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Hong Kong's Experience and Remaining Challenges

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Introduction

Sheila Bair, the Chair of the US Federal Deposit Insurance Corporation, observed some time ago that there can no longer be any doubt about the link between protecting consumers from abusive products and practices, and the safety and soundness of the financial system.

I am sure there is little doubt now, that this is the case. However, given the current response to calls from consumers for adequate protection, I wonder if the message has really sunk in.

Global Financial Crisis

The many examples of civil unrest and disobedience that have arisen in the aftermath of the Global Financial Crisis are a dramatic indication that there is something seriously wrong with the state of affairs in the financial sector. There is a clear public concern that consumer rights have been violated, and that consumer interests are considered of only secondary importance to those of business.

Second Class Status of Consumers

The second class status of consumers is confirmed by the fact that financial bailouts and the concept of “too big to fail”, have resulted in consumers having to pick up the bill. Moreover, whenever consumers seek improved protection they are still faced with an insistence that “buyer beware” should be the basic standard that applies to consumer transactions. This is still argued in circumstances where many in business and government do not understand the complexity of financial products being offered in the marketplace; let alone ordinary consumers.

In the face of this stubborn resistance by business and government, is it any wonder that there is anger and frustration at the misery and hardship that is being levelled at ordinary consumers.

Business likes to complain and focus on the difficulty in meeting the costs of providing a service, the cost of employing high powered executives, and the cost of competing with each other. But how much focus is being put on the cost in human terms, resulting from market failure. How much effort is given to ensuring that the failures we have seen in the past will not happen again?

The longer that indecision and obstruction goes on, the more it seems that we will face a long, drawn-out process of consumer dissatisfaction, market stagnation and a cycle of failures that will lead society into uncharted waters.

Will Consumer Protection Undermine Financial Stability?

I have been reliably informed that at a recent OECD meeting, a comment was made by one of the participants to one of my colleagues in Consumers International, that the financial sector cannot afford stronger consumer protection because that would undermine the financial stability of the sector.

This is a terrifying prospect because it suggests that the industry has become financially dependent on weak consumer protection and therefore relies on abusive relations with its clients to survive. To my mind it also suggests that there has been

an inherent dishonesty in any claims by business that they are willing to work with the consumer movement to improve the position of consumers.

This alleged conflict between stability of the sector and protection of consumers is a terrible dilemma. Either consumer protection measures are reformed, which will, according to this theory, destabilise the industry, or we continue to tolerate abusive practices and end up with the kind of instability and human misery that we have recently experienced. I and my colleagues at CI come down firmly on the side of reform, as continuing with abusive practices will in due course end up destabilising the industry anyway, indeed it has done so already.

Report of Financial Stability Board (FSB)

The priority should be to ensure there are strong measures in place to protect consumers. The recent report by the Financial Stability Board (FSB) which was requested and endorsed by the G20, is particularly relevant¹. The FSB has made a recommendation that calls for more work on institutional arrangements to ensure clear mandates, accountability and sufficient resources to protect consumers. More effort is required to pursue this recommendation, and the onus should be placed on business to adapt to a new paradigm aimed at recognising consumer interests. I do not believe that society can, or should, continue to suffer material losses as have occurred in the past.

The FSB has also recommended that an international organisation with a clear mandate and adequate capacity could

- help maintain the international momentum on consumer protection;
- strengthen the connection with domestic developments;
- facilitate engagement with consumer advocacy groups and other stakeholders; and

¹ http://www.financialstabilityboard.org/publications/r_111026a.pdf

- steer the work in a productive direction².

Consumers International strongly supports this recommendation.

Hong Kong Experience

Deposit Guarantees

From my own experience in Hong Kong, I can attest to the destructive forces that can be unleashed as a result from a lack of confidence in the financial sector. Hong Kong has in the past experienced episodes of consumer panic over the viability of some banks. It is largely because of the trauma that these events have wrought, and good foresight, that the Hong Kong Government introduced a deposit protection scheme, over five years ago.

The Hong Kong Deposit Protection Scheme is administered by an independent statutory body and has responsibility for maintaining a deposit protection scheme, which is recognised as an important part of the overall financial safety net in Hong Kong.

Consumers International has consistently asked for strengthened deposit guarantees, and called for the following in its evidence to the OECD Task Force:

- insolvency procedures should be reformed so that the rank of creditors is changed to put depositors at the top;
- deposit protection schemes should provide cover for each separate brand and create a seamless transition of essential banking services, with consumers maintaining access to deposits used for transactional banking;
- any payment from the protection scheme regarding deposits held in savings accounts should be made within a fixed and reasonable time limit.

² Op Cit pages 5 & 22

Firewall between safe and unsafe products

We have seen far too many cases of consumers buying products that they do not understand and which are in fact not really comprehensible by many very expert people, including sales staff. An example in Hong Kong was the sale by various banks of Lehman Brothers 'minibonds' that resulted in over twenty thousand consumer complaints, and resulted in legal action sponsored by the Council through its Consumer Legal Action Fund. The complaints raised various legal issues regarding the existence of a fiduciary relationship between the banks and customers concerning the Lehman products, and whether the bank had acted in the best interest of customers and made full disclosure of all material facts. Equally significant were legal issues such as the effect of misrepresentation or negligent misstatement or omission of material facts, and the legal effect of signature on contractual documents under such circumstances.

The type of products which were the subject of complaint can only be described as 'dangerous' to the general public. Measures should be introduced to prevent these products from being marketed as anything but dangerous. Minimum standards should be developed with a basic requirement that products on general offer to the public must be readily comprehensible. If a reasonable consumer does not understand the ramifications of any product on offer, then it should be considered unsafe.

Sale of Investment Products

The Hong Kong Monetary Authority recently issued a circular to all Authorized Institutions (AIs) to draw their attention to a number of conduct-related issues in relation to the sale of investment products so as to ensure adequate protection of investors.

This includes:

- Adequate disclosure of relevant material information, with particular attention on some special product features and risks of certain investment products (examples are Subordinated debentures, Perpetual debentures, Contingent convertible or bail-in debentures, Basket equity-linked products).

- Ensure that, among other factors, special features and risks including the issuer's credit risk are properly taken into account in their product due diligence process.
- Take into consideration all relevant factors, including the customer's concentration risk, in performing suitability assessment.
- Maintain proper records of client orders. Use of mobile phones for receiving client order instructions is discouraged.

Consumers International Recommendations

Lenders to Seek Information

Consumers International believes that consumers have a responsibility to provide necessary information to lenders regarding their capacity to repay the loans that are requested. But at the same time, lenders should also have a responsibility to seek such information. Consumers International proposed an addition to the OECD principles to that effect. Some jurisdictions, such as South Africa, allow the annulment of credit contracts where the financial service provider has not analysed a contract to determine whether it meets the client's needs; such as affordability. Consumers International agrees with that provision, and considers that

- all information provided to consumers about financial services should be guided by the principle that the information must be clear, sufficient, reliable, comparable and timely;
- failure to provide information that meets the above requirements should cause the contract to be voidable;
- standard formats (such as Key-Information Documents) should be used for the presentation of information about financial service products so that consumers can easily compare products;
- financial service providers should be responsible for testing the quality and comprehensibility of the information provided, with additional audits conducted by national regulators; and

- contracts must include clear upfront pricing so that consumers can appreciate the cost of the product before becoming obligated to pay.

Disclosure

Some of Consumer International's recommendations to the OECD, mentioned above apply to disclosure, and recommendations have also been made regarding disclosure of agents' remuneration. In an ideal world financial advice should be separated from sales based remuneration. While this may take some time, the reference in the principles to financial service providers and agents declining to provide a product in the event of conflict of interest, should be welcomed. In addition, there should also be

- protection against inappropriate marketing methods; and
- removal of remuneration structures for financial service providers that lead to conflicts of interest that impinge on consumers.

Human Rights

The decision by Time magazine to make "the protestor" its person of the year was in part influenced by the many protests around the globe at failures in the financial system. The protests reveal the sorry fact that there is a strong belief that those with power are disconnected from the plight of ordinary citizens; and have no regard for the consequences of their actions on fellow human beings.

In Chinese culture, the principle of 人情 (Yan Ching or Ren Qing in Mandarin) plays a vital role in personal behaviour; in private lives as well as in business and the professions. It is almost always the final criterion that is used to determine what is right and what is wrong in our dealings as human beings with each other.

Yan Ching recognises a citizen's individuality in terms of their intellectual, emotional and spiritual feelings. Unlike in the West, where human rights were typically enshrined in laws, the Chinese made Yan Ching the basis for virtually all decisions and behaviour that were not precisely covered by law; to protect their feelings as human beings.

This principle continues to play an important role in private lives as well as in business and the professions. Examples can be found in the demands that the Hong Kong Consumer Council faces, especially from Mainland tourists who come to Hong Kong and have been cheated and have had their complaints mediated by the Council. It is often the case that the complainants will not simply be satisfied by material compensation, but will also demand that they receive a personal apology directly from the person who has inflicted the grief.

Conclusion

We will no doubt continue arguing into the future about adequate levels of consumer protection. The same old arguments will be thrown back at our recommendations, and we will face obstructions from vested interests who are only interested in preserving their well-being.

However, I believe we have reached a crisis point that needs a new paradigm of thought. We need to develop a mindset to secure a positive future for both consumers and business. We have reached a state of affairs in the global financial arena where the financial sector cannot continue to disregard the consequences of their actions on ordinary human beings.