread recognition that strengthening people's financial capability is increasingly necessary as financial products become more complex and people obtain financial products for the first time as a result of a wider range of distribution channels, including non-bank providers. New products and services (for example, e-money, microinsurance), and the use of new delivery channels, such as mobile phones, smart cards, and agent networks, operated by new service providers (mobile network operators) can provide opportunities to reach large sections of populations that were previously underserved. Efforts to improve financial inclusion through access to basic transactional accounts, as well as through more sophisticated financial products and services, have also increased in the past decade, in part due to substantial commitments to increasing financial inclusion by international institutions, governments, and private sector players.

However, in order to take advantage of these opportunities, people need to be equipped with the knowledge, skills, motivation, and confidence to make informed decisions on how to manage their personal finances. They need to have a basic understanding of products and services and know how to take advantage of them. They then need to take actions to implement those decisions and to understand and manage associated risks, such as over-indebtedness and fraud. People who make good financial decisions and then implement these decisions are more likely to achieve their financial goals, improve their household's welfare, and protect themselves against

BOX 6

Definitions of Financial Capability, Financial Education, and Financial Literacy

While the terms *financial capability*, *financial education*, and *financial literacy* have different meanings, in practice they tend to be used interchangeably. This annex uses the following definitions:

Financial capability is defined by the World Bank Group as “the capacity of a consumer to make informed decisions and act in one's best financial interest, given socioeconomic and environmental conditions.”¹ Financial capability is the knowledge, skills, attitudes, and confidence that lead people to make financial decisions that are appropriate to their circumstances.

Financial education is a tool for increasing financial capability. According to the Organisation for Economic Co-operation and Development (OECD), it is “the process by which financial consumers/investors improve their understanding of financial products, concepts and risks and, through information, instruction and/or objective advice develop the skills and confidence to become more aware of (financial) risks and opportunities to make informed choices, to know where to go for help, and take other effective actions to improve their financial well-being.”²

Financial literacy refers to a person's understanding of key concepts required for managing their personal finances. Theoretically, it has a narrower meaning than financial capability.³

financial risks and negative shocks. For countries as a whole, strengthening the financial capability of a population can strengthen the economy, improve financial stability, and help to move some of the poor out of poverty.⁴

As shown in Box 6, financial capability encompasses not only financial knowledge, but also the skills, attitudes, and confidence of consumers—and is ultimately about consumers' behaviors. Behavioral economics, the study of how psychological factors influence economic decision-making by individuals, identifies common human

biases that can affect financial decisions. For example, people whose level of financial knowledge is low may nevertheless set aside some savings. On the other hand, a person who understands the benefits of saving, knows how to save with a financial institution, and intends to set aside savings may fail to save for a rainy day or to make provision for their retirement. This failure to translate an intention to save into concrete actions can sometimes be because, in practice, the person prefers immediate gratification or is subject to stress or other influences on their decision-making.

In addition to a person's financial capability, other factors influence a person's financial behavior. These factors include the accessibility of financial products and services, their affordability, and the extent to which people trust financial institutions to safeguard their money and treat them fairly (including if they have a grievance). Thus, supply-side measures need to be pursued in parallel with demand-side measures. Prudential regulation, financial consumer protection conduct regulation, financial inclusion initiatives, and financial capability initiatives are complementary, rather than alternatives, and each has a vital role to play in the development and maintenance of a stable and vibrant financial sector.

The development and subsequent implementation of a national financial capability strategy (NFCS) can provide the opportunity to involve a broad range of stakeholders and to set out a clear and agreed-upon pathway to strengthen financial capability within a country. In many countries where significant steps have been taken to strengthen the financial capability of the population, either a stand-alone NFCS or a financial capability section within a broader national financial inclusion strategy have been developed. The OECD/International Network on Financial Education defines a national strategy for financial education as “a nationally coordinated approach to financial education that consists of an adapted framework or program that

- Recognizes the importance of financial education—including possibly through legislation—and defines its meaning and scope at the national level in relation to identified national needs and gaps;
- Involves the cooperation of different stakeholders as well as the identification of a national leader or coordinating body/council;
- Establishes a road map to achieve specific and pre-determined objectives within a set period of time; and
- Provides guidance to be applied by individual programs in order to efficiently and appropriately contribute to the national strategy.”⁵

This annex sets out good practices (GPs) for increasing people's financial capability that are particularly useful for policy makers, financial sector regulators, and other key stakeholders who prioritize financial capability and/or are introducing an NFCS. This annex does not cover all issues relevant to financial capability—in particular good practices regarding the operations of financial capability programs. Rather, it focuses on those topics most relevant from a policy maker's perspective and within a policy maker's remit. While many of the good practices discussed herein are derived from experiences in providing traditional financial education programs, the GPs also include other emerging and promising practices, such as choice architecture, timely reminders, and use of incentives as tools for encouraging behavioral change. Since circumstances vary from country to country, this annex does not seek to prescribe practices that should be followed invariably in all countries but instead synthesizes good practices from around the globe and offers alternative options where possible, for policy makers to use as a reference and to apply and adapt to their own country's context.

More specifically, the GPs provide guidance on (a) the design of an NFCS; (b) the leadership of, and stakeholder involvement in, the design and implementation of an NFCS; (c) the selection, design, and implementation of financial capability programs, and (d) the monitoring and evaluation (M&E) of both the overall strategy and individual programs. The GPs take into account a variety of existing principles and guidelines to help increase financial capability, including the High-Level Principles on National Strategies for Financial Education and the Guidelines for Private and Not-for-Profit Stakeholders in Financial Education developed by the OECD with the guidance of the International Network on Financial Education. The GPs also draw from relevant work of international organizations such as the World Bank and global think tanks and non-governmental organizations (NGOs), including on financial capability surveys, effective financial capability programs and strategies, and M&E. The GPs incorporate the latest insights from behavioral economics as well as experiences from a range of countries in different geographic regions, with differing contexts and levels of income and capacity.

The GPs included in this annex are designed to be adoptable in a broad range of countries. However, in some less developed countries, resource constraints may mean that it may not be practicable to implement all GPs from the outset. Choices may therefore need to be made about which to implement first, with some of the GPs being regarded as medium- to long-term objectives. The explanatory notes include practical examples drawn from

a mix of countries, including countries that face capacity constraints.

Finally, these GPs should be read with a few important caveats in mind. The implementation of the GPs needs to take account the particular circumstances of the country. These include the willingness of specific stakeholders to make an effective contribution to the development and implementation of an NFCS and specific programs and activities, together with other opportunities and constraints within the country. There is no single “model”

NFCS—each NFCS so far developed has significant differences from other NFCSs. Moreover, despite substantial growing interest in financial capability in recent years, research on the impacts achieved by financial capability programs remains limited and, in some cases, mixed, especially for interventions for encouraging behavioral change. The current lack of replication and of robust results from different countries limits the ability to obtain a deeper understanding of factors that can contribute to successful results in different contexts.

A: NATIONAL FINANCIAL CAPABILITY STRATEGY

- a. Either a stand-alone NFCS or a dedicated financial capability section in a national financial inclusion strategy should provide a framework for all relevant stakeholders to strengthen the financial capability of the population.
- b. Steps should be taken to provide robust foundations for an NFCS, including the following:
 - i. An analysis of available information about the financial needs and behaviors of different segments within the population, including, if practicable, undertaking a baseline financial capability survey
 - ii. The mapping of significant existing financial capability initiatives within the country
 - iii. A stocktaking of good practices and relevant tools developed in other countries and at the international level
- c. At a minimum, an NFCS should include the following:
 - i. Definitions of key terms
 - ii. The results of any financial capability surveys that have been undertaken and other relevant data about people’s financial needs and behaviors
 - iii. An explanation of why it is important to strengthen financial capability in the country, who will benefit, and what the main expected benefits are
 - iv. An explanation of how the NFCS relates to other national priorities
 - v. The vision, goals, and objectives of the NFCS, which should be realistic and SMART—that is, specific, measurable, actionable, realistic, and time-bound
 - vi. A brief description of any significant existing financial capability programs on which the NFCS will build
 - vii. The key financial capability programs that form part of the NFCS and their target groups
 - viii. A description of arrangements for leading and coordinating the implementation of the NFCS and for involving stakeholders (see section B)
 - ix. So far as practicable, a description of arrangements for funding the implementation of the NFCS
 - x. A description of arrangements for testing proposed financial capability programs in advance, monitoring and evaluating financial capability programs, and measuring progress on implementing the NFCS
 - xi. An action plan summarizing the steps that will be taken over a specific timeframe, as well as the responsibilities of relevant stakeholders with regard to the NFCS implementation
 - xii. A M&E framework should be developed and published for assessing the implementation of both the strategy and individual programs (see section D)
- d. A manageable set of programs should be selected for inclusion in an NFCS.
- e. Programs should be selected for inclusion in an NFCS only if they are likely to be cost-effective—that is, they can be expected to reach scale and significant impact at reasonable costs.

- f. **Programs that are selected for inclusion in an NFCS should strike a reasonable balance between reaching different segments of the population, as well as between programs that are expected to generate quick wins and those that have longer-term impacts.**
- g. **Once it has been finalized, an NFCS should be published and communicated to stakeholders.**

Explanatory Notes

More than 60 countries are developing, or have already developed and are now implementing, a national financial capability (or financial education/literacy) strategy to strengthen the population's financial capability.⁶ In many cases, the strategy is aligned with other national development policies, such as increasing financial inclusion or strengthening financial consumer protection. The development of an NFCS helps provide focus and momentum, avoid unplanned gaps and unnecessary duplication, and establish sustainable partnerships. It provides opportunities to involve a broad range of stakeholders and to develop a road map setting out the steps that will be taken to strengthen the population's financial capability.

In some countries, a financial capability strategy forms part of an overarching national financial inclusion strategy or financial sector development strategy. This can help to ensure that plans to strengthen financial capability are rooted within a broader set of national priorities. However, a potential disadvantage of this approach is that it can dilute focus from financial capability.

Baseline financial capability survey. A nationwide financial capability survey provides a useful basis for identifying target groups⁷ within the population that have the greatest need for financial education, together with information about the strengths and weaknesses in people's knowledge, understanding, skills, and confidence regarding personal financial management. A survey also provides a basis for developing M&E indicators against which future progress in strengthening people's financial capability can be measured. Therefore, resources permitting, a comprehensive financial capability survey should ideally be undertaken, and the results analyzed, before an NFCS is developed. When deciding on the size and characteristics of the sample population, care should be taken to ensure that statistically significant results can be derived, both for the population as a whole and for relevant subsections of the population (for example, for young women living in rural areas).

The World Bank has developed a survey instrument, the Financial Capability and Consumer Protection questionnaire,⁸ to measure financial capability. The questionnaire has been tested extensively in low- and middle-income countries and can be adapted to fit country-specific contexts. To date, the survey instrument has been used in more than 20 countries in Africa, Latin America,

East Asia and the Pacific, the Middle East, and Europe. Other international financial capability and literacy measurement instruments and resources are available from the World Bank's Responsible Financial Access Team,⁹ the OECD,¹⁰ and the Alliance for Financial Inclusion. A review conducted by the World Bank of existing approaches to measuring financial literacy and financial capability also provides a useful reference for policymakers.¹¹

The adaptation, testing, implementation, and analysis of a nationwide financial capability survey are expensive and likely to take eight months or longer to complete. If it is not feasible to undertake a comprehensive survey due to resource constraints, policy makers should try to leverage the results of any surveys that have already been undertaken, such as FinScope surveys,¹² which explore consumers' perceptions toward, and use of, financial products and services. A few financial capability questions can also be incorporated into any broader survey that is already planned, such as a general household survey or a financial inclusion survey. Other data sources that should be leveraged to build up a picture of people's financial capability include consumer complaints data (which may provide insights into areas where people's financial knowledge is erroneous or lacking) and supply-side data (for example, on non-performing loans and dormant accounts). Key results of any relevant surveys and other pertinent data should be summarized in an NFCS and taken into account when identifying target groups and deciding on the nature and content of interventions to strengthen the financial capability of these groups.

Mapping of existing financial capability initiatives. Significant existing financial capability initiatives by public, private, and non-profit organizations should be mapped. These organizations may include not only government ministries and agencies but also financial service providers, credit bureaus, educational organizations, employers, NGOs, and donors. The mapping of existing initiatives can help to identify those initiatives that can potentially be built on, gaps in coverage (for example, population segments and geographic locations), and relevant and credible partners for the design and implementation of the NFCS. Mapping helps to avoid duplication of efforts in the strategy and to identify good practices and lessons learned from existing efforts.

At a minimum, the mapping for each initiative should include the identity of the implementing institution(s) and

any available information about the type of initiative (for example, face-to-face basic financial education for farmers); whether it is part of a broader initiative; target populations; delivery channels; delivery locations; topics covered; languages of delivery; duration of the initiative; when it was first implemented; whether it has been independently evaluated; and, if applicable, a website link. If possible, the mapping should also include any available information regarding costs, outreach, achieved impacts, lessons learned, and future plans.¹³ It is useful to summarize the results of this mapping in the NFCS, such as in an annex.

Mapping should not include so-called “financial education” that is in reality marketing campaigns for financial products or services of a specific provider, rather than information that is applicable across providers. However, it should include significant initiatives—by financial providers or others—that aim to influence people to behave in more financially capable ways (such as reminders or other prompts to save money).

Taking stock of successful financial capability initiatives in other countries. When developing an NFCS, policy makers should also consider successful initiatives and good practices in other countries as well as good practices and relevant tools developed at the international level. Some of these are referred to in section C of this annex.

Minimum contents of an NFCS

Definitions. The NFCS should define key terms (including *financial education*, *financial literacy*, and *financial capability*, depending on which term(s) are used in the NFCS). See Box 6 for guidance on possible definitions. While the terms *financial education*, *financial literacy*, and *financial capability* have different meanings in theory, they tend to be used interchangeably in practice. Therefore, for use in the NFCS and in communications, it can be better to pick the term(s) that stakeholders and the wider population in a particular country are most likely to understand generally. Stakeholders should also be able to understand and remember easily the definition selected, so that they can use this definition when communicating with others. It is therefore helpful to pick a definition for the NFCS that is short and simple.

Benefits of strengthening the financial capability of the population. An NFCS should set out the benefits that different stakeholders can expect to gain as a result of strengthening the financial capability of the population. Stakeholders are more likely to support and contribute to the development and implementation of an NFCS if they understand the potential benefits to them. Typically, these benefits include the following:

- **Consumers:** Consumers can make their money go further (for example, by earning more interest on their savings and by paying less interest on their borrowing,

saving for future emergencies or other needs, and protecting themselves against financial risks, such as by saving with regulated financial institutions and taking out appropriate insurance); reach retirement with sufficient financial provision to enable them to enjoy a reasonable standard of living; exercise their rights as financial consumers; and be less vulnerable to mis-selling and financial frauds and scams.

- **Financial service industry:** It makes good business sense for financial service providers to have consumers who have an understanding of financial issues and are engaged, rather than disengaged or suspicious. Consumers who have confidence in their ability to manage their personal finances are likely to be more active in acquiring financial products and services, which can help to reduce marketing costs and increase business volumes. Financially capable consumers are also less likely to acquire unsuitable products or services, or products or services that they do not understand, reducing the likelihood of dissatisfaction and consumer complaints.
- **Government bodies and financial sector authorities:** Improving the population’s financial capability can help to improve financial stability, stimulate savings, promote financial inclusion, and reduce overindebtedness, ultimately helping to reduce poverty. Moreover, it is in the interests of government agencies that support vulnerable groups (for example, people who live in rural areas or agricultural workers) that these people manage their money well.
- **Educational organizations:** Personal financial management is an important life skill not only for students but also for teachers. Teachers can benefit from being trained to deliver financial education to their students, since this will not only help them to manage their own family’s personal finances but also equip them to help their students acquire life skills that they will need as they move into adulthood.
- **Employers:** Employees who are in financial difficulties may well be distracted by these worries and therefore be less productive at work. Financial education can reduce the risk of employees getting into financial difficulties.
- **NGOs:** Many of the people whom NGOs typically support face financial stress. Improving people’s financial capability can help them not only tackle those challenges but also avoid getting into financial difficulties in the first place.

Other national priorities. An NFCS should explain the linkages between strengthening the population’s financial capability and the achievement of other relevant national

priorities. These priorities can potentially include financial stability, financial sector development, promoting financial inclusion, improving financial consumer protection, and poverty reduction.

Funding. To the extent possible, an NFCS should include funding arrangements for implementation of the NFCS. In addition to funding financial capability initiatives, there should be sustainable core funding for the leadership and coordination of NFCS implementation itself. Core funding is typically provided by the lead organization of the NFCS. A lower level of funding is likely to be available in the early stages of developing a NFCS, but more funding could be allocated if and when implementation of the NFCS can begin showing success.

Potential sources of funding for financial capability initiatives include: the government's central budget, the central bank and other financial sector regulators, public-private partnerships, financial service providers, foundations, donors, and implementing organizations' own resources. The development of an NFCS demonstrates that a country is committed to strengthening financial capability and has a plan to do so, which can serve as an encouraging sign for donors to contribute funding for financial capability initiatives.

Alternative models for funding of financial capability initiatives include the following:

- Stakeholders voluntarily provide funding and/or in-kind support for specific activities that are aligned with the stakeholders' interests and objectives, with the lead organization also providing core funding. This is the model used by the majority of countries that have developed an NFCS.
- Stakeholders either compulsorily or voluntarily contribute funds into a central pot. The allocation of these funds is determined by the lead organization, in conjunction with any steering or coordinating committee. In practice, however, stakeholders often tend to prefer to retain control over funds that they allocate for financial capability initiatives and to be able to see specific results from use of their funds.

Another potential model is for each financial service provider to be obligated to undertake, at its own expense, some financial education activities. While this model is used in some countries, it raises several issues. It may generate relatively small-scale initiatives with little reach or impact. It may also result in a lack of coordination, with both overlaps and gaps as well as inconsistent messages being delivered to target populations. Finally, it may be difficult to ensure that financial education initiatives are genuinely useful to consumers and objective.

Action plan. An action plan should be published at the same time as the NFCS. The action plan should set out specific and measurable activities, together with the responsible entities, timeframes, and prioritization level of each activity. The activities should cover the development, testing, and implementation of financial capability programs, as well as communications with the public and partners/stakeholders (for example, to share lessons learned). The action plan should be reviewed regularly (ideally on an annual basis) and amended as necessary.

Setting priorities for an NFCS is essential in order to maximize the impact of available resources. If an NFCS is too ambitious as a result of excessive or unrealistic priorities, resources will be spread too thinly, and limited concrete progress may be achieved. Priorities will vary from country to country, depending in part on a country's broader objectives, the findings from any financial capability survey(s) and other relevant data, the mapping of existing initiatives, characteristics of the population, and opportunities available in that country. In consultation with key stakeholders, priorities should be set for the strategy's objectives, target groups, and programs.

The following criteria that should be considered when determining which activities are cost-effective and impactful:

- **Need.** Which groups within the population (for example, children, youth, women, micro- and small entrepreneurs, elderly) have the greatest need for improvements in their financial capability, and which issues (budgeting, saving, understanding how to use digital financial services, responsible borrowing) are most important for each group?
- **Potential reach.** How many people are likely to be reached by a program? Some programs are likely to reach people indirectly as well as directly. (For example, children who have received financial education in schools can help their parents manage the family's finances.) Mass media and new technologies offer the potential to expand reach, delivering messages to many people at low cost. But some recipients may not take sufficient note of such messages, so the impact of such messages may be limited.
- **Costs.** The costs involved in developing and delivering financial education programs vary widely and depend on a number of factors, including the number of people reached, methodology (for example, face-to-face training, mass media, digital tools), accessibility of the target population, whether educational materials will need to be translated into different languages, and duration of the program. Opportunities to harness resources that may be available free of charge or at minimal cost should be leveraged. For example, a gov-

ernment agency or NGO that supports people in rural areas may be willing to deliver financial education.

- *Effectiveness.* Program experience within a country, as well as international good practices and experiences, should be taken into account in assessing the potential effectiveness of a program. For example, people tend to form attitudes toward money at a young age. Thus, financial education for younger children has the potential to be more effective for certain goals, by helping establish at an early age positive money-management habits that can continue throughout a person's life.
- *Feasibility.* The feasibility of a potential program should be assessed realistically. For example, even if it is widely accepted that financial education could potentially be delivered effectively through entertaining TV programs, it would not be realistic to prioritize this type of program if it was clear either that no broadcaster was interested or that no one was willing to meet the costs of developing good-quality programs.

Balancing population segments and short- and long-term gains.

In making judgments about which programs to prioritize, it is important to ensure that there is a reasonable overall balance between programs targeted at different segments of the population (for example, different age groups, different income levels, women and men, rural and urban areas). There should also be a reasonable balance between programs that can be expected to generate quick wins and programs that can be regarded as longer-term investments. For example, financial education for children is a longer-term investment, because it is likely to take years before this leads to significant changes in financial behavior.

The following financial capability programs are often undertaken in an NFCS:

- *Financial education in schools.* Such programs should be coordinated closely with relevant education authorities, including ministries of education. In virtually every country, curricula are crowded. It is likely to be more practical to incorporate financial education into an existing subject than to add a new subject, such as financial education, into an existing curriculum. Teachers need to be trained, so they have the knowledge, skills, and confidence to provide effective financial education to their students. If financial education is included in school curricula, this needs to be reflected in public examinations, so that students have a clear incentive to learn.
- *Financial education/financial capability messages to youth (for example, programs targeted at children of school age, university and college students, and members of youth clubs and associations).* This can also include financial capability messages that are deliv-

ered through both traditional and new media targeted at young people.

- *Financial education in larger workplaces.* For example, members of an employer's personnel or training departments could be provided with financial capability presentations, and trained to deliver them effectively to employees.
- *Financial capability programs/messages delivered by trusted intermediaries.* Trusted intermediaries can include government ministries and agencies (for example, those supporting youth, women, rural areas, or the agricultural sector); ministries of education, schools, and universities; health workers; community leaders; community-based organizations; NGOs; and religious leaders. These intermediaries can be leveraged to deliver targeted financial capability programs or messages during their regular contacts with clients. Organizations that are trusted by their target audiences are well-placed to deliver guidance on how people can protect themselves against, for example, financial frauds, scams, and mis-selling.
- *Financial capability programs/messages integrated into cash-transfer programs.* Since cash-transfer programs have program staff and infrastructure already in place, including training for consumers, and reach large numbers of excluded populations, these programs can be used to deliver financial education. Cash-transfer beneficiaries may be receptive to new information and to changing their behaviors when receiving their transfer, as this is potentially a "teachable moment" (see section C) when information is more likely to be retained and cash-management behaviors influenced.¹⁴
- *Financial education through social networks.* Social networks and communities can help promote and normalize positive changes in financial knowledge, attitudes, and behaviors. Organized groups, such as women's savings groups, youth clubs, church groups, and workplace groups, can provide opportunities for peer learning and sustained social support. They can also reinforce learning and encourage perseverance to reach financial goals. Individuals who participate in financial education programs often share what they learn with family members and friends, resulting in a positive multiplier effect. Training of trainers also produces multiplier effects. For example, HerFinance is a global workplace-based financial education program that targets low-income women working in factories and connects them to appropriate financial services. Local partner NGOs train female workers to serve as peer educators in their workplace and for members of their communities.¹⁵

- *Financial education websites.* A number of countries have developed financial education websites. Examples include Australia's MoneySmart website¹⁶ and New Zealand's Sorted website.¹⁷
- *Financial education via traditional and new media channels.* For example, newspapers and magazines, TV and radio, text messages, social media and apps.

Technology platforms and mass media channels provide opportunities to disseminate information in a manner that bridges great distances to reach large numbers of people and widely dispersed populations in a timely manner and at lower cost. Regular engagement and customized approaches that take into account individuals' circumstances are key to utilizing such channels effectively.

B: LEADERSHIP AND STAKEHOLDER INVOLVEMENT IN AN NFCS

- A credible lead organization should be identified to lead the development and coordination of an NFCS.**
- Well-resourced executive support should be made available by the lead organization.**
- Government support should be secured for the development and implementation of an NFCS.**
- Stakeholders from the public, private, and NGO sectors should be involved in both the development and the implementation of the NFCS.**
- A dedicated, national-level, multistakeholder structure should be established to oversee or advise the lead organization on the oversight of an NFCS and key financial capability programs.**
- The private sector should play an important role, but marketing initiatives should not be put forth as financial capability programs.**

Explanatory Notes

Lead organization. The lead organization for an NFCS needs to have credibility with stakeholders and the public and must be able to devote sufficient time and resources to undertake its role effectively. In most countries with an NFCS, the lead organization is a public sector body, most often the central bank or another financial sector regulator. Typically, one of the main challenges in the development and implementation of an NFCS is initial buy-in by stakeholders and their long-term commitment to an NFCS's objectives and activities.¹⁸ The lead institution needs to have the authority and influence to help persuade stakeholders to participate, forge partnerships between key public, private, and civic sector organizations, and secure the necessary resources and actors for implementation of the activities set out in the NFCS.

Experience from a broad range of countries shows that the development and implementation of an NFCS is more effective if there is strong leadership to drive work forward. The lead organization should not attempt to do everything itself. In every country, the improvements that are needed in the population's financial capability are beyond the scope of any single organization to achieve on its own. Instead, leadership should involve the following actions:

- Spearheading the development and implementation of a NFCS
- Advocating for financial capability at the national policy level and with stakeholders
- Consulting with stakeholders
- Ensuring that priorities are set and that unnecessary duplication and unplanned gaps are avoided
- Building partnerships and coordinating
- Promoting good practices and high-quality standards for programs
- Maximizing cost-effectiveness
- Overseeing funding, where appropriate
- Monitoring and evaluating the overall strategy and promoting effective M&E of financial capability programs
- Communicating with the public and stakeholders (for example, disseminating lessons learned and resource materials produced by partners and reporting on progress in meeting NFCS milestones)

In some countries, two or more organizations may jointly lead the NFCS. This arrangement can increase the resources available to lead and coordinate work. However, potential disadvantages are delays in reaching decisions and uncertainty in the case of disagreements among leads. If there are joint leaders, it is important that the responsibilities of each leader are set out clearly and protocols are put in place to enable any differences of view to be resolved swiftly and effectively.

Sufficient staff support. The lead organization will need sufficiently motivated staff with relevant skills to enable it to undertake effective leadership and coordination. Effective leadership and executive support are particularly important in the field of financial education because a wide range of (often unconnected) organizations can potentially be involved in developing and delivering programs. Priorities need to be set, and the activities of organizations involved in the development or implementation of financial education programs need to be coordinated in order to best utilize resources. One of the most common causes of failures in effective implementation of NFCSs is the failure to put in place sufficient staff with the right skills and motivation to support the lead organization.

A variety of roles are typically undertaken by the NFCS team within the lead organization. When identifying staff to provide support for an NFCS, it is important to ensure that they have the skills and experience to enable them to undertake the following sorts of roles:

- Promoting the case for improved financial education to stakeholders and more generally within the country
- Securing the support and involvement of key potential partners, including through fundraising
- Ensuring that priorities for the strategy are set appropriately, so that resources are used cost-effectively and are not spread too thinly
- Promoting high standards in the design and implementation of financial capability programs—for example, by issuing guidelines to stakeholders and making available high-quality resources
- Informing stakeholders about overall progress regarding implementation of the NFCS, financial capability activities that are being undertaken, future plans, and good practices within the country and elsewhere
- Where necessary, initiating financial education programs or ensuring that suitable programs are initiated
- Ensuring that activities are coordinated to avoid duplication and waste of resources
- Identifying needs for technical assistance and ensuring that such assistance is provided
- Developing a financial capability website
- Monitoring and evaluating the implementation of the strategy
- Providing advice to stakeholders on the effective M&E of financial capability programs and collating and disseminating to stakeholders the results of M&E exercises

- Commissioning, interpreting, and disseminating the results of national financial capability surveys

National-level, multistakeholder coordination structure.

In a number of countries, the lead organization is supported by an oversight or advisory body. Typically, these bodies comprise around 12–15 senior people drawn from a range of public, private, and NGO/donor organizations. This body can play a role in overseeing or advising on the development and the implementation of the NFCS. It can also be helpful to establish working groups of technical experts drawn from relevant sectors to help develop and oversee the delivery of financial capability programs.

For example, in Uganda, a Financial Literacy Advisory Group comprised of 11 representatives from the public, private, NGO, and educational sectors was established to provide strategic advice to the Bank of Uganda (the lead organization) on the development and implementation of the Strategy for Financial Literacy. In addition, five working groups (one for each topic) were established to develop cost-effective, sustainable, replicable, scalable, and well-targeted activities for strengthening financial literacy.

It will often take some time for people who serve on steering committees and working groups to gain a good understanding of how best to strengthen financial capability. Therefore, it is preferable to ensure reasonable continuity in the membership of such bodies.

Stakeholder involvement. Stakeholders from the public, private, and NGO sectors who can potentially provide technical or financial support should be involved in the development and implementation of the NFCS and financial capability programs. Stakeholders should possess a broad range of skills and experience to draw upon. Stakeholders are more likely to be willing to contribute to the implementation of an NFCS if they have been given opportunities to help shape the NFCS, rather than being presented with a completed product. Stakeholders should be consulted on key components of the NFCS, including the vision, goals, and objectives; existing financial capability programs; gaps and issues that need to be addressed; programs that should be prioritized; and issues on which they need support or guidance. The consultation process can help promote a sense of ownership and legitimacy in the NFCS that will be crucial in the implementation phase of the strategy.

For all stakeholders, their roles and responsibilities should be “consistent with their strengths, interests, and resources” as well as “flexible to adapt to changing circumstances and allow for negotiations among stakeholders to avoid duplication.”¹⁹

The following public sector stakeholders can potentially play important roles:

- The central bank and any other financial sector regulators
- Government ministries (for example, finance, education, and ministries responsible for youth, women, social protection/cash-transfer programs, rural/agricultural areas, and health)
- State-owned banks (as their clients often include people with lower incomes or lower educations)
- State-owned enterprises and government agencies
- Public schools and universities

Potential civil-society stakeholders include relevant NGOs, community-based organizations, private schools and universities, trade unions, consumer advocacy groups, and the media.

Private-sector stakeholders include the full range of financial service providers, their industry associations, credit bureaus, employers, and telecommunications com-

panies. Support from the private sector can range from developing and implementing specific financial capability programs to contributing resources, such as funds, manpower, expertise, and accommodation, to programs that are being led by others. Marketing initiatives to promote specific financial products or brands should not be disguised or promoted as financial education programs.

However, this should not preclude initiatives (for example, reminders or other prompts to save money) by financial service providers that aim to influence people to behave in more financially capable ways. Potential conflicts of interest, such as the marketing of specific financial products or brands instead of the provision of objective financial information, can be mitigated through guidance and monitoring of stakeholders involved. National codes of conduct or quality standards for financial capability programs can be developed and overseen by the lead organization. (See section C.)²⁰

C: FINANCIAL CAPABILITY PROGRAMS AND ACTIVITIES

- A variety of channels and delivery mechanisms should be used for financial capability programs, including both face-to-face training programs and non-traditional channels that leverage technology, mass media, or behavioral interventions, such as nudges, reminders, and choice architecture.**
 - The delivery channels for, and content of, financial capability programs should be client-focused and reflect the demographics, cultural and financial context, and learning needs and preferences of the target population.**
 - Financial capability programs should be cost-effective and make optimal use of resources.**
 - Financial capability programs should be designed not only to increase recipients' knowledge, but also to enable them to develop and practice their skills, to instill responsible attitudes, and, most important, to promote financially capable behaviors.**
 - So far as possible, financial capability initiatives should be fun, entertaining, and interactive and use simple messages that will resonate with the target audience. Where practical, they should involve "learning by doing."**
 - Financial capability programs should be delivered at "teachable moments."**
 - Financial capability messages should provide objective advice and should not be used as marketing initiatives for financial products or services.**
 - Financial capability messages should be repeated and reinforced over time, as one-off interventions are unlikely to be successful.**
 - So far as practicable, financial capability programs should build on successful programs already being undertaken in a country and leverage insights from the existing evidence base of effective financial capability programs in other countries.**
 - If practical, a system of accreditation of financial capability initiatives should be introduced, and an online platform and database of resources created.**
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Explanatory Notes

After an NFCS has been developed, the effective implementation of financial capability programs is critical to the success of the NFCS. Policy makers should take into consideration the following success factors, which can improve the effectiveness and impact of financial capability programs and activities.

Variety of delivery channels. Different people learn in different ways. Thus, it is good practice to make use of a variety of channels and methods. If people hear similar messages several times through a variety of channels and methods, this can help to reinforce such messages.

Key considerations in selecting delivery channels are their level of accessibility to the target population and their effectiveness. Accessibility concerns include location (if face-to-face training is involved), timing, duration, and frequency of the program, including whether it fits with the target audience's schedule. The use of mobile technology and other new media is growing, but it is important to consider how many members of a target audience for any specific initiative have ready access to such devices or the Internet. For example, while mobile phones are fast becoming ubiquitous in low-income countries, some sections of the population may still have limited access, including economically vulnerable people who own SIM cards but do not own their own phones, or adolescents who rely on their parents' mobile phones. Poor network connectivity or limited access to electricity in some areas also limits access. In terms of effectiveness, interventions based on text messages are unlikely to be effective among sections of the population with poor literacy levels. Moreover, some people will be more receptive to information that is delivered face-to-face.

Effective design for face-to-face training. Participant take-up and completion of voluntary financial capability programs are often difficult to achieve. It can be harder still to bring about longer-term change in knowledge, skills, attitudes, self-confidence, and behaviors. Participating in programs competes with other demands and pressures in people's daily lives. Unless individuals clearly understand the benefits and relevance to them of the financial capability program, they are unlikely to register, attend regularly, and make real improvements in their financial capability. Psychological biases that influence individuals' participation in programs and financial behaviors should also be considered when designing financial capability programs.

A key challenge that needs to be tackled when devising financial capability interventions is ensuring that they address the learning needs and preferences of the target populations. Too often, programs are designed without

sufficient consideration given to the priorities and concerns of the target audience. As a result, programs may not sustain participants' interest or address their specific needs. The quality of the content, and the way in which a program is delivered, affect the outcome of a financial capability program.

Good design begins with a client-centric focus and an understanding of the target population's demographics and the group's cultural and financial context. For example, the following key questions should be asked:

- What stage are they at in their financial lives and which types of financial issues do they typically encounter?
- Based on the above question, what are the relevant priority financial issues or topics they need to understand better?
- What are the potential biases that might provide a barrier to behavioral change?
- How can the information or levers to encourage behavioral change best reach the target audience, considering their sociodemographic background (for example, gender, age, education, literacy level, income level) and culture?

A few focus group discussions with members of the target audience can help to answer these questions. The results of any financial capability surveys and other relevant data should also be taken into account.

Situations, stories, examples, terminology, and visual aids used in financial capability programs need to be relevant, culturally appropriate, and emotionally engaging. Delivery methods should reflect the target group's learning needs, styles, and preferences. For example, for low-literacy participants and other groups possessing a strong oral tradition, programs should rely on oral or visual presentations. People should also be able to perceive the program's immediate usefulness and real-world relevance to their lives. This helps to maximize participant take-up and retention in the program and to motivate them to apply the new information, skills, or sense of confidence in their finances.

Technology can potentially provide a customized learning experience for individuals. For example, in Chile, computer kiosks installed in social service offices provide individuals with projections of their pension payouts based on their personal financial profiles. They also provide a simulator to indicate how individuals' different financial decisions might affect their payouts. Individuals who have had this personalized learning experience are more likely to make voluntary pension contributions and to increase the amount they contribute, compared with people who received generic information about the benefits of contributing to pensions and how to increase their payouts.²¹

So far as practicable, participants should be given ample opportunities to reflect on, pose questions about, and practice what they have learned, thus encouraging them to be active agents in their own learning. As much as possible, training (whether face-to-face or online) should involve dialogue between trainers and participants and/or among participants, so that learning is not one-directional (only from trainer to participants) but is instead an interactive process that also involves participants providing information, questions, and opinions. Interactive learning can occur through a variety of means, such as classroom discussions, games, group activities, and online discussion forums, and through online financial tools, such as savings, debt, or retirement calculators, where participants input their data to estimate the amount of money and time needed to reach their financial goals. Interactive learning should aim to anchor the content within participants' experiences and help them to apply what they have learned.

Face-to-face financial education is more likely to be sustainable if it is integrated into existing programs with a broader purpose. Face-to-face training can be expensive to deliver as a stand-alone intervention. But if financial education is integrated into initiatives with a broader purpose, such as livelihood training for social protection beneficiaries, workplace training, or school curricula, it can be more affordable and reach large numbers of people.

Non-traditional delivery mechanisms incorporating behavioral insights. Recent research examining financial decision-making by people in poverty suggests that the stress caused by coping with financial problems can severely reduce the cognitive ability to make better choices, potentially causing a negative feedback loop and reinforcing the conditions that gave rise to poverty in the first place.²² "Financial illiteracy and perverse behavioral biases are two related but distinct aspects of the same overall problem: poor financial decision-making."²³ Research has found that some financial capability programs can be effective in changing financial behavior—even if the financial literacy of the target participants has not improved—by appealing to people's emotions and sticking in their memories. Financial capability can be improved through a variety of different methods that take into consideration behavioral insights, including non-traditional delivery channels and mechanisms, such as edutainment, nudges, choice architecture, or technology-enabled solutions.

- **Edutainment.** When financial education is fun and entertaining, it can spark and hold participants' interest. "Edutainment" combines educational content with entertainment to improve learning by making it more enjoyable. Dramas, stories, and other narrative devices that appeal to emotions can be effective tools

for communication. Research suggests that non-traditional delivery channels, such as TV dramas, can bring about significant improvements in knowledge and behavior; viewers' emotional connections with characters and their stories play a key role in motivating these changes.²⁴ However, the cost of producing and broadcasting TV programs can be very high and may not be affordable in some environments. Games can also provide opportunities for participants to learn and practice knowledge and skills in a safe and entertaining way. A research study on online games in which adults from low-income and minority groups practiced navigating finances through a series of evolving circumstances suggested that participating in the game led to increases in financial knowledge and self-confidence. However, the scope of the study was limited, and the sample size relatively small.²⁵

- **Nudges.** Nudges can include sending reminders, using peer pressure, and providing incentives. For example, regular, timely reminders about making a deposit can help to flag the importance of saving as part of an individual's routine financial decision-making process, prompt individuals to take action, and encourage the habit of saving. When paired with a pre-identified savings goal, reminders serve to highlight to individuals their original reason for delaying current consumption and help them to control their spending. Employers can incorporate nudges and reminders into their payroll systems. An experiment in the Philippines found that reminders from their bank increased the likelihood of clients reaching a savings goal and increased the total amount saved. Reminders that referred to the client's pre-stated savings goal were even more effective in increasing the client's savings.²⁶ Other nudges can entail financial incentives, such as savings lotteries, which can make saving behavior more attractive by giving savers a chance to win prizes. In Nigeria, a national marketing campaign along with a lottery promoted savings and resulted in improvements in savings behavior and the use of financial products over the short-term.²⁷
- **Choice architecture.** Changing default options from "opt in" to "opt out" harnesses the status quo bias for positive results. An example is automated payroll deductions that deposit directly into retirement accounts but allow individuals to stop the deductions at any time. The status quo bias means that individuals are unlikely to opt out of these deductions, so their retirement savings will grow more than otherwise. Employers can increase the likelihood that employees will contribute to a private pension scheme by making pension deductions the default option, instead of requiring employees to actively opt in if they wish to

contribute. Commitment devices, such as a savings product that restricts or penalizes withdrawals before a specified date, are another example of leveraging choice architecture to alter savings behavior. Research has demonstrated that there is significant demand for commitment savings products, and that those individuals who are more impatient—that is, more likely to be tempted by present consumption than by future gains—are the most likely to take up a commitment savings product.²⁸

- **Leveraging technology.** The explosion of data created by social networks and mobile phone usage, substantial improvements in the power of and decreases in the cost of computing, and advances in analytics, particularly machine learning, have led to an increase in the use of artificial intelligence in the financial services industry.²⁹ Examples of how artificial intelligence can be deployed to help people make sound financial decisions include automated financial advisors and planners. For instance, IBM Watson has developed a virtual agent, Eva, that enables app users to complete transactions, such as transferring money and paying bills. Another example is smart wallets, such as Wallet. AI, that can monitor and learn users' habits and needs, then alert and coach users to alter their personal spending and savings behavior. Such technology-enabled solutions hold promise to deliver real-time customized financial advice, calculations, and forecasts at reduced costs based on users' needs and habits, although the jury is still out on the long-term effectiveness of these solutions to encourage positive behavioral change.

Financial education at “teachable moments”: Financial capability programs should leverage so-called “teachable moments”, those times in people’s lives when they are facing important financial decisions and may be more likely to be receptive to financial education. Teachable moments can include when someone starts university or college, starts a new job, gets married, starts a family, starts a business, buys a home or a car, becomes eligible to join a pension scheme, prepares for retirement, or lives in retirement. Stakeholders more likely to reach people at such moments include government ministries and agencies, such as social protection ministries that provide targeted cash/electronic transfers when their beneficiaries need them the most, NGOs, financial service providers that provide financial products around life events (for example, savings products for children’s education, loans to launch a business).

Reinforcement. Results from recent WBG financial capability programs point to how difficult it is to improve financial capability among the poor via sustained behavioral

change over the longer term.³⁰ One-time interventions, such as workshops, can have an impact in the short-term, but over time, these effects fade, and individuals revert to their former behaviors. Periodic reinforcement and longer-term exposure to information is needed to sustain knowledge and behavioral change. Financial capability programs should aim to combine interventions with short-term impact (for example, workshops, temporary financial incentives) with tools and treatments to help individuals maintain positive behaviors over the longer term, such as commitment devices, reminders, embedded financial education, personalized financial tools that track people’s finances and their progress toward goals, and social network platforms. Financial education integrated into school curricula and reinforced at home can also help to develop life-long positive financial habits starting at a young age.

Opportunities to practice skills. The application or practice of new knowledge and skills can help individuals to build confidence and develop skills. For example, new users of formal financial services may learn or practice how to use a service through their dealings with front-line staff or bank agents. Simulators for automated-teller machines and mobile banking provide opportunities for individuals to learn how to transact safely when using digital financial services. Where feasible, practice should be integrated into the design of a program, so that people can practice what they learned immediately through a real-life or simulated context.

Build on existing evidence base of effective programs. Where practical, programs that are included in an NFCS should build on successful financial capability programs already being undertaken in a country. This can reduce costs and increase the prospects that the programs will be effective. However, it is important that the programs that are built on have genuinely been successful. Where possible, opportunity should be taken to make improvements to the content of the program or to the delivery mechanisms that are used. Insights from effective financial capability programs in other countries should also be considered.

Accreditation of financial capability initiatives. It can be helpful to introduce a system of accreditation of financial capability initiatives, so that stakeholders and the general population can be confident that the initiative can be trusted. In Brazil, the National Committee for Financial Education enables organizations that deliver financial capability initiatives to apply for accreditation, which is granted if the initiative meets specific criteria, including if it incorporates appropriate educational principles, is inclusive, is provided free of charge, does not involve the commercial promotion of products or services, and incorporates an M&E methodology.

Online platform and database of financial capability resources. The creation of an online platform and database of financial capability resources enables financial education providers to gain access to a variety of resources. The Financial Consumer Agency of Canada maintains the Canadian Financial Literacy Database, a comprehensive list of resources, events, interactive tools, and information offered by financial education providers and a tool for those involved in financial education to network and identify potential collaborations with other organizations. While the Financial Consumer Agency of Canada does not have

sufficient staff to review every submission in detail, it does undertake some checks on website content and has rejected submissions from financial service providers that it felt were commercial in nature (for example, an account selector tool that points only to accounts from that provider). In the United Kingdom, the Personal Finance Education Group includes on its website descriptions of resources that help those who teach young people about money. It enables teachers to search for resources by both topic and the age group at which the resource is aimed, and it includes links to many of these resources.

BOX 7

Lessons Learned from Select Financial Capability Programs

1. Financial education in schools in Brazil. A large-scale financial education program was designed and delivered to 26,000 secondary-school students in 900 schools. Initially beginning with a pilot from August 2010-December 2011, the program has since been rolled out nationwide. The classroom training focused on a broad range of themes, including saving, budgeting, and general financial management. A complementary workshop was offered to parents to involve them in their children's financial education. The content of the textbook and materials in the program, which had been designed by experts, was highly relevant to the students. The teaching staff were well trained and motivated with incentives. The exposure to financial education was over a significant period of time (three academic semesters).

Findings/lessons learned: A study of the program found significant increases in students' financial proficiency scores and in their savings. Their intentions to save and financial autonomy also improved significantly. Parents experienced "trickle-up impacts" as well, showing significant improvements in their financial knowledge, savings, and spending behavior.³¹

2. Integrating financial capability into government cash-transfer programs in West Africa. In Guinea, Liberia, and Sierra Leone, tailored financial education modules were developed for recipients of social protection programs and pilot tested in 2017. Modules were also developed to enable their trainers to deliver financial education effectively. The financial education module aimed to enhance the skills of beneficiaries to respond to income shocks, such as the one caused by the Ebola crisis, proactively manage their household finances, and make effective use of their

transfers in order to meet critical day-to-day needs and invest in the development of their families. The financial education module also aimed to strengthen beneficiaries' understanding of relevant payment mechanisms, including electronic payments.³²

Preliminary findings/lessons learned from pilots: These pilots demonstrated how financial capability programs can be produced using little if any reading material, since it relied essentially on oral content supported by audio and visual materials. They also showed how a continuous series of day-to-day life stories, presented in a series of sketches, can cover various financial capability topics.

3. Edutainment through TV soap operas in South Africa. Financial education messages on debt management were integrated into the storyline of a popular prime-time soap opera, *Scandal*. The financial storyline, which ran for two months in 2012, featured a leading character who borrows irresponsibly and finds herself in financial distress.

Findings/lessons learned: Viewers who watched the financial storyline showed significant improvements in their financial knowledge and behaviors around debt management. Viewers were more likely to borrow from formal sources and less likely to engage in gambling or enter into hire purchase (installment-plan) agreements. Qualitative focus groups with viewers indicated that their emotional connection with the leading character was a key motivation in changing their behavior. Financial education messages delivered through the leading character tended to be more memorable to viewers than when those messages were delivered by a new character developed specifically for the financial storyline and outside of the show's normal cast of characters.³³

D: MONITORING AND EVALUATION

- a. An M&E framework, covering both the NFCS as a whole as well as key financial capability programs, should be developed alongside the NFCS.
 - b. The M&E framework should be published, either as part of the NFCS or separately.
 - c. A national survey to measure financial capability should be conducted regularly (around every five years) to identify changes in the level of financial capability of the population over time and adjustments that may be needed to strategy priorities and programs.
 - d. An annual review should be undertaken of the implementation of the NFCS.
 - e. Before finalizing and launching a financial capability program, the program should first be tested through the use of focus groups and/or a small-scale pilot program.
 - f. To the extent possible, strategically important, costly, and promising innovative programs should be rigorously evaluated prior to their national rollout to ensure that programs are rolled out only where there is evidence that they will achieve their intended impact.
 - g. Where resources permit, the use of external evaluators should be encouraged.
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Explanatory Notes

M&E framework. A robust and well-planned M&E framework will enable informed assessments to be made about the effectiveness of the NFCS as a whole—including the impact on the overall population and on key target groups—as well as the effectiveness of individual financial capability programs. Increasing financial capability is a long-term endeavor, and it may take several years before significant impacts emerge across the population. The M&E framework needs to track progress against the objectives, activities, and outputs outlined in the action plan to enable informed decisions to be taken on whether resources are well spent on effective programs.

At the national level, the M&E framework should provide for the monitoring of activities undertaken by various stakeholders and for the evaluation of overall progress in meeting the objectives and priorities set out in the NFCS and action plan. An M&E framework encourages consistency in the type of data collected across a diversity of programs, sectors, and stakeholders. The establishment of standard financial capability indicators, as well as guidance and tools to stakeholders on how to collect data, will allow for easier and more effective comparison and analysis of program data and results. The M&E framework should provide for monitoring of the scope, scale, and quality of each financial capability program and an evaluation of which interventions work and which do not.

National financial capability survey and indicators. Financial capability surveys typically include questions relating to people’s demographics and financial status, together with questions designed to provide information about

their financial knowledge, behaviors, and attitudes. Financial capability indicators, developed from information collected by a national survey, should be used to create benchmarks against which progress can be measured over time. Simple indicators should be developed to identify the percentage of the population with particular attitudes and behaviors. For example, the WBG Financial Capability and Consumer Protection surveys track the percentage of adults that plan how to use money they receive, try to save for the future, or agree with statements about not being impulsive.³⁴ A national survey repeated on a regular basis will enable progress toward NFCS objectives and changes in the financial capability of the general population and of specific sociodemographic segments to be measured over time. In Malawi, for example, the national financial education strategy outlines key performance indicators for financial capability, based on variables from a national financial capability survey and the FinScope survey, and identifies specific indicators for each priority target group in the strategy.

Annual review. It can be useful to develop a central database of stakeholder initiatives, showing their target groups, geographic locations, the financial capability topics being addressed, and the results of evaluations. The most recent national financial capability survey and the central database of initiatives, together with consultations with stakeholders, can then provide the basis for an annual review of implementation of the NFCS. The results of the annual review should be used to make appropriate changes to the NFCS as a whole and to individual programs.

Testing/piloting proposed programs. Proposed financial education programs should be tested with members of the target audience before they are finalized and rolled out. Possible methods include focus groups³⁵ and pilot projects. Testing helps to improve the design and delivery of the program and to establish whether changes need to be made before the program is rolled out. For example, even though a communication has been designed to be clear and simple, feedback from members of the target audience may well be that the communication needs to be made even simpler. Before embarking on a pilot program or other small-scale delivery, it is also good practice to consider first whether it is realistic to expect that if the program proves to be effective, it is possible to scale up so that it reaches significant numbers of people. If it is not practical to scale up, then the pilot is not an efficient use of resources.

Rigorous evaluations. To date, robust evidence on which types of financial education programs and interventions are the most effective is limited. More rigorous evaluation is needed to determine the efficacy of different types of financial education or financial capability programs. Countries such as Australia, Malaysia, and the United Kingdom are making efforts to collect data and build a body of evidence from the programs in their countries.³⁶ Initiatives should be evaluated to assess their impact on those people they are intended to reach. This can help policy makers and funders decide, on an informed basis, which

initiatives should be continued (and perhaps scaled up) and which should be modified or discontinued.

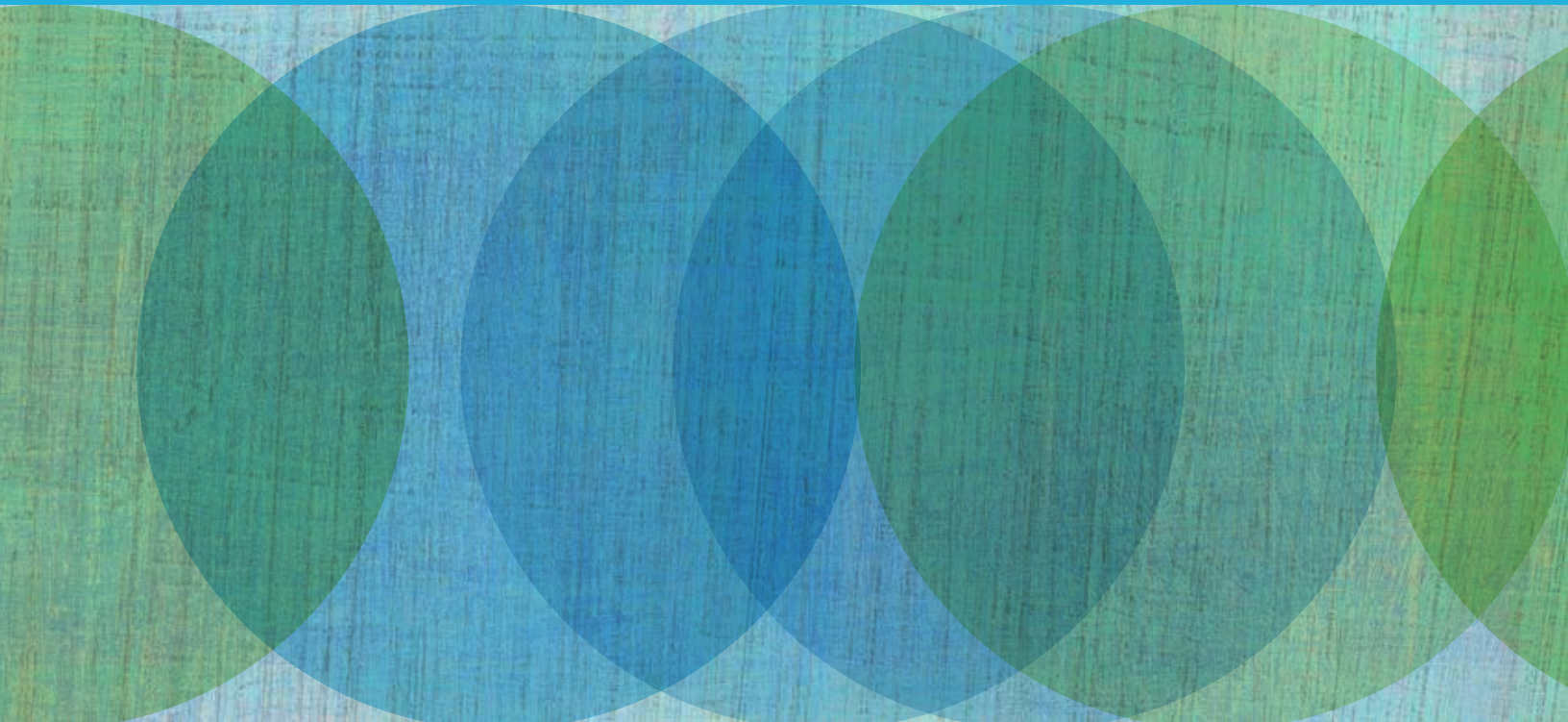
Program evaluations should be rigorously designed to ensure that they answer critical questions, such as what impact the program had and the key factors in achieving that change. The World Bank developed a toolkit that provides practical guidance for the evaluation of financial capability programs in low- and middle-income countries.³⁷ The OECD has also developed high-level principles and guidance on the evaluation of financial education programs.³⁸ Depending on available resources, countries may need to be selective about which financial capability initiatives are subjected to rigorous evaluation. Selection criteria should include strategically important programs (for example, national school-based programs), costly programs that could potentially be scaled up, and promising innovative interventions that have never before been tested.


External evaluators. Using external evaluators helps to provide credibility, specialist skills, and independence. When choosing external evaluators, consideration should be given to whether they have appropriate levels of familiarity with each element of the program, including the subject matter, delivery method, and target group. Similar consideration should be given to the evaluators' skills and experience as an evaluator, including their ability to report the evaluation findings in a manner that is accessible to all key stakeholders.³⁹

NOTES

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