Issue 3 | September 2019

CONTENTS

Welcome to the FinCoNet newsletter

Welcome to the third 2019 edition of the FinCoNet newsletter.

The FinCoNet annual general meeting will be held on 13-14 November 2019 in Rome, Italy. The Bank of Italy is hosting FinCoNet. It is also co-organising with FinCoNet an international seminar entitled "Behavioural Insights for Conduct Supervision" on 15 November.

Both events are by invitation only. If you would like to attend either or both, please contact the FinCoNet Secretariat [sally.day-hanotiaux@oecd.org] for further information.

We look forward to welcoming FinCoNet members and other interested parties to Rome in November.

In focus

World Bank discussion note: Product Design and Distribution: Emerging Regulatory Approaches for Retail Banking Products

This discussion note reviews emerging international approaches for regulating the design and distribution of retail banking products. Such products include deposit, credit, and payment products, being the products that new financial consumers typically acquire first. Policy makers are finding that financial consumer protection measures implemented to date, such as disclosure requirements, while still important, are insufficient to protect consumers against all key risks. Anticipating new or changing risks to consumers has also become more difficult for regulators given rapid financial sector innovation. Regulation of providers' product design and distribution processes aims to ensure that products distributed in a market are designed to meet the needs of consumers in that market. This discussion note analyses relevant frameworks in a number of jurisdictions and highlights emerging common approaches, including in relation to requirements for governance arrangements, target market assessments, distribution arrangements and product reviews.

The discussion note can be downloaded here.

World Bank publication: Complaints Handling within Financial Service Providers : Principles, Practices, and Regulatory Approaches

Core to an effective financial consumer protection framework – and consequently to responsible financial inclusion – is an accessible and efficient recourse mechanism. Ideally, such recourse allows consumers both to know and to assert their rights to have their complaints addressed and resolved in a transparent and just way, within a reasonable timeframe. This highlights considerations for regulators and FSPs when developing and implementing internal dispute resolution (IDR) frameworks to ensure they are consistent with international good practices. It synthesizes concepts, principles, and practices for complaints that are handled by FSPs, and shares examples of legal and regulatory requirements for FSPs to resolve complaints. The note also covers how complaints-related data can be collected, analyzed, and shared as appropriate to support improvements in FSP performance, industry market conduct, and market conduct regulation.

The report can be downloaded here.

Current issues forum

FCA measures for fairer and simpler overdrafts in the UK

Contributor: Ann Sanders, Financial Conduct Authority, UK

Introduction

In June 2019, the UK's Financial Conduct Authority (FCA) introduced a package of measures to make overdrafts simpler, fairer and easier to manage for the 26 million people in the UK who use an overdraft.

Overdrafts allow consumers to borrow money through their current account. For arranged overdrafts, a borrowing limit is agreed in advance between the consumer and the bank or building society that provides the account. An overdraft is unarranged if it exceeds the agreed limit or if there is an overdraft on an account without an agreed limit.

UK banks and building societies made more than £2.4bn from overdrafts alone in 2017, with around 30% from unarranged overdrafts; about 30% of this was from "unarranged" overdrafts. 1.5% of customers paid 50% of unarranged-overdraft fees in 2016. These fees can be more than ten times as high as fees for payday loans. This concentration of excessively high fees, which tends to affect vulnerable consumers disproportionately, was key to FCA's decision to radically reform the overdraft market.

Our review of high-cost credit identified that 80% of consumers cannot identify the most affordable overdraft deal at present. That's hardly surprising as different banks have different pricing structures. This complex pricing leads to poor competition in the overdraft market, and contributes to poor understanding and awareness of overdrafts.

The UK overdraft market

Our work on overdrafts was informed by our Strategic Review of Retail Banking Business Models (SRBB). We undertook the review to understand the impact of changes to retail banking business models, and the implications of the changes for consumers.

In our final report, we found that concentration in retail banking was high and had increased following the financial crisis. Despite some progress being made by "challenger" banks (ie smaller retail banks that compete with more established players) and the emergence of alternative business models, major banks still hold over 80% of the personal current account (PCA) market. Our analysis showed that a key component of competitive advantage for major banks has been the combination of a high number of PCAs and large branch networks, which brought, amongst others, the following benefits:

- a funding cost advantage from large numbers of customers holding balances in PCAs paying no interest

- significant additional income from fees and charges on PCAs, particularly overdraft charges

In our SRBB report we made it clear that digital propositions using data to help consumers (e.g., to manage their money or to get better deals) will be a key determinant of how retail banking markets will evolve. We recognised that innovation, facilitated by Open Banking and the EU Directive on

Payment Services (PSD2)[1], could bring substantial benefits to consumers in the future. However, the evidence of current levels of harm led us to act now to protect consumers.

New rules

Given the harm caused by high prices and complex charging structures, it was clear the overdraft market is dysfunctional, causing significant harm to consumers.

We have made rules that will give greater protections to millions of overdraft customers, particularly the most vulnerable. Our rules and guidance will:

- stop banks and building societies from charging higher prices for unarranged overdrafts than for arranged overdrafts
- ban fixed fees for borrowing through an overdraft, bringing an end to fixed daily or monthly charges and fees for having an overdraft facility
- require banks and building societies to price overdrafts by a single annual interest rate
- require banks and building societies to advertise arranged-overdraft prices with a representative APR[2].

These rules come into force on 6 April 2020.

The changes to overdraft pricing are part of a wider package of remedies designed to increase competition in the UK. Other new rules, coming into force in December 2019, will make it easier for customers to manage an overdraft.

- Digital eligibility tools will allow customers to check whether they can get a cheaper overdraft from another provider.
- Overdraft charge calculators will help customers to translate interest rates into pounds and pence so they can easily see how much their overdraft will cost.
- Text message or push notification alerts will alert consumers to address unexpected overdraft use.
- Changes to display overdrawn balances at cash machines so that consumers using an overdraft will see a negative balance and better understand that their overdraft is debt.
- We have provided guidance to the industry to reiterate that refused-payment fees (e.g., when a standing order can't be paid due to a lack of funds) should reasonably correspond to the cost of refusing payment.

Expected benefits

We believe that requiring firms to use a simple annual interest rate will bring an end to complex pricing, making sure that charges are proportionate to the amount borrowed and the period of it is borrowed.

The combination of a single interest rate and the display of representative APR in advertising should increase transparency and allow customers to compare, in a

[1] Payment services (PSD 2) - Directive (EU) 2015/2366

[2] The annual percentage rate (APR) is a standardised way to show the overall cost of borrowing; it enables comparisons with other, similar forms of credit. It takes into account interest and any other charges for credit and reflects the period of use of the credit advanced. With overdrafts, since there is not usually a fixed term, there are rules which requires certain assumptions to be made as to the use, period and repayment of the credit.

meaningful way, the cost of borrowing between products (e.g., overdraft versus credit card) and between FSPs. We also anticipate benefits to competition from increased pricing transparency between overdrafts and other credit products, producing better outcomes for consumers in the long run.

The changes to pricing rules will reduce the burden of unarranged-overdraft charges and refused-payment fees on vulnerable customers. Thirty per cent of overdraft users live in the most deprived areas of the UK; we estimate they could see an aggregate reduction in fees and charges of £101m per year.

At the level of the individual consumer, the typical cost of borrowing £100 through an unarranged overdraft is expected to drop from £5 a day to less than 20 pence a day.

The wider package of remedies will bring additional benefits, with the package of text message and push notification alerts alone potentially benefitting consumers by reducing the overdraft fees and charges they incur by £59m – £160m per year.

Protecting consumers – impact of FCA changes

Our evidence and analysis suggest that firms will likely seek to recover lost overdraft revenue from within their overdraft offering by, for example, increasing arranged-overdraft prices and reducing interest-free buffers.

FCA analysis found that consumers are still likely to experience a net benefit even if firms increase their arranged-overdraft charges for some consumers to offset reductions in unarranged charges and refused-payment fees. This is because FCA's changes should reduce the burden of unarranged-overdraft charges and refused-payment fees on vulnerable consumers; currently, they are disproportionately affected by these charges.

Also, the wider package of remedies should increase competition for arranged overdrafts, and it is expected this will constrain any such increase in charges.

We will continue to actively monitor firms' overdraft pricing and we will consider further intervention if our remedies do not address the harm we have identified.

There are particular concerns about the possible adverse impacts of increases in arranged-overdraft prices on consumers who are heavy overdraft users. Our analysis shows that 14% of overdraft users use their overdraft every month of the year, and pay 69% of all overdraft fees and charges at present.

To address this, banks and building societies will be required to do more to identify customers who are showing signs of financial strain or are in financial difficulty, and develop and implement a strategy to reduce repeat overdraft use. Firms will also be required to identify customers who may be adversely affected by any pricing changes made and, where appropriate, take steps to support them. These requirements come into force on 18 December 2019.

Overall, the measures will change the distribution of charges incurred by consumers for their overdraft use.

The Financial Conduct Authority (FCA) is the conduct regulator for 59,000 financial services firms and financial markets in the United Kingdom and the prudential regulator for over 18,000 of those firms. The firms regulated by the FCA include around 1,500 banks, building societies, credit unions, insurers and major investment firms, which are also regulated by the Prudential Regulation Authority as their prudential regulator.

Amendments to the Law on Microfinance in the Russian Federation

Contributor: Daria Silkina, Bank of Russia

On 2 August 2019, Russian Federation Federal Law No 271-FZ was signed into law, amending existing microfinance legislation.

Beginning on 1 November 2019, microfinance institutions will no longer be entitled to provide consumer loans against residential property (home accommodation) even if the property is not the only one the borrower possess. They will still be allowed to extend loans against non-residential premises. This rule does not affect microfinance institutions with governmental participation offering loans for business purposes to small and medium-sized enterprises, including individual entrepreneurs.

From 1 October 2019, extension of mortgage backed consumer loans to individuals will be prohibited to all market participants except for the following lenders: credit organizations, microfinance organisations, consumer credit unions, agricultural consumer unions supervised by the Bank of Russia, Russian military mortgages and Russia's Agency For Housing Mortgage Lending (Dom.rf) and institutions authorized by Dom.rf.

The prohibition does not apply to mortgage loans extended by employers to their employees.

The new amendments outlaw mortgage-loan extensions by illegal lenders. Previously, there was only a ban imposed on the extension of consumer loans by illegal lenders.

As of 1 October 2019, consumer credit unions and agricultural consumer unions must cap interest rates for mortgage-backed consumer loans: these may not exceed the maximum set by the Board of Directors of the Bank of Russia.

Ireland: New requirements for financial intermediaries on commission arrangements

Contributors: Fiona Woods, Central Bank of Ireland

The Central Bank of Ireland is introducing changes to the Consumer Protection Code 2012 to ensure transparency of commission arrangements between financial intermediaries (such as brokers and financial advisers), and product producers (such as banks and insurance firms).The changes will also minimise the risk of conflicts of interest related to commissions arising when consumers receive financial advice from an intermediary. These changes are set out in a Code addendum published on the central bank website on 25 September 2019 and follow a public consultation process (Consultation Paper 116 – Intermediary Inducements, Enhanced Consumer Protection Measures).

Why is the Central Bank introducing these changes?

The operation of intermediaries in the Irish market offers many potential benefits to consumers, including access to advice, greater competition and a wider choice of products. However, in keeping with its mandate to protect the consumers of financial services, the central bank must also evaluate the risks posed to consumers

through the existence of commission arrangements between intermediaries and product producers. Commission arrangements must be designed in such a way that they encourage responsible business conduct and fair treatment of consumers and avoid conflicts of interest. It is in this context, and in line with its strategic objective of strengthening consumer protection, that the central bank is now making significant amendments to the Code to enhance the consumer framework in relation to the payment of intermediary commissions.

What are the changes?

The new measures introduce a new disclosure regime for commissions received by intermediaries and are summarised as follows:

- Consumers to have transparency of commission arrangements between intermediaries and product producers;
- Prohibition on certain types of commission arrangements such as volume based targets;
- Firms cannot describe themselves and their regulated activities as 'independent' where they accept and retain commission in circumstances where advice is provided; and
- Free hospitality such as golf trips and sporting event tickets is not permitted.

When will the new measures come into effect?

The Addendum to the Code will take effect from 31 March 2020. The press release on the publication of the Code Addendum can be found here.

.

Innovation Lab in Banco de Portugal

Contributors: Nuno Pereira, Banco de Portugal

'*For the things we have to learn before we can do them, we learn by doing them*.' – Aristotle

Digital is proliferating in the financial sector, both start-ups and incumbent institutions focus on continuously improving the customer experience, simplifying processes and introducing increasingly sophisticated services at a faster pace keeping cost reduction as a strong motivating factor.

Disruption is touted by the ease with which new business models boom, stimulated mainly by new players. They are challenging, for example, payment and credit services, differentiating their offer by claiming faster action, increased security and transparency, continuous risk assessment and a superior response capability leveraged by the computing power of predictive analytical models.

Buzzwords like artificial intelligence, machine learning, big data, data science, blockchain or fintech relate directly to the so-called Industry 4.0, or fourth industrial revolution, and are considered the gears and engines of this revolution we are witnessing and for which a significant transformation in society and markets is foreseen.

Innovation Lab's proposed value

Banco de Portugal has been following these new business paradigms and supporting technologies closely by founding or collaborating in targeted working groups, both nationally and internationally, and by conducting experimental projects or initiatives. Early in 2019, the central bank introduced a new capability to extend knowledge of these transforming agents: the Innovation Lab, known as inov#, aims to catalyse an innovative mindset within Banco de Portugal and to support its decision making.

The main motivations for launching inov# comprise:

- *Technological and process evolution*

The emergence of technological paradigms such as artificial intelligence, machine learning and blockchain can be applied to risk analysis, economic forecasting, payments and financial product life-cycles, evoke both interest and apprehension about how a supervisor may, on the one hand, take proper advantage of these technological paradigms to fulfil its mission and, on the other hand, obtain relevant knowledge to assess risks and potential constraints such developments may entail for the financial system.

- *Internal and external demand*

Internally, several units in Banco de Portugal are assessing the feasibility of using these new technologies to streamline current supervisory processes and to identify new working methods.

Externally, many financial service players seek clarification from Banco de Portugal on innovative products and services. This has driven the creation of specific communication channels and collaboration with other financial authorities.

- *ESCB collaboration*

The European System of Central Banks (ESCB)[1] network is also following innovative developments closely, working together in either formal or informal groups to assess the advantages and possible concerns of financial and technological advancements.

With these motivations as its foundation, the Innovation Lab aims to "promote a culture of innovation, propitious to generating new ideas, developing new competences to value people and support evolution for Banco de Portugal."

To uphold this vision, inov# encourages:

- the ability to act upon constant change
- low-risk experimentation
- digital-culture development
- innovation-culture development
- strengthening employees' skills
- collaboration between departments
- internal and external information sharing
- dealing with failure
- motivation and attractiveness
- focus on innovation and entrepreneurship
- contributions to the strategic plan

[1] The ESCB is composed of the European Central Bank (ECB) and the national central banks of the European Union (EU) Member States

In the Lab

The most tangible activities of inov# are, undoubtedly, the innovation initiatives. Once an idea is targeted for experimentation, a multidisciplinary team is formed within the Innovation Lab to ideate on the proposal. Whenever a potential innovative method could address the use case, the team subjects it to iterative experimentation to test the validity of the original idea. The final step in the initiative's life cycle may be the longest or the shortest. In the adoption step, the team draws conclusions on how to pursue it, either by proposing its integration in the organisation's "business as usual" processes, or abandoning the idea. For an appropriate decision-making it is of primary importance to involve relevant stakeholders from the very first step.

In the first months of the lab's operation, after communicating its operating model, it is perceived a strong focus from business units in using innovative approaches to improve current activities either in terms of speed or in accuracy.

Regarding the Supervision Function, two initiatives were carried out:

- improving the validation of draft credit agreements based on a set of legal rules
- extracting financial institutions' sentiment from social media.

Both experiments were based mostly on natural language processing, as well as with a reduced level of machine learning capabilities, and evidenced the potential applicability of these disciplines to current functions by improving efficiency and broadening the scope for analysis.

Additionally, in functions other than Supervision, the lab developed a chatbot and a blockchain solution to address user support and business transactions, respectively. The lessons learned from these experiments can also be applied to further uses within the Supervision function.

The application of emerging technologies to Supervisory functions, known as SupTech, is on the rise with the prospects of improved capabilities for supervisory agencies willing to extend the benefits the increasing volumes of data hold and also it will require a faster adaptation to the new challenges of the financial ecosystem. Innovative approaches to collecting data and significant advances in data analytics are strong contenders for experimentation within the controlled environment of the Innovation Lab, which encourages exploration of bold ideas in search of improved tools. inov# will certainly assess ways of leveraging automation of complex tasks, extending financial agents' analysis, enhancing forecasting and now casting, and other approaches that have the potential to improve the Supervisory function.

Next steps

The inov# journey has just begun. Its length rests on its participants' ability to inspire new ideas, providing evidence of its potential when applicable and subsequently promoting adoption within the organisation, developing new skills and finding new and improved methods.

Internal demand is high, and expectations keep growing. These constitute solid ingredients for facing interesting challenges in finding new ways.

It’s Time to Change the Equation on Consumer Protection

Contributor: Gerhard Coetzee, Consultative Group to Assist the Poor (CGAP)

This blog was originally published on the CGAP website.

Whenever we sign up for financial services online, we are asked to sign “I agree” to terms and conditions that most of us scarcely understand. Usually these are couched in complex legal language and presented in small print or hidden behind a link, making them especially difficult to read on small mobile devices. Imagine the absolute challenge if you are functionally illiterate, or unfamiliar with financial terms, as is the case for many poor people in developing markets who use mobile devices to manage their financial lives. You would miss the reams of rules, warnings and essential information about the product or service that you are accessing. Why is the information presented in this way? I would argue it is not intended for the customer, rather the financial service provider (FSP) is solely concerned about legal compliance.

Imagine if the intent was to inform and empower the customer how different the experience would be. I once saw financial information presented in a comic strip. Quirky characters demonstrated the product functions, terms of use, and two or three core conditions. It was easy to understand. It gave me the impression that the FSP cared that I read and grasped the essentials, allowing me to determine whether the product would be of value to me. The FSP had made an effort to inform me and empower me to make a decision, which led to a good customer outcome.

A positive experience like this could become commonplace if we changed the equation and took an alternative approach to consumer protection, one that focuses on customer outcomes rather than on meeting legal obligations. I define customer outcomes as what clients take away from their interactions with and use of financial products and services and engagement with FSPs. It is an approach that goes beyond “do no harm” to customers and considers instead how access to and use of high-quality and responsibly delivered financial products and services can create value for customers and lead to positive outcomes for the consumer. I would argue it is a goal well worth policy makers and FSPs pursuing collectively, in order to both strengthen the financial sector and advance inclusive finance.

> ”
>
> I define customer outcomes as what clients take away from their interactions with and use of financial products and services and engagement with FSPs. It is an approach that goes beyond “do no harm” to customers...

Let me delve more deeply into the link between value, customer outcomes and the role of the financial service provider. Customers seek two types of value when they make access and use choices - functional value and experiential value. Functional value focuses on the question “can the product or service offered do the job required?” For example, I want to send money to you: Is the service easy to understand? Is it easy to sign up for and send money? How affordable is the service? Are both parties protected against fraud and predatory practices during this transaction? If the answer is 'Yes' to all these questions, the service has good functional value for the customer and thus delivers positive customer outcomes. Experiential value focuses on how we felt during the transaction. What did we experience? Was it stressful? Did it empower us? Did it improve our confidence in dealing with FSPs? If it increased our confidence and our trust in the financial system and gave us more agency, it had positive experiential value and contributed to a positive customer outcome.

In both instances, the provider has direct influence over creating value for the customer, which in turn can lead to positive customer outcomes. There are a range of different factors that customers consider when interacting with financial products and services, and a number of different ways that providers can ensure a positive experience. Let us explore some:

- Choice as a customer outcome _ *I can make an informed choice among a range of products, services and providers, based on appropriate and sufficient information and advice available in a transparent and easy-to-understand way*. This empowers me to choose the best product or service for my circumstances. For example in the Philippines, the government conducted behavioural research and designed loan cost and terms disclosure forms that were easy for customers to understand. Customers were better able to make informed decisions about the products. In Tanzania, a service provider used SMS messages to educate customers on how to check digital loan limits or use a cost calculator tool. This approach improved customer engagement and armed with more knowledge, customers chose to increase their total average digital savings. In each case, helping to motivate and enhance choice delivered good outcomes for the customers.

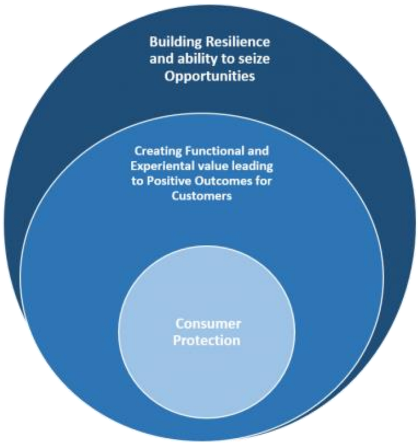
- Safety and security as an outcome — *My money and information are kept safe, and the provider respects my privacy and gives me control over my data*. I can rely on my money and data being safe from theft or security breaches. I always have control over my data and remain fully informed about the implications of sharing it. For example M-Kopa, a PAYGo solar energy provider in Kenya, provided its customers with access to, and the ability to correct their credit histories, which M-Kopa had generated from the customers' use of digital loans. FirstAccess, an alternative data-analytics and credit-scoring firm for FSPs in emerging markets, uses SMS messaging to explain their services to customers and seek customer consent to sharing their data, assisting them in deciding what to disclose to providers. By exercising care in protecting and informing their customers, these providers offer a service that leads to good outcomes for customers.

- Voice as an outcome — *I can communicate with the provider through a channel of my choice and get my problems resolved quickly at minimal cost to me*. I know where to go when I have questions or concerns or when something goes wrong, and I am being heard. My problems are resolved quickly. The provider also solicits my feedback and shares how it uses my comments to improve products or practices. An example is Tigo Ghana, who uses WhatsApp, email, Twitter, Facebook, Instagram, YouTube, and LinkedIn, as well as a call center to ensure that customers can voice their opinions, ask a question or lodge a complaint. The company further instills values in its agents and call center employees to listen to customers and treat them with dignity and respect. The results are that customers have a voice, they are listened to and they get a response from the provider.

- Meets my purpose as an outcome — *By accessing and using products designed and delivered in this way and by getting the services I need, I am in a better position to control my financial life, manage a shock or attain other goals*. An example is responsibly delivered digital credit, the microloans offered instantly on mobile phones. Research in Kenya shows that many customers borrow early in the morning to buy inventory for their small businesses or fuel for their taxis. They often repay the digital loans the same day or within a week. The ease and convenience of accessing funds remotely at the moment the person needs the money makes a difference in running and growing a small business. It adds value and creates a good customer outcome.

In all of these examples, the efforts of the FSPs to understand the customers and their needs and to act on those insights to provide valuable products and services are instrumental in delivering positive customer outcomes. At the same time, it becomes evident that protecting the consumer is integral to the process and deeply embedded within a customer-outcomes approach. In other words, the FSP who designs products and services from the perspective of whether this will ensure good outcomes for the customer is at the same time making sure that the consumers interests are protected, as we depict in this diagram.

Why are these elements so integrally



related? Because when consumer protection fails, it destroys both functional and experiential value causing negative outcomes for customers. One vivid example is when digital credit fails. Easy to access digital loans, as we have seen, can be very beneficial to poor customers. But most digital lenders' practices fall short on transparent, timely and sufficient disclosure, a shortcoming that all too often leads to negative customer outcomes. CGAP research found that roughly half of all digital credit customers in Tanzania and Kenya are behind on their loan payments, and up to 31 percent default entirely. Many of these customers are listed as bad credit risks by credit bureaus, sometimes for failing to repay amounts as low as $0.20 (USD) because they did not understand the terms and conditions of the loan. This often has lasting consequences for the borrowers who may be charged higher rates or excluded from the financial system for years to come, preventing them from using financial tools to build assets, invest in education, housing and improving their livelihoods. The short-term effects also can be severe. Researchers found people cutting back on daily meals and not paying health expenses in order to repay loans. Without adequate consumer protection in place for digital credit, customer value can be destroyed, resulting in negative customer outcomes.

How do we move toward achieving customer outcomes-driven financial inclusion?

Given the interdependencies of customer value, customer outcomes and consumer protection, CGAP is exploring a Customer Outcomes Framework that can be practically applied for FSPs and regulators as an alternative consumer protection regime. It would go beyond the traditional approach of "doing no harm" to customers and consider instead how access to and use of high-quality, affordable and responsibly-provided financial services can create value for customers and thereby contribute to positive outcomes. From our early research, it is clear that this will require a shift in focus by regulators as well as financial service providers, and a willingness to work collectively toward new solutions.

For financial service providers

A customer-outcomes approach means asking different questions when considering their business models and practices. They must understand the linkages between positive customer outcomes built on customer value, and business models built on sustainable delivery of revenue over the long term. If businesses pursue short-term gains and use predatory practices, they risk destroying customer value, creating negative customer outcomes, and destroying future revenue for their firms. Good outcomes for poor customers in contrast produce long-term value for the individual and the business alike. Once the concept of customer outcomes is understood and firms realize that there is a positive correlation with business value, we observe significant results. In Haiti, Digicel moved from 40,000 active mobile money customers to over 800,000 within two years after management realized that the company was not delivering value to customers. Digicel was using agents to train individual customers on the functions and options of the mobile money menu. This failed as the agents were time constrained and never really reinforced the training the customer received. Customers felt disempowered and embarrassed to acknowledge that they did not understand the instructions. After field research with customers, Digicel changed to group-based training in the communities. Groups consisted of all community members, including younger more tech-savvy people and other early adopters of technology. This meant that training could be reinforced for those that did not grasp it the first time, as they could ask for help within the community until they mastered the technology. This led to high adoption and use rates as Digicel empowered people based on choice and use outcomes. In the Philippines, Pioneer insurance tripled its customer sign-up and nearly doubled its revenue over three years, when the company invested in understanding what created customer value and led to good customer outcomes. One example is a basic product comparison map that helped customers to choose the right insurance product for their specific needs. This helped to diminish product confusion and empowered customers to make product choices, a vital customer outcome.

For policy makers

The change in approach means connecting the dots between customer outcomes, consumer protection and financial stability, and positive developmental outcomes. Consumer protection efforts so far in the regulatory sphere have been rules based and largely focused on doing no harm to the customer with insufficient attention paid to the outcomes. Doing no harm is necessary, but it is not enough. To achieve positive results for customers at scale, policy makers must incentivize FSPs to deliver positive outcomes for the customer. A new regulatory approach can emphasize doing good for the customer, in the knowledge that it serves the interests of the customer as well as delivers value for the firm, and in the final analysis for society.

Innovation in digital financial services is moving at such a fast pace that it is virtually impossible for regulators to keep up and applying the rules-based approach developed for another era is challenging. A customer outcomes-based approach allows regulators to adapt by balancing a combination of rules-based (by which I mean prescriptive, sometimes called tick-the-box approaches), principles-based (broad guidance with limited or no specific rules provided) and outcomes-based regulation to embed a corporate and regulatory culture that aims for better customer outcomes. Rules are still important, but they are not the be-all and end-all. Consider instead an approach where the regulatory objective is not only to make sure that the FSP provides product information to the customer, but also that the information is relevant and presented in an easy-to-understand manner. An outcomes-based approach would focus on whether the customer understood what was presented, not on whether the information was provided, and the provider is incentivized by the policy maker to support a positive customer journey.

Some jurisdictions already are embracing the approach. The Conduct of Financial Institutions, recently published in South Africa, is one example. It identifies a range of outcomes that could contribute to the financial resilience of South Africans. Let me quote a few examples from the bill. It requires that "*Customers are provided with clear information and kept appropriately informed before, during and after point of sale, and, products perform as firms have led customers to expect, …*" FSPs have to report to the regulator on these customer outcomes. It follows that providers and the regulator must agree on what will be good indicators and how it will be measured and reported. The regulatory examples we see in our research internationally focus on conduct and culture governance, as well as on customer understanding, assessment and engagement as essential building blocks for a customer outcomes-focused approach. It echoes our proposed outcomes described earlier, with one difference, that is the addition of an outcome that goes to the next level, 'meets the purpose' for the customer.

Let us return to the concept of partnerships between regulators and FSPs. In most jurisdictions this concept of a partnership is somewhat counter-intuitive as the regulator is the guardian of the rules, and the FSP monitored for adherence. An FSP leader told me recently "the relationship is so bad, I do not speak to a regulator without my lawyer present." Many regulators can share real stories of predatory practices and customer neglect unearthed at FSPs. The 2007-2008 financial crisis is still fresh in our memories where we saw what can go wrong when FSPs only focus on what is best for shareholders and management, to the absolute detriment of customers.

Imagine a world where regulators and FSPs jointly focus on customer outcomes. A few years ago, CGAP did exactly that, convening regulators and FSP leaders from across the Southern African Development Community (SADC) through a joint effort with FinMark Trust in South Africa for a workshop. The first day was a field immersion exercise in which they formed groups, each composed of two FSP leaders and one regulator, and visited customers. Some groups visited the homes of microenterprise owners. Other groups interviewed the local informal moneylenders known as mashonisas. Some interviewed the clients of money lenders, and others interviewed people waiting in line to receive social grants.

They returned in the evening for a joint debrief. We only had one request – define the main challenge customers faced in accessing and using financial services and products, and describe the challenge through the eyes of the customer. We heard many problems, from lack of information and lack of understanding of products to difficulties with access, lack of documentation, disrespect and more. The next morning, we challenged the FSPs and regulators to design solutions to the customer challenges identified. Regulators contributed ideas and information on product design, and FSP leaders cautioned where the concept would contravene the rights of the customer or be unsafe. They discussed where practices could be improved and how rules could be adjusted, in light of the specific challenges faced by the client segments they had observed. I would argue that the experience and the stories merged into a customer- outcomes based approach, rather than the FSP leaders and regulators defaulting back into looking at the obstacles narrowly through their own lenses.

> A customer outcomes focus can be the cement that constructs a different conversation between regulators and FSPs.

A customer outcomes focus can be the cement that constructs a different conversation between regulators and FSPs. At a higher level, FSPs should connect the dots between positive customer outcomes and sustainable business models, and regulators should strive to contribute to a different culture of cooperation towards achieving customer outcomes. This culture can only be the result of change management and is indeed one of the main challenges of a customer outcomes-based approach.

Many more challenges remain, especially over what to measure that can serve as proxies for customer outcomes, and how to measure them. Many insights are needed on what could be plausible and measurable indicators that can be applied by FSPs, and how regulators should support this process. However, the good news is that industry stakeholders are not starting from ground zero. Some microfinance practitioners use customer outcome-focused approaches (think about the Progress out of Poverty Index, a simple poverty measurement tool), though the concept is more recent for the wider financial inclusion community and financial sectors across the globe. In addition the Social Performance Task Force and the Smart Campaign are researching customer outcomes approaches and measurement tools. In a few countries, regulators and FSPs already are pioneering customer outcome-based regulatory approaches. The United Kingdom implemented Treating Customers Fairly in 2003, while South Africa tested the approach from 2008 and recently published the Conduct of Financial Institutions Bill for comment. In India, policy makers have drafted suitability rules, while Australia has enacted rules on the conduct of providers of consumer credit.

CGAP's initial research shows that the approach has found resonance at the level of international standard-setting bodies. In its core principles for conducting business, the International Association of Insurance Supervisors' (IAIS) cites treating customers fairly as foundational and includes achieving outcomes that are aligned with customer choice, protection, use, and voice – similar to those we discussed earlier. Our remaining research will examine what the proxy indicators for customer outcomes might be, and how these could be measured at the firm level. What is emerging is a new framework that has the potential for driving forward financial inclusion. I believe the customer outcomes-focused approach is critical for achieving our overall goal of financial services as a pathway toward financial well-being, economic growth and poverty alleviation. Customer outcomes is an intermediary step along this pathway that is vitally important to address to achieve the higher-level outcomes. This is not a linear process, as life itself is not linear. Instead, it is the product of intertwined iterations achieved through the collaboration of providers and policy makers of which customer outcomes is a part, not easy to simplistically define or place in a comprehensive framework that builds over time toward financial inclusion. However, unless we pay attention to these basic outcomes for the customer, I doubt we can succeed in reaching the higher-level goals to which we aspire of empowering poor people through financial services.

FinCoNet

Established in 2013, FinCoNet is an international organisation of supervisory authorities responsible for financial consumer protection. It is a member-based organisation set up as a not-for-profit association under French law.

FinCoNet promotes sound market conduct and strong consumer protection through efficient and effective financial market conduct supervision.

Each member of FinCoNet has responsibility for and an interest in protecting the interests of consumers of financial services. FinCoNet seeks to enhance the protection of consumers, and to strengthen consumer confidence by promoting robust and effective supervisory standards and practices, and sharing best practices among supervisors. It also seeks to promote fair and transparent market practices and clear disclosure to consumers of financial services.

Contacts

Acting FinCoNet Chair

Ms. Maria Lúcia Leitao
mlleitao@bportugal.pt

FinCoNet Secretariat

Ms. Flore-Anne Messy
Flore-anne.messy@oecd.org

Mr. Miles Larbey
miles.larbey@oecd.org

Ms. Sally Day-Hanotiaux

Sally.day-hanotiaux@oecd.org