WORKING PAPER

MAKING CONSUMER PROTECTION REGULATION MORE CUSTOMER-CENTRIC

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ACRONYMS AND INITIALISMS

BCBS	Basel Committee on Banking Supervision
CARD Act	Credit Card Accountability Responsibility and Disclosure Act
CFPB	Consumer Financial Protection Bureau (U.S.)
COFI	Conduct of Financial Institutions
EU	European Union
FCA	Financial Conduct Authority (U.K.)
FinCoNet	International Financial Consumer Protection Organization
IAIS	Insurance Association of Insurance Supervisors
IOSCO	International Organization of Securities Commissions
IRDA	Insurance Regulatory and Development Authority (India)
NGO	Nongovernment organization
OECD	Organisation for Economic Co-operation and Development
OECD TF	OECD Task Force on Financial Consumer Protection
RBI	Reserve Bank of India
ULIP	Unit Linked Insurance Plan

EXECUTIVE SUMMARY

IN RESPONSE TO THE 2008 GLOBAL FINANCIAL CRISIS, MANY countries recognized the importance of consumer protection, and they set up regulatory frameworks that emphasized short-term and easy-to-implement provider actions to curb consumer harm. Despite these efforts, irresponsible provider practices occurred in some jurisdictions, which indicated that the frameworks did not sufficiently protect customers or motivate businesses to instill a culture of fair customer treatment. Some countries are now adopting a "customer outcomes" approach that focuses on how provider actions effectively protect customers and generate greater customer value. This approach rebalances the customer–provider dynamic, moving from "buyer beware"—where the onus is on customers to analyze and compare information and identify negative practices—to a "seller beware" focus that makes providers responsible for embedding a customer-centric culture and attaining specific customer outcomes.

Our research found that several governments had created high-level stakeholder committees in response to misconduct scandals. These committees brought together regulators and industry stakeholders to identify customer outcomes that should be at the center of consumer protection regulation. The resulting reforms are anchored in clear consumer protection mandates set by law or regulation. The following are six common core outcomes from the customer perspective:[1]

1. **Suitability and appropriateness.** I have access to quality services that are affordable and appropriate to my preferences and situation, and I receive advice and guidance appropriate to my financial situation.
2. **Choice.** I can make an informed choice among a range of products, services, and providers based on appropriate and sufficient information and advice that are provided in a transparent, noncostly, and easy-to-understand way.
3. **Safety and security.** My money and information are kept safe. The provider respects my privacy and gives me control over my data.
4. **Fairness and respect.** I am treated with respect throughout my interactions with the provider, even when my situation changes, and I can count on the provider to pay due regard to my interests.

1 CGAP "Customer Outcomes Framework," draft as of July 2019.

5. **Voice.** I can communicate with the provider through a channel that I can easily access and have my problems quickly resolved with minimal cost to me.
6. **Meets purpose.** By accessing and using products designed and delivered in accordance with the principles outlined above and by getting the services I need, I am in a better position to increase control over my financial life, to manage a shock, or to attain other goals.

To support customer outcomes, some authorities have introduced common regulatory elements that go beyond traditional consumer protection frameworks. In this paper, the regulations are divided into two groups: internal provider culture and processes and provider–customer interactions.

Regulatory elements focused on internal provider culture and processes

- **Culture and conduct governance.** Requires boards and senior management to set customer-centric strategies, policies, and procedures; to oversee conduct risks; and to assess customer outcomes. Some regulators set individual accountability roles and responsibilities for key staff.
- **Conduct risk management.** Requires managers to deliver, measure, and report on customer outcomes; risk controllers and compliance overseers to be well resourced and take on customer outcomes responsibilities; and internal auditors to take on customer outcomes responsibilities. Some regulators review management information systems and staff recruitment, performance management, remuneration, and training policies.
- **Financial product governance.** Internal processes, strategies, and controls for designing, approving, marketing, selling, and assessing products throughout the lifecycle. Looks at how providers incorporate customer insights, identify segments, test products, and evaluate communications for customers and distributors. Some regulators may withdraw or amend products that cause significant customer harm or prohibit practices that disproportionately impact certain segments.

Regulatory elements focused on external provider interactions with customers

- **Customer insights.** Emphasizes the need for providers to gather and analyze information on customer needs, objectives, and constraints throughout the product lifecycle and customer journey. Follows minimum data protection and privacy safeguards.
- **Customer assessment and engagement.** Focuses on how providers assess customers and offer products that fit their needs. Entails suitability assessments and transparency. Some regulators prohibit specific advertising and marketing practices.
- **Customer recourse.** Looks at how providers collect and use data on customer inquiries, complaints, and disputes, and how monitoring and evaluation systems allow providers to analyze data, identify trends, assess causes, and address issues. Some regulators support strengthening complaints resolution processes and developing platforms that enable consumer communications, rich data analytics, and information-sharing internally or with authorities.

Customer outcomes approaches are emerging as a promising consumer protection paradigm where the regulatory focus shifts from provider compliance with prescriptive check-the-box rules to customer results or outcomes achieved through provider actions. This shift is highly relevant to emerging markets where unserved and underserved customers are targeted with a range of digital financial services that may expose them to new risks, and where vulnerable customers are disproportionately affected by global crises.

Implementing this approach in emerging markets requires regulators to (i) balance principles, rules, and performance-based regulation; (ii) determine whether the country context favors gradual or sudden implementation; and (iii) ensure that monitoring, supervision, and enforcement also become customer-centric.

This paper builds on desk research of policy documents by global bodies and regulatory frameworks in 10 countries—Australia, Canada, India, Ireland, Malaysia, Peru, Singapore, South Africa, the United Kingdom, and the United States—and field research in India, South Africa, and the United Kingdom. It aims to help national, regional, and global authorities make financial consumer protection more effective.

SECTION 1
INTRODUCTION

Misconduct scandals trigger reform

Financial sector crises, scandals, and abuses rooted in misconduct have been the impetus behind the ongoing shift toward consumer protection reforms focused on customer outcomes. (See Box 1 for examples.) Regardless of whether civil society, the media, financial authorities, international markets, or other actors raised the alarm, these incidents demonstrate weaknesses in consumer protection. Subsequent consumer distrust, reputational risk, and economic costs require a strong response from regulators and the financial industry.

At its heart, financial consumer protection aims to correct imbalances of power, information, resources, and skills between consumers and providers. The goal is to ensure that customers get a fair deal. As regulators and providers continue to gain experience with consumer protection, it is critical to persistently evaluate how consumer protection frameworks are implemented and whether they effectively address imbalances.

Traditional consumer protection frameworks were developed at a time when customer protection standards were minimal. At that time, global and country policy actors focused on noncontroversial quick wins and rules that could resolve collective problems. Easy-to-implement measures like key facts statements and comparative costs tables were created to improve transparency and overall consumer protection.

Eventually it became apparent that weaknesses in addressing provider culture affected customer outcomes. Frameworks often focused on compliance with font sizes, contract clauses, and point-of-sale rules rather than on instilling a culture of transparency and fair engagement. Providers often complied with rules but did not necessarily adopt best conduct practices, leaving regulators to constantly try to catch up. In today's rapidly evolving digital financial inclusion landscape this challenge is even greater. Now, specific rules can affect innovation or create regulatory arbitrage on products, services, and channels that did not exist when regulations were issued.

In Kenya, for example, the central bank's consumer protection guidelines required improved transparency and disclosure of total credit costs to bank borrowers (CBK 2013). But a 2017 banking sector market inquiry by the Competition Authority of Kenya (2017) revealed that providers disclosed such information only at the end of a lengthy application process—after a loan had been authorized. Providers were thereby complying with the letter of the regulation, but not the spirit.

Rules that focus on transparency and recourse are important and easy to implement and supervise. However, they are based on a "buyer beware" approach, where the onus is on customers to read, analyze, compare, and request information, and to identify negative practices that violate rules or merit complaints. Recent research shows the limits of disclosure on customer behavior (e.g., present biases and hyperbolic discounting),[2] whereas recourse often occurs only when customer harm has already occurred. Both aspects are limited in their ability to address provider–customer power imbalances and ensure that consumer protection is embedded in provider culture.

As the overall financial ecosystem becomes more complex, it is essential to reduce the burden on customers to self-protect. Providers, industry players, civil society, and regulators must assume greater ownership in promoting responsible finance. Shifting provider culture and mindsets away from rules, processes, and procedures and moving attention toward results generated for customers is the way to achieve this.

BOX 1. **Recent evidence of provider misconduct**

Substantial insurance scandals have taken place around the world over the past five years:

- Commonwealth Bank of Australia pressured its insurance arm to deny claims (Patrick 2016).
- In collusion with its subsidiary, ICICI Prudential Life Insurance, ICICI Bank in India mis-sold insurance to low-income farmers (Hazari 2018).
- South African furniture retailer Lewis Group and food retailer Shoprite mis-sold loan insurance policies (e.g., job loss insurance to pensioners and self-employed customers) (Reuters 2015a, 2015b).

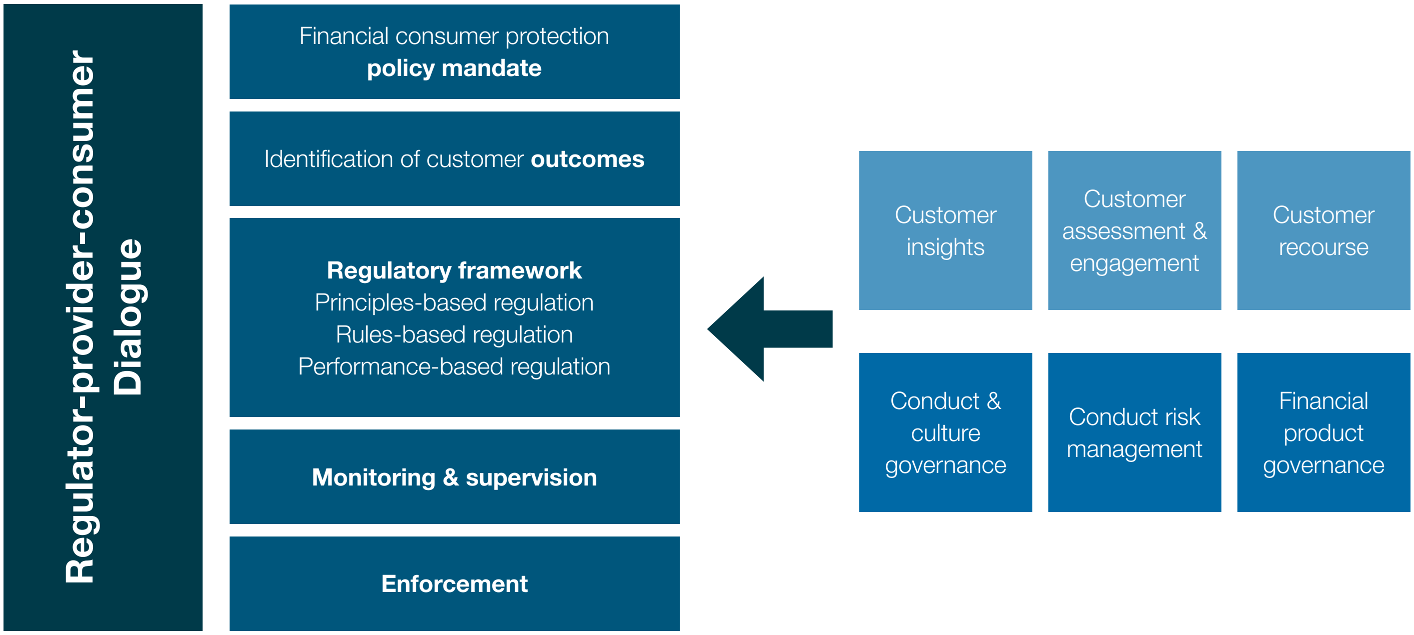
Even after the 2008 global financial crisis, widespread banking scandals came to light:

- Five of Australia's largest financial institutions improperly collected fees for services they did not provide (BBC 2018).
- $2 billion in fraud occurred at India's Punjab National Bank (Reuters 2018).
- Shareholders, bank officers, public officials, and auditors looted over $130 million from VBS Mutual, a small South African bank with many client burial societies and stokvels (Advocate Terry Motau SC and Werksmans Attorneys).

This Working Paper addresses demands from emerging market authorities looking to move toward a more customer-centric approach focused on customer outcomes. It outlines how the approach relies on a clear consumer protection mandate that supports the setup of customer outcomes developed through regulator–industry dialogue. It then analyzes key regulatory elements that support the attainment of customer outcomes. We propose that authorities (i) consider principles, rules, and performance-based regulation; (ii) evaluate whether gradual implementation may counter practical challenges and costs associated with a sudden shift away from existing approaches; and (iii) ensure that monitoring, supervision, and enforcement become more customer-centric. See Figure 1.

2 Hyperbolic discounting refers to the tendency to increasingly choose a smaller and sooner reward over a larger and later reward as the delay occurs sooner rather than later in time. See Redden (2007).

FIGURE 1. **Components of consumer protection frameworks focused on customer outcomes**



The paper builds on desk research of policy documents by global bodies and country-level regulatory frameworks at various stages of development in Australia, Canada, India, Ireland, Malaysia, Peru, Singapore, South Africa, the United Kingdom, and the United States. It also examines field research in India, South Africa, and the United Kingdom.

SECTION 2

WHAT DOES A CONSUMER PROTECTION FRAMEWORK FOCUSED ON CUSTOMER OUTCOMES ENTAIL?

Clear financial consumer protection mandates

A clear mandate in law or regulation can anchor the development or reform of any financial consumer protection regime. This type of directive gives authorities the power to develop, enforce, and improve a full-fledged consumer protection framework and to exercise judgment in the use of regulatory and supervisory tools.[3] Good practices for implementing clear mandates include (i) a "twin peaks" model and (ii) a separate consumer protection function embedded in a financial authority.

In a twin peaks model, an authority has a core financial consumer protection/conduct mandate that is separate from another authority that has a core prudential mandate—as is the case in Australia, Canada, South Africa (which has two conduct authorities), and the United Kingdom. A key benefit of the twin peaks model is that prudential risks do not dominate and are not prioritized over consumer protection risks, as would be the case if both mandates came under the same authority. However, it may not be viable in all jurisdictions because of the human, economic, and operational costs of setting up a new authority.

An alternative model establishes a consumer protection function separate from, and with the same hierarchy as, the prudential function. This is the case in Hong Kong, Malaysia, Peru, and Singapore. A challenge in this model is that mandates are fragmented among financial sector

3 For guidance and good practices on financial consumer protection mandates, see BCBS (2016), OECD (2011, 2014), and World Bank Group (2017).

authorities, which may lead to uncertainties and inconsistencies in regulation, supervision, and enforcement. Interagency coordination is key to improving financial consumer protection, especially as products evolve and responsible authorities become harder to identify.

Customer outcomes at the center of regulation

Consumer protection frameworks that focus on customer outcomes clearly identify and instill outcomes attained by individuals who use financial services and engage with financial services providers. These outcomes are linked to protecting against harm and generating customer value, with a focus on experiences directly influenced by providers. Box 2 illustrates six core customer outcomes.

Regulators, supervisors, and industry players must consider customer outcomes to be a constant key lens and their North Star. Consumer protection frameworks that focus on outcomes rebalance the customer–provider dynamic by shifting the construct from buyer beware to seller beware. (See Figure 2.) These complement "do no harm" measures of minimum acceptable conduct with measures that make positive customer outcomes a provider responsibility.

Several global standard-setting bodies have already begun this shift by referring to customer outcomes in their guidance (see Box 3 and Annex).

Customer outcomes frameworks can help authorities implement preemptive and proactive consumer protection policies. While traditional approaches typically focus on point-of-sale disclosure and post-sale recourse requirements, the holistic approach assesses whether providers have attained specific outcomes throughout the customer journey. It also considers provider culture and governance policies that help identify risk before harm.

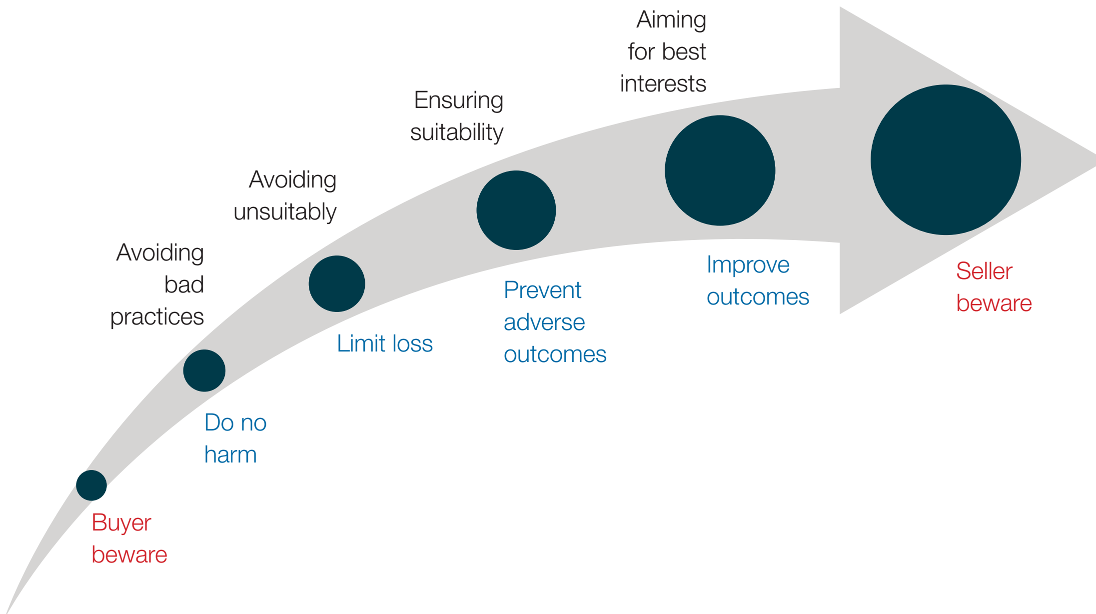
BOX 2. **The CGAP Customer Outcomes Framework**

CGAP research has identified six core outcomes from the customer point of view:

1. **Suitability and appropriateness.** I have access to quality services that are affordable and appropriate to my preferences and situation. I receive advice and guidance appropriate to my financial situation.
2. **Choice.** I can make an informed choice among a range of products, services, and providers based on appropriate and sufficient information and advice that are provided in a transparent, noncostly, and easy-to-understand way.
3. **Safety and security.** My money and information are kept safe. The provider respects my privacy and gives me control over my data.
4. **Fairness and respect.** I am treated with respect throughout my interactions with the provider, even when my situation changes, and I can count on the provider to pay due regard to my interests.
5. **Voice.** I can communicate with the provider through a channel that I can easily access and have my problems quickly resolved with minimal cost to me.
6. **Meets purpose.** By accessing and using products designed and delivered in accordance with the principles outlined above and by getting the services I need, I am in a better position to increase control over my financial life, to manage a shock, or to attain other goals.

Source: CGAP "Customer Outcomes Framework," draft as of July 2019.

FIGURE 2. **Shift from buyer beware to seller beware**



Authorities also may recognize the link between customer value and sustainable business value. Through regulatory and supervisory actions, regulators may encourage providers to build capacity to understand, identify, assess, and strengthen that link.

Depending on the country, language on customer outcomes may be incorporated into legal or regulatory documents. For example, South Africa and the United Kingdom include customer outcomes in financial sector acts while Canada and Singapore include such details in subsector guidelines. In India, the central bank has issued and enforces a charter of customer rights.

The countries researched for this paper identify similar types of customer outcomes. Canada, India, Malaysia, Singapore, South Africa, and the United Kingdom identify outcomes related to choice (e.g., information transparency) and voice (e.g., post-sale problems or complaints resolution).[4]

"In seeking to align commercial incentives with consumer outcomes, the regulatory framework is focused on point of sale. Recent examples of poor conduct suggest the alignment needs to start at the point of product design, and then be strengthened through distribution and advice."

—Government of Australia (2014, 193).

Each jurisdiction treats suitability in different ways. For example, Singapore, South Africa, and the United Kingdom separate advice from product design and sale. India includes product design in the right to suitability, while product sale and advice fall under the right to transparency and fair and honest dealings. Canada separates advice, product design, and product distribution.

4 See CCIR and CISRO (2018), RBI (2014), Bank Negara Malaysia (2019), Monetary Authority of Singapore (2013), National Treasury, South Africa (2014), and FSA (2006).

BOX 3. **Customer outcomes according to the Insurance Association of Insurance Supervisors**

The Insurance Association of Insurance Supervisors (IAIS) Insurance Core Principle 19, Conduct of Business, lays the foundation for treating customers fairly. It indicates that fairness should be integral to business culture as well as to insurer and intermediary support policies and procedures. Principle 18, Intermediaries, emphasizes a supervisor's duty to examine how policies and procedures ensure fair customer outcomes and the duty to mitigate adverse customer outcomes. IAIS also states that fair treatment encompasses the following outcomes:

- Developing, marketing, and selling products with due regard for a customer's interests and needs.
- Providing the customer with accurate, clear, and not misleading information before, during, and after the point of sale.
- Minimizing the risk of sales not appropriate to a customer's interests and needs.
- Ensuring high-quality advice.
- Dealing with customer claims, complaints, and disputes in a fair and timely manner.
- Protecting the privacy of information obtained from the customer.

Source: "IAIS Insurance Core Principles," https://www.iaisweb.org/page/supervisory-material/insurance-core-principles.

In India, the right to fair treatment focuses on courteous, prompt, and nondiscriminatory treatment. In the other countries we researched, fair treatment is considered an all-encompassing component of corporate culture.[5] Canada and India mention privacy as a customer outcome.

The importance of regulator–provider–consumer dialogue

Both regulators and providers benefit from an environment that helps to align customer outcomes objectives. Considering the challenges of implementing regulatory reforms, it is essential that all parties engage in active, positive dialogue from the outset. In Australia, India, and South Africa,[6] multi-stakeholder committees with financial sector members have analyzed issues, jump-started government–industry dialogue, and proposed reforms focused on customer outcomes.[7] However, related reforms will take time.

Once reforms begin, strengthened dialogue can (i) clarify definitions and expectations, (ii) help develop realistic but sound measurements, (iii) build on industry initiatives, and (iv) openly address new challenges. Collaboration may be particularly helpful to providers that are well intentioned but ill-informed on regulatory requirements (Black, Hopper, and Band 2007). Collaborative communication with regulators can ensure that providers embed customer outcomes into corporate culture. To that end, regulators may choose to do the following:

5 See Annex for a reference on how global bodies use fair treatment as an encompassing term.
6 Australia: The Financial System Inquiry Committee and International Advisory Panel, https://treasury.gov.au/review/financial-system-inquiry-murray; India: RBI (2013) and the Financial Sector Legislative Reforms Commission, https://dea.gov.in/fslrc; South Africa: The Competition Commission's Banking Market Enquiry, http://www.compcom.co.za/banking-enquiry.
7 See George (2019) for more on India's challenges and continuous efforts to adopt a charter of customer rights.

- Set up a panel of industry representatives in an advisory role. One example is the U.K. Financial Conduct Authority (FCA) Practitioner Panel.
- Open an extensive consultation process that allows providers to comment on and test key proposals. An example is the National Treasury of South Africa's consultation on the treating customers fairly regime and the Conduct of Financial Institutions (COFI) Bill.
- Support industry associations in developing and monitoring codes of conduct. Examples include the Microfinance Institutions Network, the Association of Community Development Finance Institutions, and the Business Correspondent Federation of India.
- Establish innovation offices to facilitate regulator–provider engagement and mutual learning on new products, services, and business models, as well as associated customer risks and outcomes. For example, the Australian Securities and Investments Commission's Innovation Hub considers improvement of customer outcomes to be a key factor for engagement.

"Delivering good outcomes for vulnerable and excluded consumers requires a degree of co-operation between firms, stakeholders and the FCA and requires us to devise coherent strategies rather than merely reaching for the rules or delivering piecemeal remedies."

—Financial Conduct Authority (2017, 10).

These instances of regulator–industry dialogue have improved customer outcomes. Clear goals—and the procedures to preserve them—can prevent cases of industry lobbying that tip the balance away from positive customer outcomes. In some countries, firsthand consumer experience can strengthen the regulatory framework and counterbalance industry lobbying. For example, in the United Kingdom, feedback from consumer advocates on the FCA Consumer Panel helped the organization to strengthen its customer outcomes regime. See Box 4 for an example based on the U.K. payday loans case.

Key regulatory elements focused on customer outcomes

At the next level of detail, financial sector authorities can set up regulatory frameworks that use rule-making powers to attain outcomes. Depending on jurisdiction, they may set up an entirely new legal framework (e.g., South Africa's COFI Bill), introduce regulations that incorporate new topics (e.g., the United Kingdom's Senior Management and Certification Regime), or modify existing regulations (e.g., norms for India's revised Internal Ombudsman Scheme).

There are six distinct elements of regulation common to jurisdictions that adopt customer outcomes frameworks. Three elements focus on internal provider culture and processes (culture and conduct governance, conduct risk management, financial product governance) and three focus on external provider actions with customers (insights, assessment and engagement, and recourse). Each is described in Section 3.

BOX 4. **The U.K. payday loans case**

A payday loan is a type of unsecured credit offered in the United Kingdom. Payday loans can carry an annual percentage rate of 100 percent or more and must be fully or substantially repaid within one year.[a] Since payday loans primarily are available via smartphone apps or online, consumers can take out a loan within minutes.

The rapid expansion of payday lending after the 2008 global financial crisis brought with it a significant increase in consumer complaints. A network of U.K. charities called Citizens Advice, which assists with financial, legal, and consumer issues, witnessed a tenfold increase in payday loan problems. The 2012 campaign it sponsored in response caught the attention of several authorities (Citizens Advice 2016).

A 2013 review by the Office of Fair Trading—the consumer credit regulator before FCA—found payday borrowers to be at high risk and recommended a sector overhaul. The payday loans market had grown from £900 million in 2008–2009 to £2.5 billion in 2013, with 10 million loans provided to 1.6 million customers. Loans averaged £265–270 with an average term of 30 days (Competition and Markets Authority 2014).

In late 2013, the U.K. parliament mandated that FCA protect borrowers by capping payday loan prices. FCA proposed price caps in July 2014, soon after it became the regulator of payday lenders. Caps on high-cost, short-term credit comprised (i) a total cost cap of 100 percent of amount borrowed; (ii) an initial cost cap of 0.8 percent per day on amount borrowed for new or rollover loans; and (iii) a cap of £15 on fixed default fees and a cap of the initial rate on default interest (FCA 2014a, 5). FCA also issued business practices rules, including a two-loan rollover limit, limits on the use of continuous payment authorities,[b] and a requirement to display risk warnings on electronic financial promotions (FCA 2014b).

It held a public consultation on its price cap proposal. Consumer groups expressed concerns that FCA had underestimated the negative impact of payday loans on consumers and the extent of illegal lending activities, arguing for mandatory data-sharing between lenders and credit bureaus. In November 2014, FCA confirmed price cap rules upon concluding that customers who qualified only for payday loans faced unacceptably high default risks and could worsen their financial situation and well-being after getting a payday loan.

Subsequent FCA regulatory measures followed a customer outcomes approach, which aimed to ensure that borrowers be treated fairly, not become subject to predatory lending, and be approached only if they could afford this type of loan. Following on consumer groups' concerns, FCA began working closely with government-supported Illegal Money Lending Teams to monitor the robustness of lender affordability assessments. It also determined that customer impact of payday rules must be assessed every three years.

In 2015, the Competition and Markets Authority introduced additional requirements for payday lenders:

- Online lenders must be listed on at least one FCA-authorized price-comparison website.
- Lenders must give borrowers a summary of the total costs of their most recent loan, the cumulative cost of borrowing over the previous 12 months, and information on how late repayments affect costs.

In a 2017 review of the impact of the price cap, FCA found that payday borrowers generally were better off than before the cap was implemented. Customers experienced significantly lower borrowing costs and default rates—from over 14 percent in 2014 to below 5 percent in 2016. The share of customers seeking debt advice from charities also fell significantly, with Citizens Advice alone reporting a 60 percent decline. There was no evidence that those who lost access to payday loans had turned to informal money lenders. Instead, they had primarily turned to family and friends (25 percent) or alternative formal lenders (15 percent).

a. Excludes loans by community finance organizations, home-collected loans, bill-of-sale loans, and arranged or unarranged overdrafts. See https://www.handbook.fca.org.uk/handbook/glossary/G3328.html/.

b. A regular automatic payment where customers give vendors permission to take money from a credit or debit account whenever the vendor feels money is owed.

SECTION 3

COUNTRY EXPERIENCE WITH CUSTOMER OUTCOMES REGULATION

Culture and conduct governance

Culture is the mechanism by which shared values, norms, and behaviors are developed, transmitted, and instilled within a financial institution.[8] It is based on desired outcomes and is a key driver of conduct.[9] However, traditional consumer protection approaches have paid little attention to culture or the role of corporate governance in ensuring customer outcomes.

A customer outcomes approach requires a provider's board of directors and senior management to set a customer-centric tone through strategies, policies, and procedures. Examples include:

- The Canadian Council of Insurance Regulators and Canadian Insurance Services Regulatory Organizations, the Reserve Bank of India (RBI), and South Africa's Financial Sector Conduct Authority (through the COFI Bill) make boards responsible for conduct standards around customer outcomes.
- In Singapore, boards must internally and externally communicate customer outcomes as an institutional priority.
- In India and Malaysia, boards must approve policies and procedures for conduct associated with customer outcomes.

In all these cases, authorities may carry out an *ex post* review of board-approved policies or standards.

8 See Group of Thirty (2015) and FMA and RBNZ (2018).
9 See BCBS (2016), IAIS (2018), and OECD (2011) on the need for providers to incorporate fair treatment into the business culture.

Regulators also have set requirements for governance structures that enable boards and senior management to develop customer-centric culture, oversee conduct risks, and assess attainment of customer outcomes. Examples include:

- Banks in India must constitute a board-based Customer Service Committee, with guest experts and customer representatives that help formulate policies and assess compliance.
- Peru's Superintendency of Banking, Insurance and Pension Fund Administrators provides financial institutions with general requirements for developing policies that incorporate market conduct into organizational culture and corporate governance structures.

A key takeaway from recent financial sector scandals is that true accountability does not exist until a firm defines individual accountability. This lesson has inspired some regulators to incorporate clear accountability rules into their regulations. Australia, Hong Kong, and Singapore set up accountability regimes following the FCA launch of the U.K.'s Senior Managers and Certification Regime in 2016 (see Box 5).[10] These regimes require financial institutions to describe roles and responsibilities, allocate roles to specific individuals, and hold those individuals accountable. Responsibilities include agent, intermediary, and third-party conduct, as well as customer outcomes. Authorities may have the power to approve a senior manager before their role starts and remove or sanction that individual upon breach of duty. The Financial Stability Board (FSB) recently noted that such efforts are key to mitigating misconduct risk (FSB 2018).

Duty of care is another promising regulatory element. The term refers to a provider's legal obligation to exercise reasonable skill and care in providing customers with financial products and services. A breach typically makes a provider liable for victim compensation. Examples include:

- Australia, Ireland, Malaysia, New Zealand, and the United States recognize duty of care in legal frameworks.[11]
- South Africa plans to extend duty of care to a broader range of financial services.[12]
- There are ongoing efforts in the United Kingdom to strengthen duty of care, which already is included in its Principles for Business and Conduct Rules. Discussions on a new legal duty are underway (FCA 2018a, 2019a).

10 See Hong Kong's Manager-in-Charge Regime (SFC 2016), effective since April 2017, and Management Accountability Initiative (Hong Kong Monetary Authority 2017), effective since March 2018; Australia's Banking Executive Accountability Regime, https://www.apra.gov.au/banking-executive-accountability-regime, effective for large deposit-taking institutions since July 2018; and the Monetary Authority of Singapore's "Guidelines on Individual Accountability and Conduct" (2019), proposed in April 2018, and the revised "Guidelines on Fair Dealing—Board and Senior Management Responsibilities for Delivering Fair Dealing Outcomes to Customers" (2013), issued April 2009.

11 Australia's Future of Financial Advice Act 2012; Central Bank of Ireland's Consumer Protection Code 2012; Bank Negara Malaysia's Introduction of New Products 2014; New Zealand's Financial Supervision Act; and U.S. Dodd–Frank Wall Street Reform and Consumer Protection Act of 2020, Title IX Investor Protections and Improvements to the Regulation of Securities, Title XIV Mortgage Reform, and Anti-Predatory Lending Act.

12 Conduct of Financial Institutions Bill 2018; Conduct Standard 2 of 2018; Financial Markets Act 19 of 2012; Financial Advisory and Intermediary Services Act 37 of 2012.

BOX 5. **Case Study—The United Kingdom's Senior Managers and Certification Regime**

The United Kingdom's Senior Managers and Certification Regime seeks to improve conduct by encouraging individuals to take responsibility for their actions. The regime aims to ensure that firms and staff clearly understand and can demonstrate "who does what." Its provisions have applied to banking firms since 2016, insurers since 2018, and FCA-regulated firms (e.g., credit unions, consumer credit firms) since December 2019 in a tiered approach: core, enhanced, and of limited scope.

The regime comprises three parts:

1. The **Senior Managers Regime** requires specific senior management functions, such as executive directors and compliance oversight officers, to be approved by FCA before roles are performed. Managers must meet fit-and-proper standards and agree to a statement of responsibility on accountability (FCA 2018b, 12). If a firm breaches an FCA rule, a senior manager is held accountable and is subject to disciplinary measures, financial penalty, or public censure for not taking reasonable steps to prevent or stop a breach and failing to perform duties.[a, b]
2. The **Certification Regime** applies to employees, such as business unit managers or retail advisers, who may cause a firm or its customers significant harm.[c] FCA approval is not required, but senior management must annually certify that individuals are fit to perform their roles (FCA 2018b, 8, 12).
3. **Conduct Rules** hold firms responsible for ensuring that customers are treated fairly, staff members are trained on rules, and FCA is notified of rule breaches.[d] Five Individual Conduct Rules apply to staff: (i) act with integrity; (ii) act with due care, skill, and diligence; (iii) be open and cooperative with FCA, the Prudential Regulation Authority, and other regulators; (iv) pay due regard to the interests of customers and treat them fairly; and (v) observe proper standards of market conduct. Additional Senior Manager Conduct Rules also apply (FCA 2020a).

Despite initial concerns, some U.K. banks reported positive benefits, such as increased awareness by senior managers on how firms operate. Also, the number of cases of irresponsible risk-taking has dropped.

a. See FCA (2019b, 14, and 2020b).
b. A decision by a senior manager that causes a U.K. banking firm to fail may amount to a criminal offense. See UK Financial Services (Banking Reform) Act 2013, http://www.legislation.gov.uk/ukpga/2013/33/section/36/enacted.
c. "FCA Handbook, SYSC 27 Senior Managers and Certification Regime: Certification Regime," as of March 2020.
d. The Code also applies to firms that indirectly deal with retail customers (e.g., through distribution networks) and to regulated and unregulated financial services activities (e.g., ancillary activities).

Conduct risk management

A conduct risk management framework is a set of roles and practices that help firms identify, record, assess, report, and mitigate conduct and culture risks associated with attaining customer outcomes. Three lines of defense play important but distinct roles in the framework. In theory, operational managers are the first to ensure customer outcomes. However, full consideration of customer outcomes in day-to-day operations may require a significant shift in mindset and take time to realize.

The second line of defense—risk control and compliance oversight—must be given adequate resources, power, and authority by boards and senior management. This layer embeds customer outcomes, sometimes via conduct risk committees and officers. For example:

- Financial institution boards in Peru must designate a high-level market conduct officer.[13]
- Banks in India are expected to hire customer service officers to liaise with customers, the banking ombudsman, and the central bank—at headquarters and in controlling offices.[14]

Some jurisdictions require internal audit functions to explicitly include customer outcomes as a third line of defense. In India, internal audits must assess internal ombudsmen. During on-site supervision, regulators may recommend sound conduct risk management frameworks but leave the specifics of implementation to individual firms.

Reporting and management information systems also are crucial in identifying and measuring customer outcomes. They should be able to produce short-term lag indicators on previous actions and long-term lead indicators on customer outcomes trends. Measuring customer outcomes can entail a broad range of quantitative and qualitative information-gathering techniques, including customer surveys and mystery shopping exercises. Provider–regulator dialogue also helps to identify data sources and data gathering processes. Examples include:

- Singapore, South Africa, and the United Kingdom, where firms are required to have sound systems for monitoring and assessing customer outcomes performance.
- The U.K.'s Financial Services Authority (FSA), which issued a guide to help firms develop management information systems and demonstrate that they treat customers fairly, including by delivering customer outcomes (FSA 2007).

"The regulatory regime for market conduct should therefore provide for the explicit identification and management of conduct risk, complementing the regulatory regime addressing prudential risk, and ensuring that all risks are holistically managed."

—National Treasury, South Africa (2014, 26).

Jurisdictions are paying greater attention to how policies support the conduct risk management framework and affect customer outcomes. Some regulators recommend or require that performance evaluation, remuneration, and compensation practices consider employee contributions to customer outcomes. U.K. firms are required to implement *ex post* risk adjustments of remuneration, whereby bonuses, for example, are paid only when justified by performance and are subject to "clawback" in cases of adverse performance or misconduct.[15] The Organisation for Economic Co-operation and Development Task Force on Financial Consumer Protection (OECD TF) also indicates that regulators may explicitly ban remuneration structures and incentives that lead to practices not in the interest of consumers. They also can prescribe structures that minimize the risk of conflicts of interest (OECD 2011).

13 Peru's Superintendency of Banking, Insurance and Pension Fund Administrators, *Regulation on Market Conduct Management in the Financial System*, Resolution No. 3274-2017, August 2017, and *Regulation on Market Conduct Management in the Insurance System*, Resolution No. 4143-2019, September 2019.

14 A controlling office monitors and services a group of bank branches. See RBI (2015).

15 FCA sets and oversees implementation of remuneration requirements from a conduct perspective and coordinates with the Prudential Regulation Authority to ensure seamless oversight of institutions falling within the domain of both regulators. FSA (2013, 23–9); FCA, "Dual-regulated Firms Remuneration Code" (as of November 2018), https://www.fca.org.uk/firms/remuneration/dual-regulated-firms-remuneration-code-sysc-19d.

Jurisdictions are looking at how commissions structures in third-party product offerings may affect customer outcomes. In India, the scandal around the mis-selling of unit-linked insurance led the Insurance Regulatory and Development Authority (IRDA) to issue guidelines and rules around product sales and commissions (see Box 6).

Financial product governance

Financial product governance can be defined as internal processes, strategies, and controls aimed at designing, approving, marketing, selling, and assessing a product throughout its lifecycle. Good governance results in a product that meets a customer's needs and delivers appropriate customer outcomes (FCA 2020c, 1.1.2–3). Product governance is another element that is not adequately addressed by traditional consumer protection approaches.

BOX 6. **Regulatory response to India's insurance mis-selling case**

In India, the Unit Linked Insurance Plan (ULIP) offers a small insurance payout in the case of death. It invests a large share of premiums in stock market equity and debt funds. Customers choose an equity-to-debt fund ratio at the time of purchase and may make up to five fund switches per year at no additional cost. The novelty of the plan led customers to think of ULIPs as an investment rather than an insurance product. Initial low uptake as a traditional insurance model also led to "bancassurance" models whereby banks distributed insurance and earned profitable sales incentives (Balaji and Bhaskaran 2015). However, bankers held little accountability for insurance sales and tried to take advantage of regulatory arbitrage since the primary regulator was RBI rather than IRDA. After many complaints and media reports, regulators finally began to notice the mis-selling of ULIPs.[a]

Two issues were at the root of the mis-selling:

- **Poor product design.** As a life insurance policy, ULIPs levied front-loaded commissions plus administrative, mortality, and fund management fees.[b] They carried high surrender charges, with investors losing everything if they lapsed in the first three years. The product catered to middle-class customers seeking tax breaks, and the risk levels of investments in capital markets often were not communicated at the time of sale.
- **Inadequate incentives.** Driven by commissions, frontline bank branch staff "hard sold" life insurance policies, even when they were not suitable for certain customers. Up-front commission payments provided little incentive to remind customers to pay premiums after the first year. Overall, regulation did not hold bankers liable for sales of third-party products, and sellers held no fiduciary responsibility.

In September 2010, IRDA issued new ULIP guidelines that linked commissions to the premium-paying term rather than allowing them to be paid up front. It also required insurers to provide customers with information on all product costs and charges for each policy year and suggested a prospect product matrix to assess suitability and match the product with customer needs.

a. Halan, Sane, and Thomas (2013) estimated ULIP-related investor losses at Rs 1.5 trillion ($28 billion) by 2012.
b. Fees were constant at about 5–10 percent per year. First-year commissions as high as 40 percent were paid from the insurance premium to the bank as a reward for getting the business. Commissions dropped to 7.5 percent in years two and three, then remained a constant 5 percent per year thereafter.

To that end, several regulators issued principles and rules on product design and approval for providers, including incorporating consumer insights, identifying segments, and assessing how product features are communicated. For example:

- Malaysia established principles and rules for approvals of new financial products offered or distributed by banks, development financial institutions, insurers, and *takaful* operators (Bank Negara Malaysia 2014, 2015).
- The United Kingdom set principles and rules on design and approval processes for newly developed or significantly adapted insurance and investment products (FCA 2020c, 3.2, 4.2).
- South Africa's COFI Bill proposed standards on design and approval processes for all financial products (see Box 7).

BOX 7. **South Africa proposes approach to financial product governance**

In moving toward a customer outcomes approach, South Africa chose to focus on product design and oversight rather than on regulatory preapproval. Its COFI Bill requires that retail products and services be designed in the interest of customers and tailored to meet the needs of identified consumer groups.

The bill mandates provider oversight and monitoring of product design and approval processes, periodic reporting on product performance, and remedial action if a product leads to poor customer outcomes (Republic of South Africa 2018, Articles 47–56).

The Financial Sector Conduct Authority also may prohibit products or services, restrict certain customers, and require minimum product features and specific contract terms. In its 2018–2021 regulatory strategy (p. 35), the Authority stated: "We will expect these providers to demonstrate that they have effective processes in place for ensuring that their products . . . are and remain appropriate to their targeted customer base . . . . However, there are contexts in which *a more intrusive, rules-based approach, including prescribing product features, may be effective in supporting our objectives.*" [Emphasis added.]

Some regulators have considered a direct approval role to supplement provider product governance. In India, IRDA set up "file and use" to quickly assess viability and suitability of insurance products before they are sold. (However, there are few details on the effectiveness of the approach.) IAIS has indicated that regulatory approval of product conditions may be justified in cases of new, complex, or mandated insurance products, or those that target vulnerable customers. Other regulators have established integral collaborative approaches to product approval, including, for example:

- Peru and South Africa encourage providers to share ideas and proposals for new products and services early on.
- Australia and Singapore set up innovation offices that engage with innovative providers based on eligibility criteria, including a product or service's potential to provide better outcomes for investors and consumers.[16]
- Kenya and the Philippines employ "test and learn," which allows innovators to live-test new products and services under *ad hoc* safeguards and roll them out upon successful completion of tests.[17]

16 For more on innovation offices, see UNSGSA FinTech Working Group and CCAF (2019).
17 For more on test-and-learn approaches, see Jenik and Lauer (2017).

- The United Kingdom and Malaysia set up regulatory sandboxes that allow providers to perform small-scale, live testing of innovations in a controlled environment and under regulatory supervision before authorization is given under a modified or existing license.[18]

Beyond approvals, regulators establish management and oversight processes that incorporate customer voice. Throughout the product lifecycle, it is important that relevant parties consider target segments and whether distribution strategies and features remain appropriate. Customer voice can be incorporated through direct feedback (e.g., surveys, interviews, complaints), through product use analyses and retesting, and through communicating changes to customers.

To address customer harm, some regulators require that a product be withdrawn or amended. For example:

- Since 2012, FCA has been empowered to create intervention rules in cases where market integrity is threatened or ineffective competition exists (FCA 2020c, Chapter 2). If prompt action is warranted, FCA can create a 12-month product intervention rule without consultation. However, permanent rules require consultation and apply only to insurance and investment products.
- FCA used intervention powers to set price caps and business practices in the payday lending industry (see Box 4).
- More recently, the Australian Securities and Investments Commission was given intervention powers of up to 18 months on products of significant detriment to retail clients.
- In the United States, the Consumer Financial Protection Bureau (CFPB) can prohibit discriminatory creditor practices that have a disproportionately negative impact on borrower segments.

Customer insights

In traditional consumer protection frameworks, information gathering typically entails mechanical compliance exercises and point-of-sale information requirements. By contrast, jurisdictions with customer outcomes frameworks require providers to gather and analyze sufficient customer information to understand customer needs, objectives, and constraints throughout the product lifecycle and the customer journey. This helps both providers and authorities identify customer profiles and monitor attainment of outcomes.

However, while a deeper understanding of customer profiles may ensure suitability, a lack of information does not justify unsuitable or harmful products or services. The Central Bank of Ireland's Consumer Protection Code, for example, requires providers to gather and record sufficient consumer information before offering or recommending products or services. Providers must gather details on a consumer's needs and objectives, their personal circumstances and financial situation, and details of material changes.

18 For more on regulatory sandboxes, see Jenik and Lauer (2017) and UNSGSA FinTech Working Group and CCAF (2019).

Given the importance of customer information gathering, data protection and privacy policies and practices are crucial. They limit information gathering to legitimate business or legal purposes, set minimum information-sharing rules, and ensure accountability for unauthorized sharing and breaches. To that end:

- RBI's Charter of Customer Rights establishes a Right to Privacy whereby personal information must be kept confidential unless the customer consents or it is required by law.
- Following the insurance mis-selling scandal and to reduce misuse of bank databases, IRDA issued restrictions on sharing user databases for distribution of insurance products.

With off-site supervision, authorities can assess how provider policies and procedures meet regulatory requirements for customer information gathering and protection. With on-site supervision, authorities can examine how providers apply nonprescriptive guidance to the types of information gathered.

Customer assessment and engagement

Customer outcomes frameworks carefully examine how providers assess customers and offer them appropriate financial products and services. From the customer perspective, suitability and appropriateness are defined as access to affordable, quality offerings that fit their preferences and recommendations that fit their situation.[19] From the provider perspective, suitability ensures that offerings are appropriate to individual customers and adequately understood. Product governance processes help identify which customers are best suited to a product. Therefore, customer-facing staff and third parties must have access to information on target segments, product features, risks and rewards, and delivery channels in order to explain products, gather customer information, address questions, and offer advice and recommendations.

Unlike traditional consumer protection frameworks, suitability in customer outcomes frameworks includes assessment throughout the product lifecycle and the customer journey, encompassing staff training and monitoring and third-party efforts to carry out suitability assessments. In the context of investment products, several jurisdictions have discussed the importance of ongoing suitability assessment:

- The European Union's Markets in Financial Instruments Directive (MiFID) includes provisions on periodic suitability assessments that may be annually performed for customers.
- New Zealand banks are required to regularly review products to ensure continued suitability.
- U.K. firms are required to monitor customer repayment records and establish an adequate policy to help those who show signs of financial difficulty, including persistent credit card debt.

Regulators also may require that providers document steps taken to assess customer suitability during supervision.

19 CGAP, "Customer Outcomes Framework," draft as of July 2019.

In traditional consumer protection frameworks, transparency refers to detailed format and content rules that focus on point-of-sale disclosure. These rules place the burden on customers and are hard to keep current. In contrast, the transparency component of customer outcomes approaches focuses on how simple, nonmisleading communication throughout the product lifecycle empowers customers to make better financial decisions. For example:

- In Singapore, financial institutions are tasked with monitoring whether representatives keep proper records of representations made and advice given. Additional safeguards are in place for dealing with customers who do not understand investment products.
- South Africa emphasizes that financial customers must be given adequate, clear information before, during, and after a contract or agreement is made and must be kept appropriately informed.

"The caveat emptor principle that has underpinned India's customer protection architecture has not created desired outcomes. The Committee believes that India needs to move to a customer protection regime where the provider ascertains through due process that the products sold or the advice given is suitable for the buyer, considering her needs and current financial situation."

—RBI (2013, 28).

Untruthful or misleading marketing and advertising can lead to customer harm. Some regulators prohibit certain marketing and advertising practices while others have the power to apply product intervention rules to stop misleading advertising. This type of authority is especially critical in cases where complex or bundled products are oriented toward financially underserved and unserved customers. Regulators in South Africa and the United States strongly emphasize this aspect, including the responsibility of financial institutions that rely on third parties to promote or market for them.

As a rule, customer outcomes approaches pay greater attention to vulnerable customers than traditional approaches do—from ensuring fair and respectful treatment to outlining procedures to identify situations that may increase harm. There is growing discussion in the United Kingdom on the need for providers to identify episodes of vulnerability that may affect suitability and increase the risk of customer harm.

Customer recourse

Although traditional consumer protection approaches address recourse, customer outcomes frameworks emphasize provider systems that adequately capture data on consumer inquiries, complaints, and disputes. Complaints monitoring systems enable providers to analyze information, identify trends, assess root causes of problems, and take swift action to eliminate issues, for example, via product governance processes. For example:

- In Ireland, financial institutions are required to identify widespread problems by analyzing complaints patterns and escalating analyses to risk functions and senior management.
- In Singapore, reviewers not involved in advising customers assess complaints and, where appropriate, escalate issues to boards and senior management.

Regulators have strengthened the timeliness and fairness of complaints handling and resolution processes, which may be assessed during supervision. For example:

- Australia and Ireland set timeframes during which providers must update customers on the status of complaints, finalize investigations, and communicate results. Customers have the right to external dispute resolution mechanisms if complaints are not satisfactorily resolved.
- In the United Kingdom, consumer lenders must investigate complaints of third parties engaged in recovering debts or tracing customers on a lender's behalf.
- In India, to improve timeliness and fairness, RBI strengthened the independence of internal bank ombudsmen. RBI now requires a managing director to appoint an ombudsman for a fixed term of three or five years, and the ombudsman cannot be removed without RBI approval.

Regulators use technology to enter, classify, track, escalate, and respond to consumer communications. Complaints platforms that enable rich data analytics and rapid information sharing within and between financial institutions and authorities are now set up or supported. For example:

- In 2011, IRDA launched the Integrated Grievance Management System—an online portal that allows insurance companies to expedite redress. The portal is a central repository for industry-wide complaints data, a monitoring tool for regulators, and a mechanism to encourage providers to maintain high-quality information. It also allows consumers to track or escalate complaints.
- The Consumer Complaint Database in the United States allows CFPB to accept complaints online and redirect them to companies for response. It also collects and publishes complaint/response details.
- Providers in Peru and the United Kingdom are required to publish complaints statistics and inform customers that this information is available.

Over the past decade, as new digital financial products and delivery channels appeared and multiple entities began to offer financial services, dispute resolution systems evolved to facilitate better customer engagement and cover a broader range of products and services. Customer outcomes frameworks now promote strong coordination among dispute resolution mechanisms so consumers do not carry the burden of figuring out where to raise a complaint and authorities have a better understanding of customer problems. For example:

- RBI continues to expand coverage of the ombudsmen system. RBI and IRDA have strong communication with ombudsmen.
- South Africa set up an Ombud Council to promote cooperation and coordination among ombuds, facilitate ombud access by financial customers, and resolve overlaps in jurisdictional coverage of ombud schemes.
- FCA benefits from the support of the ombudsman and the competition authority in the United Kingdom.

These jurisdictions have the tools to identify practices that may lead to customer harm, orient customers to the outcomes providers must attain, and communicate with providers on practices that could lead to negative customer outcomes.

SECTION 4

IMPLEMENTATION CONSIDERATIONS FOR EMERGING MARKETS

TRADITIONAL CONSUMER PROTECTION REGULATION HELPED SET minimum standards at a time when none existed. However, early regulation could not ensure that customers were protected from harm or obtained value from financial services. Emerging markets urgently required a more effective, customer-centric consumer protection framework as they witnessed a quickly evolving financial sector landscape that also needed to build consumer trust.

Customer outcomes frameworks have emerged as a promising alternative in countries where the focus has shifted from provider compliance with check-the-box rules to providers generating results or outcomes for customers. As providers gain responsibility for consumer protection, the emphasis on buyer beware has lessened. This shift is highly relevant in emerging markets where underserved or unserved segments are offered an increasing range of digital financial services.

The change leads to effective frameworks that do not overburden providers with prescriptive rules. Providers gain flexibility in choosing and adopting measures while regulation becomes the goalpost that supports attainable customer outcomes. Emerging market regulators gain the flexibility to set up or revise regulations as markets evolve. Several important considerations for regulators are noted in this section.

Rules, principles, and performance-based regulation may coexist

Putting the focus on customer outcomes does not mean that principles must replace rules. Both are important instruments that play complementary roles in ensuring customer outcomes.

Rules-based regulation gives providers advanced notice of the actions they can and cannot engage in. Rules favor certainty of acceptable market conduct and predictability in enforcement over flexibility and exceptions. They set minimum standards for preventing customer harm that can be strengthened when customers become more vulnerable or problems arise. The following are examples of targeted disclosure rules and the harms addressed:

- In 2016, the Competition Authority of Kenya required mobile financial services providers to disclose costs via mobile phone screen before a transaction is completed, making customers aware of person-to-person transfer fees and digital credit costs (Mazer 2018).
- In the United States, a CFPB study of the 2009 Credit Card Accountability Responsibility and Disclosure Act showed that customers benefitted from restrictions on up-front first-year fees, rate increases, and penalties for late payment or exceeding credit limits. By 2016, CFPB had secured $12 billion in relief for 25 million consumers, most of whom had been harmed by credit card practices (CFPB 2013, 2016; Barefoot 2019).

However, a rules-based approach may overwhelm providers or constrain innovation. Pressure can increase on authorities with limited capacity to refine or adapt rules to rapidly evolving financial markets. Rules can negatively incentivize providers to push the limits of permissible conduct and engage in creative compliance or regulatory arbitrage that challenges supervisory and enforcement capacity. In some cases, broad disclosure rules have proven counterproductive:

- Audits in Ghana, Mexico, and Peru found traditional disclosure rules to be ineffective. Clients rarely were offered the least expensive product or given enough information to compare products, likely because staff were incentivized to offer more expensive products (Giné and Mazer 2016).
- A U.S. study on the Truth in Lending Act showed that borrowers spent little time reading required disclosures at real estate closings and rarely withdrew from loans after reading them. Many considered the disclosures to be unintelligible or misleading (Sovern 2014).

Principles-based regulation sets high standards that require providers to exercise judgment on which actions best achieve regulatory objectives. Regulators can issue guidelines indicating expectations, but permissible conduct is determined *ex post*. Principles focus on the purpose behind rules, giving providers the flexibility to find customer outcomes—including through innovation. However, flexibility may lead to lower compliance and intermediation costs (Awrey 2011; Willis 2015). Principles enhance regulator responsiveness to market developments by reducing the need for constant regulatory amendments and enabling regulatory and supervisory innovation. They can lead to compliance with a rule's purpose as senior management and internal compliance divisions develop strategies for following them (Decker 2018; Black, Hopper, and Band 2007; Burgemeestre, Hulstijn, and Tana 2009).

The principles-based approach may generate uncertainty and risk aversion that lead providers to overcomply or disproportionately reduce activities. Provider demand for clarity can lead to guidelines that become new forms of rules. Authorities may find that providers do not change practices and take advantage of vague principles language to identify loopholes. Incorporating principles may cause a short-term spike in costs that stem from overhauling regulations and building supervision and enforcement capacity, along with supporting staff decisions and judgment calls.

Performance-based regulation uses performance as the basis for regulatory standards, as criterion to allocate enforcement and compliance resources, to trigger differentiated standards, and to evaluate measures (Coglianese, Nash, and Olmstead 2002). The approach requires standards that are easy to understand, measure, and monitor—and that have well-designed and tested outcomes. Providers are compelled to meet performance standards and attain specific outcomes, but they have flexibility in how they do so. Innovation is encouraged, especially in sectors that are continuously changing. Providers and regulators must adequately measure and monitor outcomes, and although constant monitoring can enhance implementation and enforcement (Willis 2015), it may be challenging and costly and may indirectly affect innovation.

Depending on country context and market, customer outcomes frameworks may reduce the preponderance of rules, include or increase the importance of principles, or add a performance component. But the rules–principles–performance equation can evolve over time. It is worth considering the type of legal system the equation applies to. Detailed and formal systems of civil law are often conducive to the rules-based approach, while common law systems are more conducive to the principles-based approach because they embed wider interpretation of norms and case-by-case judgment of individual experience. Innovation also must be considered. Principles and performance often are best suited to innovative sectors where regulators may not have a full picture of the industry but where they share an understanding of risk, mutual trust, and open communication with providers and other regulators (Decker 2018).

Implementation timeline may vary, depending on context

Implementing a regulatory framework demands resources, effort, and time, especially if the regulator is making foundational changes to its traditional operations. A new framework must be adequately understood and embraced at all levels of the authority for mindset and culture to shift, as is the case in countries that have moved from compliance-based to risk-based prudential regulation and supervision.[20] Consumer protection reforms are even more challenging in emerging market authorities because they typically are led by newer units that have limited financial, technical, and operational resources.

Jurisdictions with traditional consumer protection frameworks and some level of conduct supervision may opt for gradual regulatory reform. The gradual approach revises traditional regulations on customer insights, assessment and engagement, and recourse in the short term and leaves new regulations on provider culture and processes for the medium term. For example, regulators may begin by shifting customer information requirements toward customer needs, objectives, and constraints throughout the customer journey. Or they may revise transparency regulation to focus on how provider information empowers customers to make better financial decisions. Next, regulators may turn to requirements on individual accountability, management information systems, or financial product governance processes that incorporate customer outcomes. See Section 3 for country examples.

20 See Brix Newbury and Izaguirre (2019) on challenges observed by supervisors implementing risk-based supervision in emerging markets.

Alternatively, regulators with a limited consumer protection mandate and limited market conduct regulatory or supervisory experience may seek to leapfrog to a customer outcomes regulatory regime. In this case, strong institutional support and capacity investment can help them set up a team capable of designing, implementing, supervising, and enforcing the new regime. See Box 8 for an example.

Emerging market authorities also may benefit from engaging with regulators that already have implemented a customer outcomes framework and can share insights and advice on regulatory reform. Global bodies can play a key role in facilitating these exchanges.

BOX 8. **The Philippines implements a customer outcomes framework**

Bangko Sentral ng Pilipinas (BSP), the Central Bank of the Philippines, recently embarked on significant reform of its 2014 financial consumer protection framework to ensure that providers consider customer outcomes in business conduct and do not engage in harmful consumer practices (BSP 2019). Reform de-emphasizes rules that were difficult to operationalize and enforce, especially in rapidly evolving sectors. Instead, the focus is on institutionalizing consumer protection as an integral part of provider corporate governance, culture, and risk management. Key changes include clarified roles and responsibilities for boards and senior management and broader disclosure principles throughout the consumer relationship.

The Microfinance Non-Government Organization (NGO) Regulatory Council also took an important step toward customer outcomes by issuing new performance standards for microfinance NGO accreditation in 2018.[a] New standards apply to finance, governance, social objectives, accountability, transparency, product design, service and delivery channels, and ethical treatment of clients (Microfinance NGO Regulatory Council 2018).[b]

a. Set up in 2015, the Council comprises four permanent members from the Securities and Exchange Commission and the departments of Trade and Industry, Finance, and Social Welfare and Development. It also includes three sector representatives.

b. Also reflects the Social Performance Task Force's "Universal Standards for Social Performance Management" (Wardle 2017).

Monitoring, supervision, and enforcement are key to success

Regardless of how rules, principles, and performance-based approaches are balanced, a customer outcomes regulatory framework can be successfully adopted only if authorities and providers are credibly committed to monitoring, supervision, and enforcement. Constructive dialogue is key in developing feasible and clearly articulated metrics for monitoring and measuring customer outcomes.

Capacity-building efforts must ensure that providers and supervisors understand that monitoring and supervision does not focus on compliance *per se* but on customer outcomes. Supervisors need to assess how providers embed customer outcomes into corporate culture and business practices and how personal conduct contributes to customer outcomes. Supervisors must develop the capacity to determine whether outcomes have been met. As the financial sector landscape continues to evolve and connected services are delivered across multiple providers and third parties, supervisors can benefit from innovative regulatory and supervisory technology, such as RegTech and SupTech, for monitoring and assessment.

Enforcement—that is, building capacity and empowering regulatory staff to identify customer outcomes breaches—also needs to become more customer-centric. This includes communicating regulatory and supervisory expectations to providers and enforcement measures to the public.

Consumer organizations, advice services, and other civil society organizations play an important role in monitoring outcomes and provider actions following enforcement. They also may help ensure that constructive provider–regulator dialogue does not lead to regulatory capture. It is crucial that these parties are invited to the table.

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ANNEX

GLOBAL STANDARDS AND GUIDANCE FOR CUSTOMER OUTCOMES

Customer outcomes in global standards and guidance

Our research indicates that most global bodies, including OECD TF, IAIS, and the International Organization of Securities Commissions (IOSCO), consider customer outcomes concepts in key policy documents. The International Financial Consumer Protection Organization (FinCoNet) and the Basel Committee on Banking Supervision (BCBS) mention customer outcomes in secondary policy documents and guidance for implementing standards.

Fair treatment of customers is the most common concept included in policy documents. Fair treatment encompasses consumer-oriented activities such as product design and product governance, advertising and transparency, advice and contracts, assessment of creditworthiness, and credit execution. It also is associated with internal processes that affect consumers such as remuneration, conflicts of interest, corporate governance, and accountability. IAIS considers fair treatment outcomes to be a cornerstone of business conduct regulation.

Seeking the **best interests of consumers** is another concept often recognized by global bodies. OECD TF's High-Level Principle on Business Conduct states that providers and agents should work in the best interest of customers and uphold financial consumer protections. IOSCO and IAIS state that intermediaries and providers should act with due care and diligence in the best interest of clients. Overall, preserving customer best interest is considered a strong argument for robust regulatory and supervisory interventions.

Key components in achieving customer outcomes

At a high level, **corporate governance** is considered a key component in achieving customer outcomes. According to OECD TF, governance structures allow providers to embed fair treatment within corporate culture and manage conflicts of interest. BCBS indicates that robust corporate governance is important to sustained financial inclusion. Global bodies also mention mechanisms that strengthen corporate governance, among them internal codes of conduct or ethics; clear policies and processes, such as accountability for third-party actions; periodic consumer satisfaction surveys; appropriate information management systems; mystery shopping; and staff training.

Corporate or business culture is mentioned as key to promoting fair treatment, suitability, and similar concepts within providers, their agents, and other third parties. OECD TF indicates that treating consumers fairly should be an integral part of good governance and provider–agent corporate culture. IAIS notes that ensuring fair outcomes requires providers and intermediaries to adopt fair treatment of customers as a part of business culture.

Global bodies note that **remuneration structures** should encourage responsible business conduct and fair treatment while avoiding conflicts of interest. A key common message indicates that remuneration should be determined not only by sales performance but by assessing consumer satisfaction and product retention and applying guidelines or codes of conduct that reflect duties of care. Concepts such as ethical behavior and acting in good faith are considered key to provider operations—especially when implementing fair treatment and seeking customer best interest.

Global bodies emphasize the importance of provider and agent **assessment of customer needs, interests, and situations** before a product (service or advice) is offered—and throughout its lifecycle. Global bodies stress that information required for assessment should be proportionate to the nature and complexity of a product and that providers should retain oversight over those performing third-party assessments, such as agents.

OECD TF and FinCoNet stress the importance of **creditworthiness and affordability assessments** in indicating whether credit obligations are likely to be met. Affordability focuses on consumer interests and implications for consumer welfare and is rooted in principles like fairness and ethics. Assessment takes a holistic view of a customer's ability to repay debt, including financial and economic situation, standard of living, and subjective factors such needs, requirements, and objectives. FinCoNet indicates that credit providers and intermediaries may be prohibited from facilitating credit unless an affordability assessment proves that customer interest is met. OECD TF states that creditworthiness requirements are among the responsible lending criteria that help providers avoid mis-selling.

OECD TF, FinCoNet, and IAIS indicate that providers should pay attention to the needs, interests, and situations of vulnerable groups and that authorities may introduce additional protective measures. OECD TF suggests that information on **vulnerable groups** and their fair treatment be gathered through outreach to consumer groups, consumer research, supervisory actions, complaints data, and other means.

Assessing suitability and appropriateness is another building block of fair treatment and customer best interest. OECD TF, IOSCO, BCBS, and IAIS mention that providers may be subject to a "suitability obligation," which minimizes mis-selling by ensuring that a product is appropriate for a particular consumer. FinCoNet highlights good practices for providers on assessing suitability and preventing irresponsible lending; practices on regulatory actions that restrict certain credit product designs to address systemic unsuitability; and practices that encourage consumers to select suitable credit products or limits.

Internal product approval processes are mentioned as relevant to product assessment. OECD TF states that processes should adequately allow providers to offer products that meet the needs of target consumers—especially vulnerable groups—and enable providers to rapidly withdraw or suspend the sale of products that harm or do not consider consumer best interest. IAIS also highlights the importance of adequate product governance processes, including product design, distribution, and review, with special emphasis on approvals of inclusive products.

Principles-based and rules-based approaches

Although global bodies incorporate customer outcomes concepts for consumer protection, they have yet to emphasize the **customer angle**. Global bodies follow a more traditional trajectory: declaring **principles** and indicating industry and provider goals and business processes and, in some cases, specific **rules** for providers. There is little discussion on the types of customer outcomes providers should consider; rather, they are left to identify, elaborate on, choose, and discuss customer outcomes with authorities. IAIS is the only global body that clearly connects to customer outcomes in discussions of the importance of measuring customer outcomes generated by insurance use and balancing customer value and protection goals in designing those approaches.

Global bodies indicate that regulators could apply both **principles-based and rules-based approaches** to customer outcomes concepts. OECD TF and IAIS indicate that a principles-based approach to fair treatment could complement specific rules of customer engagement—for example, rules-based product approvals for complex or mandatory products and engagement with vulnerable segments, or when establishing suitability obligations and protections.

Regulators could use **rules-based prohibitions to protect vulnerable customers**. FinCoNet explicitly indicates that authorities may prohibit products or features by considering the type and level of vulnerability of a consumer or class of consumer, adverse financial effects on consumers, a product's complexity and risk, distribution channels, and the nature of a provider or intermediary. Some jurisdictions consider it appropriate to include extra protections for classes of consumers obtaining a particular product or to limit certain features, such as capping interest rates or addressing systemic market concerns by prohibiting a product.

Global bodies highlight the importance of developing a **risk-based proportionate approach**. IAIS further states that regulators should adequately incorporate conduct risk into a holistic, risk-based framework. Otherwise, a narrow regulatory definition of conduct risk may lead to negative customer outcomes. A risk-based proportionate approach would ensure that business conduct risks are well managed throughout the product lifecycle:

- When setting strategy or working with design processes, classifying conduct risk only as operational risk may put the focus on customer service efficiency and transactional processes but neglect customer outcomes.
- Classifying conduct risk only as reputational risk may result in mitigation that protects an organization's reputation but does not necessarily improve customer outcomes or ensure appropriate redress.
- Classifying conduct risk only as legal or regulatory risk may lead to a check-the-box exercise that achieves minimal regulatory compliance but does not fully consider customer outcomes or embed a culture of fair treatment.

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