

Are Consumer Protection initiatives meeting expectations? A Reality Check
Bill Knight, former Commissioner Financial Consumer Agency of Canada

Market conduct or non-prudential regulation is a relatively new concept to regulatory structures worldwide and is not considered to be as important as prudential regulation by most central bankers. In the developing world, many governments are just beginning to introduce new rules related to non-prudential regulation. With grudging support from central bankers and prudential regulators, consumer protection measures are sporadic at best and unable to meet expectations of consumers internationally.

In Canada, market conduct regulation has existed for many years but it has only recently been acknowledged as a key component of the regulatory regime through the creation of a separate federal market conduct regulator. While Canada is still working hard to find the right balance between consumer protection and competition in the financial services sector, its' regulatory regime is evolving to meet the challenges of a consumer driven marketplace.

In Canada, federal market conduct regulation has its origins in the late nineties, when a government sponsored task force, *The Task Force on the Future of the Canadian Financial Services Sector*, (MacKay Task Force) chaired by Harold MacKay broke new ground by dedicating several volumes of its final report to research about consumers in the financial services sector. The report set out some key principles for the Government of Canada to consider in the review of financial services legislation including plain

language, consumer education and increased disclosure.¹ For the first time, the MacKay Task Force set out the importance of the retail consumer to the efficient and effective functioning of the marketplace. The MacKay Task Force pointed out that “markets in which consumers function well are markets which maximize benefits overall.”² The Government responded to the MacKay report by establishing a separate federal agency responsible for regulating financial institutions and their interaction with retail consumers. The Financial Consumer Agency of Canada (FCAC) was established in October, 2001 with William G. Knight as its’ first Commissioner.

The Canadian financial services regulatory regime is complex as financial institutions are regulated both federally and provincially. The federal government has jurisdiction over “banking” while the provinces have traditionally been responsible for the market conduct of financial intermediaries (e.g. insurance brokers and agents, securities dealers, mortgage brokers, financial planners); and, for the regulation of credit unions and caisses populaires. With the creation of the FCAC, market conduct of “banking” was clearly set out to be the responsibility of the federal government. FCAC has jurisdiction over approximately 420 federally regulated financial institutions. As the designated federal market conduct regulator, FCAC was assigned responsibility for all consumer provisions set out in financial services legislation. The main categories of provisions and regulations include: opening bank accounts; cashing federal government cheques; closing bank branches; coercive tied selling; disclosing cheque holding policies; providing information to consumers about FCAC; disclosing information about account charges and interest;

¹ Task Force on the Future of the Canadian Financial Services Sector, Change, Challenge and Opportunity; Empowering Consumers September 1998

² Task Force on the Future of the Canadian Financial Services Sector p. 1

producing Public Accountability Statements; establishing procedures for dealing with complaints; and disclosing the cost of borrowing.³ FCAC also monitors compliance with voluntary codes of conduct and public commitments put in place by financial institutions to protect consumers. In Canada, these codes cover a variety of topics including: the responsibilities of consumers and financial institutions in the event of an unauthorized use of a debit card; the credit card associations have put in place codes dealing with liability and unauthorized use of a credit card; and, there is a code addressing issues related to credit relations with small business. While FCAC's Commissioner has powers under the law to fine financial institutions who violate consumer provisions, he can only monitor compliance with the codes or public commitments and report out in a generic way about the level of compliance.

With the creation of the FCAC, the Government set out a supervisory regime that was quite different from the prudential supervisory structure. The Commissioner is appointed for a five year term and has a quasi-judicial role within the regulatory structure. The Commissioner has powers under the law to investigate potential violations of the law and to make decisions on specific cases that could include an administrative monetary penalty (AMP) in the range of 0 to 200,000.⁴ The Commissioner has the discretion to publicly name a financial institution that has violated the law. With these powers in place, there is strong incentive for the regulated financial institutions to cooperate and meet standards and best practices as articulated by the Commissioner. Consumers are made aware of the cases through publication on the website, thus,

³ FCAC Annual Report Value for Canadians 2005-2006 See Appendix 1 for a detailed list of consumer provisions

⁴ The AMP regime was amended in the 2006 review of the FCAC Act moving from \$100,000 to \$200,000.

allowing them to shop around for financial products and services with increased knowledge of the pitfalls.

In the first five years of operation, FCAC used a variety of techniques to fulfill its supervisory mandate. It operated a national call centre and investigated complaints from the general public that related to the consumer provisions in the various acts. It established a compliance framework that uses a self reporting model where banks and other financial institutions report complaints that might relate to the consumer provisions in the Act or compliance with the voluntary codes. With that information as a base, FCAC was able to investigate cases and identify issues that were systemic in nature and required major changes to the practices of banks and other financial institutions. Identification of systemic issues is done through an initial review of the issue and relates to the number of consumer affected and the potential harm done.

The creation of a separate agency for market conduct regulation was at first greeted with skepticism by financial institutions whose initial view was that interactions with retail consumers was the responsibility of their marketing department not a regulator. However, the seriousness of the issues being addressed by the Agency silenced many critics. Early in its mandate, after receiving a complaint from an individual consumer, the Agency undertook a review of bank mortgage documents to determine whether the mortgage prepayment penalty clauses were clear and accurate. As a result of the review most banks had to revise their documents.⁵ Today, mortgage documents are clearer and

⁵ Financial Consumer Agency of Canada Annual Report 2005-2006

include the information needed by borrowers to allow them to determine the real costs of paying out a mortgage early. FCAC ensured that consumers were made aware of pre-payment penalty clauses by providing information to the public through the media and website. By focusing on awareness, FCAC helps to build confidence in both the regulatory structures and the products that consumers buy.

Systemic issues have been revealed with other key financial products including credit cards. As a result of a single complaint, the Agency undertook a review of credit card solicitation practices and found several banks were using a tactic whereby consumers were offered a rate usually much lower than the interest rates on other credit cards. But once the consumer applied for the card, the overwhelming majority of consumers ended up with interest rates higher than what the solicitation materials suggested were possible. FCAC's Commissioner dealt with several financial institutions through the legal process and then worked with the industry as a whole to eliminate the practice. Credit card solicitation practices were discussed in the media and FCAC was able to raise awareness that regulators are watching financial institutions practices as they relate to the consumer and thus building confidence in the system as a whole.

While the Canadian regulatory regime leaves redress to an independent ombudsman system, FCAC's interventions impacted hundreds of thousands of consumers and the Agency has estimated that over \$80 million has been voluntarily refunded to Canadians by their financial institutions. With voluntary refunds from institutions directly to consumers, there is an overall impact of assurance that both regulators and financial

institutions are working together to ensure that consumers are well served. The Canadian redress system works in parallel to the non-prudential supervisory system. The Banking Ombudsman is the final step in a complaint system mandated and enforced by the market conduct regulator. It is a system whose main task to deal with individuals and their financial institutions to determine fairness with respect to a complaint and to recommend redress where appropriate. When this system does not meet the expectations of consumers, they are turning increasingly to the courts in the form of class action suits something that has been more common in the United States than in Canada.

The market conduct regulator has been able to track new emerging issues that relate to the consumer through its call centre. The call centre was receiving an average of 40,000 calls a year from Canadians while the website attracted over 150,000 visitors a month. This has allowed consumer to be advised of key issues but also given them a forum to raise issues with the Canadian government. One key example, is pay day loan companies in Canada that fell outside market conduct regulation. With consumers calling to complain about high interest rates and questionable practices, Canadian policy makers moved to establish a regime that will allow for the regulation of pay day loan companies. With a forum to raise issues and a way to be informed of key issues consumer confidence in the system as a whole is enhanced.

While market conduct is relatively new to regulatory regimes in Canada and around the world, it is my view that its importance is just beginning to be realized. In mature economies, consumer confidence drives prosperity and that confidence is central to a

profitable financial services sector. While prudential regulation is the foundation for regulation and the safety and soundness of a financial system, it is the consumer that decides whether that foundation is solid. The most recent example of the impact consumers have was in the United Kingdom with Northern Rock. The world saw media pictures of consumers lining up to take out their money from Northern Rock while regulators prudential and non-prudential alike rushed to guarantee deposits. Northern Rock demonstrates in my view, that the notion that in a market driven economy, market forces should prevail does not hold. We saw that in a situation of a potential failure regulators stepped in with prudential and non-prudential decisions to resolve the problem. The consumer's confidence in the financial system and their protection became the driving force behind the regulators moving to avert a potential failure. Consumer protection was paramount and regulators around the world took note of the response in the UK.

Market conduct and non-prudential regulation is clearly an important component of an appropriate regulatory regime. Financial education and literacy play an important role in building consumers understanding of financial services and indirectly their confidence in the system. In Canada, many of the issues addressed by FCAC are linked to the complex nature of financial products and services. With financial institutions racing to meet demand and create choice for the consumer in a very competitive environment, the complexity of products is increasing rather than getting simpler. With multi-channel distribution of services, risk for the consumer increases. That risk may not be to the safety of a given product but instead to the complexity of the product and the

implications to the consumer of making a bad decision. Governments internationally are beginning to worry about the implications to the “state” in situations where consumers are not prepared to make key decisions about their financial affairs. In many countries, pensions have moved from defined benefit to defined contribution with many consumers not grasping the impact that could have on their retirement. Governments have moved responsibility for income security to citizens and not provided them with tools to make good decisions. In several countries, including the UK, governments have begun to take action to address the information gap for their citizens. In the UK there is a 10 year comprehensive financial capability plan that has been set out by the government to meet the needs of their citizens in this regard. That plan includes school based training, and tools available to people in the workplace. In Canada, the Government committed \$3 million in the last budget toward a financial literacy program aimed at youth. Financial literacy/capability will become a greater focus for all governments concerned about consumer confidence in the financial services sector.

The importance of the consumer to a vibrant and healthy economy has moved non-prudential/market conduct regulation to a place at the table beside prudential regulators in the financial services regulatory structures around the world. Safety and soundness of the financial system is dependent not only on the financial institutions themselves but increasingly on a confident consumer. While consumer initiatives are not yet meeting expectations, it is my view that most governments are on the right track. As Governments move forward to adjust regulatory structures they will pay close attention to

the consumer and their needs. In my view, regulators and financial institutions alike will have to reflect on their practices in the context of a consumer driven economy.





Appendix 1





Summary of Consumer Provisions and Related Matters

The chart below summarizes the provisions and indicates which institution(s) they apply to.





Legend:

-  **Banks**
-  **Trust and loan companies**
-  **Insurance companies**
-  **Retail associations**

Provisions	Type of Institution			
				
Requirement to disclose interest and charges applicable to deposit accounts	X	X		X
Requirement to disclose the cost of borrowing	X	X	X	X
Requirement to have procedures for protecting customer information (no regulations in effect)	X	X	X	X
Requirement to open retail deposit accounts	X			
Requirement to provide notice that deposits are not insured when bank is not a member of CDIC	X			
Requirement to offer a standard low-cost account (not in effect) Note: Instead of a regulatory approach to bring this provision into effect, eight financial institutions have voluntarily committed to providing a low-cost account within guidelines established by the government.	X			
Within 14 days of opening a retail deposit account by telephone, consumer's right to close the account without charge	X	X		X
Prohibition on charging for cashing Government of Canada cheques	X	X		X
Obligation to cash Government of Canada cheques to a maximum of \$1,500, as specified by regulation	X			
Requirement to provide notice before closing a retail branch	X	X		X
Requirement for each institution with equity of \$1 billion or more to file a Public Accountability Statement	X	X	X	

Requirement to set up complaint procedures and to file a copy of those procedures with FCAC	X	X	X	X
Requirement to join a separate complaints resolution organization		X	X	X
Consumers' right to prepay loans	X	X	X	X
Requirements to disclose information to consumers in accordance with regulations (e.g. regulations on index-linked deposits, cheque holding policies)	X	X	X	X
Requirement for an institution to provide information about FCAC when consumers have complaints about the institution's compliance with consumer provisions	X	X	X	X
				



Related matters	Type of Institution			
				
Requirement for FCAC to monitor industry codes of conduct and public commitments (e.g. codes dealing with debit cards or with small and medium-sized businesses)	X	X	X	X
Requirement for FCAC to report annually, in aggregate form, on the number and types of complaints brought to its attention	X	X	X	X
Requirement for institutions to provide information to the Commissioner as necessary	X	X	X	X
Requirement for annual compliance examination and reporting	X	X	X	X
Ability to enter into Compliance Agreements	X	X	X	X
Requirement to pay assessments for funding of FCAC	X	X	X	X
Ability to designate contraventions that are subject to administrative penalties	X	X	X	X

