Financial Inclusion: Reforms in the Areas of Consumer Protection and Financial Literacy

During the recent financial crisis both household investors and borrowers were confronted with unpleasant surprises. Individual investors learned that the financial products they bought were much riskier than they had perceived. Borrowers found themselves overindebted and unable to service their loans. How did this come about? Investors were looking for high-yield investments and banks began offering newly designed products with the promise of higher returns. In addition many households were interested in more and higher loans to finance consumption, for example, and banks were often willing to grant them. Thus, for both investors and borrowers the demand for a financial service or product and its supply had an impact on the outcome. Both situations show how far-reaching financial decisions can be if mistakes are made – not only for the individual household but for the entire economy as the following statement shows: "Lack of effective disclosure and deceptive advertising on the part of providers and failure to understand financial products on the part of consumers contributed to the collapse of the subprime mortgage market in the United States" (CGAP/WB 2010, 23).

This implies that the institutional environment in which financial services and products are offered plays an important role. Improving institutions should thus help to prevent negative outcomes in the future. The Table provides some information on the reforms carried out in different countries. Financial inclusion is, of course, a topic of high priority in development economics. In this context it has many more aspects than the two we focus on here. But these two aspects are highly relevant for industrialised countries as well – as the financial crisis has shown. The information comes from a survey conducted on financial inclusion in a joint initiative by the Consultative Group to Assist the Poor (CGAP) and the World Bank Group among financial regulators on the agenda under purview of their agency.

Consumer protection aims at protecting consumers against unfair or deceptive practices by financial service providers, at improving transparency by complete disclosure of clear, adequate and comparable information about prices, terms and conditions of financial products and services, and at establishing a recourse mechanism to address complaints and resolve disputes quickly and inexpensively (CGAP/WB 2010, 24). "Financial literacy refers to the need to inform the public about the basics of financial services and ensure individuals' ability to make informed judgments and effective decisions about the use and management of their finances." (CGAP/ WB 2010, 17).

In both areas many countries initiated reforms in 2009. In the area of consumer protection the most common reforms aim at disclosure requirements and dispute resolution systems. In some countries, among them the Czech Republic and Finland, fraud protection is also improved. The extension of deposit insurance is sometimes also considered to be consumer protection. Reforms in the area of financial literacy comprise, for instance, the creation or update of financial education school programs, the establishment of financial literacy weeks and the launch of financial learning centres. As the Table shows, nearly all countries in our sample have introduced reforms that contribute to consumer protection. From the Table we also see that only a few countries have improved financial literacy (CGAP/WB 2010).

Table

Financial inclusion: areas of reform in 2009

	Consumer protection	Financial capability
Austria	+	
Belgium	+	
Bulgaria	+	+
Czech Republic	+	
Finland	+	
France	+	
Hungary	+	
Ireland	+	
Italy	+	
Latvia		+
Lithuania	+	
Portugal	+	
Slovak Republic		+
Spain	+	+
United Kingdom	+	+
Croatia	+	+
Macedonia		
Switzerland	+	
Turkey		
Canada	+	+
Japan	+	
New Zealand	+	+
United States	+	

Source: CGAP/WB (2010).

Numerous countries have put in place reforms related to consumer overindebtedness. Here measures on the supply as well as the demand side should help to improve the situation. On the supply side, requiring stricter risk management and improving transparency in credit markets were the first measures. In this respect, the rules under which credit bureaus and credit registries operate are of particular importance (see Hainz 2011 for a more comprehensive treatment of information sharing arrangements). Portugal, for example, makes credit bureau consultation mandatory. But, of course, the demand side for loans must also be addressed by providing better education on how to make financial decisions (CGAP/WB 2010).

The distortions that became evident during the financial crisis clearly indicate that the scope for improving the institutional environment is huge. Thus, we can expect to see many more reforms in the two areas investigated here in the coming years.

C. H.

References

CGAP/WB (Consultative Group to Assist the Poor/World Bank Group) (2010), Financial Access 2010: *The State of Financial Inclusion through the Crisis*, Washington DC.

Hainz C. (2011), "Measuring Information Sharing in Credit Markets", *CESifo DICE Report 9*(1), 21–27.