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REFORMING RBI'S CONSUMER PROTECTION REGIME AND ENFORCEMENT POWERS

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1. INTRODUCTION

The pace of financial innovation in India's rapidly growing economy has led to the development of a wide range of financial products, resulting in an overload of information for the consumers. At the same time, consumer finance has become more of a do-it-yourself activity[1], and this greater consumer autonomy in relation to important financial decisions and complex financial products poses special public policy concerns in light of the mounting evidence that consumers do not always behave as time-consistent and rational utility maximizers.[2] The key limitations for consumers interacting with financial service providers include biases and cognitive limitations, major financial decisions being undertaken only infrequently, social taboo of discussing personal finance reducing the effectiveness of social learning[3], complexity of the information being provided, ineffectiveness and incompetence of the information provider etc.

Consumer protection and financial literacy are the two sides of the same coin, and both the aspects require significant attention in the Indian context. The two concepts basically encourage financial inclusion, as they create a high quality market for consumers and lead to reduction of risk by provision of appropriate remedies. Their interaction contributes to improved efficiency, transparency and access to retail financial markets by reducing information asymmetries and power imbalances among providers and users of financial services.

Although the Indian Consumer Protection Act, 1986, allows consumers to initiate proceedings in relation to all deficient products, including financial products, the latter being credence goods cannot be equated with other products for several reasons[4] such as – (i) the financial products are much more complex than other physical products; (ii) the consumers are vulnerable to the problems of imperfect information and imperfect rationality; (iii) most sellers of financial products have the ability to change the terms and conditions of the product even after it has been used by the consumer; (iv) the use pattern for the same financial product may be different depending on the user; (v) the lenders may not treat all the customers of the same financial product alike etc. Since the principles of law that may apply to consumer protection in general are not suitable for financial products and therefore, there arises a need for a robust and exhaustive regime for consumer financial protection.

The consumer financial protection laws are typically aimed at redressing the information imbalance between the sellers and buyers by (a) requiring disclosure of clear, complete and suitable information to the consumers, (b) prohibiting sellers from engaging in unfair and misleading practices, (c) providing appropriate mechanisms for redress of grievances and (d) ensuring financial literacy of consumers to enable them to make informed decisions. A well informed consumer empowered with basic consumer rights can inspire market discipline and

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[1] Ryan, Andrea; Trumbull, Gunnar; Tufano, Peter, "A Brief Postwar History of US Consumer Finance", Harvard Business School Working Paper 11-058 (2010), available at <http://www.hbs.edu/faculty/Publication%20Files/11-058.pdf>, last visited on 19th May, 2015.

[2] Campwell, John Y. et al, "Consumer Financial Protection", J Econ Perspect, 25(1), 91–114 (2011).

[3] Zelizer, Viviana A., *The Social Meaning of Money: Pin Money, Paychecks, Poor Relief, and Other Currencies*, (Princeton University Press, 1997).

[4] Oren Bar-Grill & Elizabeth Warren, "Making Credit Safer", 157 U.PA.L.REV.1 (November, 2008).

lead to the development of competitive markets by encouraging financial institutions to offer better products and services.

This report contains 2 sections. Section I contains 5 parts excluding the introduction which is Chapter 1 of this report. A multi-jurisdictional approach has been adopted for identifying the basic elements of an effectively functioning consumer protection regime, with focus on mainly three jurisdictions – *the United Kingdom, the United States of America and Australia.* Additionally, the recommendations for the reforms in the Indian regime have been calibrated against not only the practices prevalent in the aforementioned jurisdictions but also against two primary international efforts in this regard, the G20 High Level Principles on Financial Consumer Protection[5] (G20 Principles) and World Banks' Good Practices for Financial Consumer Protection[6] (Good Practices) which reflect the most frequently used practices that have been successfully carried out in both developed and developing countries (examples include the United States, Australia, Canada, France, Ireland, Malaysia, Mexico, New Zealand, Peru and South Africa).

Chapter 2 of the report examines the scope of RBI's lawmaking powers under Section 35-A of the Banking Regulation Act, 1949 ("**BR Act, 1949**"). Chapter 3 delves into the institutional structures in place for the various consumer protection regulators to determine the most effective structure for discharge of consumer protection functions. Chapter 4 analyses the disclosure practices for the purposes of providing clear and complete information to the consumers with the purpose of reducing information asymmetries. Chapter 5 discusses the business practices that require being embedded into the consumer protection regime broadly covering three aspects - fair treatment to customers, responsible lending by lenders and training and competence of the bank staff. Chapter 6 focusses on the dispute resolution mechanism for aggrieved consumers. Chapter 7 elucidates the initiatives required to be undertaken for improving the consumer literacy effort, drawing from international experiences. At the outset, please note that the discussion below focusses on the concepts utilized in other countries in relation to consumer protection regulation for financial products in general. We will be happy to analyse specific financial products and advise the RBI for developing product-specific consumer protection regulations, if the RBI so requires.

Section II of this report focuses on reforming the enforcement powers of the RBI, which is relevant not just for the purpose of consumer protection, but for all matters subject to RBI's jurisdiction.

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[5] G20 High-Level Principles on Financial Consumer Protection (October, 2011), available at <http://www.oecd.org/daf/fin/financial-markets/48892010.pdf>, last visited on 20th May, 2015.

[6] "Good Practices for Financial Consumer Protection", World Bank (2012), available at <http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/Good_Practices_for_Financial_CP.pdf>, last visited on 20th May, 2015.

SECTION I

2. SCOPE OF THE POWERS OF THE RBI UNDER SECTION 35-A, BANKING REGULATION ACT, 1949

A. BACKGROUND

In order to determine the scope of RBI's law-making powers in the context of consumer protection, it is important to examine Section 35-A of the BR Act, 1949. Courts have held that the directions issued by the RBI under Section 35-A of the BR Act, 1949 are in the nature of subordinate legislation[7], and hence, they have largely adopted a non-interventionist approach and do not interfere unless the reach of the RBI's actions fall outside the limits of the parent act i.e. BR Act, 1949. In the landmark decision of *ICICI Bank v Official Liquidator of APS Star Industries Ltd. & Ors.*[8], the Supreme Court recognized that the directions issued by the RBI in exercise of its powers has statutory force and are thus binding. The same court in *Central Bank of India v. Ravindra and Ors.*,[9] declared that power conferred upon the RBI under Section 35-A is coupled with a duty to act. Such a duty entailed that the RBI issue binding directions possessing statutory force "in the interest of public in general and preventing banking affairs from deterioration and prejudice as also to secure the proper management of any banking company generally." Thus, nature of powers u/s 35-A is essentially –

a. In the nature of a subordinate legislation;
b. Possessing statutory flavour;
c. Has a legally binding character.

B. DISCUSSION OF CASE-LAWS

1. Limitations on RBI's powers

The limitations on the powers under section 35-A have been explored in various cases of the High Courts and the Supreme Court. An important principle that may be culled out from the observations of the court in *B. Ramachandran Adityan v Tamil Nadu Mercantile Bank*[10] is the administrative law principle concerning parent / subordinate Legislation wherein in the event that the parent act is silent on a matter, the subordinate legislation cannot provide for directions on the same if it falls outside the scope of the parent act. In the given case, the RBI had issued certain circulars that required scheduled and non-scheduled banks to await acknowledgement from the RBI prior to effecting a transfer of shares whenever such an application was made to the bank. Another circular stipulated that "the voting rights, restrictions and other related provisions of the BR Act will continue to be applicable as appropriate". In the given case the validity of these circulars was not the issue, however, the court noted that it was questionable as to how far the circulars dealing with the transfer of shares and conditions therein were issued u/s 35-A, could curtail property rights in shares, especially when the parent legislations (BR

[7] *B. Ramachandran Adityan v Tamil Nadu Mercantile Bank*, (2010) 1 Comp LJ 515 (Mad).

[8] AIR 2011 SC 1521.

[9] AIR 2001 SC 3095.

[10] (2010) 1 CompLJ 515 (Mad).

Act, 1949) left property rights untouched. The court further noted that given the directions issued under 35-A were subordinate legislation, when the parent act only went so far, as to merely restrict the statutory rights (voting rights), it was not clear whether the subordinate legislation could take it further and curtail the property rights in the shares also.

These observations, albeit obiter, become important when determining the potential scope of powers exercised by the RBI u/s 35-A of the BR Act, 1949. While the validity of the circulars was not in issue, the court gives us a feasible principle for determining the validity of directions issued by the RBI u/s 35-A. The subtly adverse observations regarding the said circulars on the ground that the parent legislations was silent on property rights enables us to cull out the principle that in the event the parent Act i.e. BR Act, 1949 is silent on the matters dealt with in the directions issued u/s 35-A, the same can be potentially struck down by the Court on the ground that they are *ultra vires* the BR Act, 1949. This is traced to the simple principle of administrative law i.e. subordinate legislations exceeding the scope of the parent legislations are impermissible as being *ultra vires* the latter law.

In *Mr. Surendra K. Kambli & Anr. v. Bhandari Co-op. Bank Ltd. & Ors.*[11], the petitioner challenged the order of the RBI cancelling its license in exercise of powers u/s 22 of the BR Act, 1949. Prior to the cancellation order, the RBI had issued an order u/s 35-A imposing certain financial restrictions on the Bank, and granting 6 months' time to the bank. It was argued by the petitioner that given 6 months' time had been granted, the order cancelling the license of the Bank was not judicious. The observations of the Court in the given case become important since it contributes to jurisprudence concerning the concurrent exercise of powers under different provisions of the BR Act, 1949. The Court noted the powers u/s 22(4) and 35-A are distinct and separate.[12] However, if there is an overlap of the jurisdictional facts provided in s. 35-A and s. 22(3) in a case, the RBI is free to act under either or both the provisions and the action under one cannot be faulted on the ground of recourse to the other provision.[13] Additionally, in the event that directions have been issued u/s 35-A, it is not necessary for the RBI to give an opportunity to the Bank taking necessary steps for fulfilling conditions set out s. 22(3) before cancelling its license if it is of the belief that the delay will be prejudicial to the interests of the banking company's depositors or the public.[14]

In another case, i.e. *ICICI Bank Limited v Official Liquidator of APS Star Industries Ltd. and Ors.*[15], the RBI had issued guidelines concerning restructuring of Non-Performing Assets ("**NPAs**"). The impugned guidelines allowed for inter se NPA assignment between banks to be a tool for resolving the issue of NPAs. The Gujarat High Court in the given case had held that guidelines by permitting the assignment of debts by banks inter se is not an activity which is permissible under the said BR Act, 1949 and thus *ultra vires* the Act (it may be noted that the Gujarat High Court's discourse is traceable to the principle of parent-subordinate legislation as culled out in the case of *B. Ramachandra Adityan*). The Apex Court overruling the High Court stipulated that objective of the impugned guidelines was to minimize the problem of credit risk and was a corporate debt restructuring process (and not "trading" in NPAs) which

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[11] Before the High Court of Bombay, Writ Petition No. 8393 of 2012, Decided On: 06.12.2013.

[12] *Ibid* at Para 5.

[13] *Ibid.*

[14] *Mr. Surendra K. Kambli* at Para 5 & 7.

[15] AIR 2011 SC 1521.

is one of the methods of reducing NPAs. The Court thereafter drew attention to the objective of the BR Act, 1949 and stated that the given guidelines fell u/s 21 of the BR Act, 1949. The impugned guidelines were a part of the Credit Appraisal Mechanism and as a part of Restructuring Mechanism fell within s. 21 read with s. 35-A of the BR Act, 1949. A similar fact-situation came up for consideration before the Punjab and Haryana High Court in *Sachdeva & Sons Rice Mills Ltd. v Kotak Mahindra Bank Ltd. and Ors*[16], wherein the Court ruled that guidelines issued by the RBI permitting Banks to deal inter se in NPAs were per not *ultra vires* the BR Act, 1949 and had statutory force of law given they had been issued by the regulator in exercise of the powers conferred by Sections 21 and 35-A of the BR Act, 1949.[17]

Finally, in *M/s. Deccan v Chronicles Holdings v UOI*[18], the constitutionality of Section 2(1)(o) of SARFAESI Act as well as guidelines issued by RBI pertaining to the classification of non-performing assets was challenged by the petitioners on the ground that it was highly ambiguous. However, the Court rejected the challenge and observed (as far as the Master Circular issued by RBI was concerned) that a conjoint reading of Section 5(ca), Section 21 and Section 35-A demonstrated that the RBI had ample powers to issue appropriate directions to the banking companies, and the given circular dealing with classification of NPAs fell within the scope of such power. Additionally, in the given case the Master Circular had been issued post an analysis of material factors and thus the same was not arbitrary and thus not *ultra vires* the Constitution.

It is pertinent to mention here that in none of the cases discussed above, the RBI's power was actually held to be ultra vires or bad in law.

2. RBI's enforcement powers under Section 35-A

This section intends to bring to light cases wherein the RBI has in exercise of its powers u/s 35-A imposed restrictions on activities of banking companies. The objective is to trace judicial discourse in this regard to determine the scope of such power.

In *Siwan Central Co-operative Bank Ltd. v The Reserve Bank of India and Ors.*[19], the RBI via exercise of its powers u/s 35-A restrained "the petitioner-Bank from accepting fresh deposit, including deposits in the Savings/Current Accounts, Fixed/Recurring Deposit [and also restrained] the withdrawal of any sum exceeding INR 1,000/- from the bank and further [restrained] the bank from making any, expenditure, except the salary, rent, electric bills, purchasing stationery and other legal expenses." The petitioner Bank challenged this on various grounds including the violation of the petitioner's Article 19(1)(g) rights and premature nature of directions. It was contested that the Court must intervene and issue a stay order. However, the Court while refusing to intervene on technical grounds iterated that the directions issued by the RBI were in exercise of its powers u/s 35-A and thus were legally binding on the petitioner Bank.[20]

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[16] 2013 SCC OnLine P&H 7350.

[17] *Ibid* at Para 39 & 43.

[18] AIR 2014 AP 78.

[19] (2006) 132 Comp Cas 154.

[20] *Ibid* at Para 8.

In *Ashok Kumar and Co. v Reserve Bank of India*[21], the RBI imposed various directions on the respondent Bank including such as "[prohibition] without the prior approval in writing of the [RBI], from granting or renewing any loans or advances, making any investment, incurring any liability including borrowal of funds and acceptance of fresh deposits and disbursement of any payment in discharge of its liabilities, obligations or otherwise. This [was] made subject to the condition that a sum not exceeding one thousand rupees, out of the total balance in every savings account or current account or any other deposit account by whatever name called, [could] be allowed to be withdrawn by a depositor provided that wherever a depositor [had] a liability to the bank in any manner, the amount [could] be adjusted first to the relevant borrowal account."[22] The respondent Bank challenged the legality of this order and a writ of mandamus was sought so as to permit the petitioner to withdraw the money deposited in its current account and to undertake normal banking activities. However, the Court exercised substantial deference and iterated that it was not in a position to substitute its conclusion with that of an expert statutory body like the RBI.[23] Additionally, in exercise of its powers u/s 35-A the RBI did not consider any matter that was *not relevant or germane* to the issue at hand. Instead it had acted in a fashion which was in the interest of the depositors since it was evident that the affairs of the Bank was affected by a serious financial crisis.

Finally, in *Reserve Bank of India v Pattem Surya Prakash Rao and Ors.*[24], the RBI in exercise of its powers under Section 35-A read with Section 56 of the BR Act, 1949 issued directions which propounded that the Bank shall not "without prior approval in writing from the RBI, grant or renew any loans or advances, make any investment, incur any liability including borrowing of funds and acceptance of fresh deposits, disburse or agree to disburse any payment whether in discharge of its liabilities and obligations or otherwise, transfer or otherwise dispose of any of its properties or assets except to the extent and in the manner provided in the said communication". Additionally, it also directed cancellation of license u/s 22 and instructed the Government to initiate winding up proceedings against the Bank. The Court refused to intervene with any of the directions of the RBI on the ground that in the given case there was irrebuttable evidence to justify the conclusion arrived at by the RBI and its order was thus sustainable in law.[25]

3. Principles of Deference

As demonstrated by the above-discussed cases, the courts have committed to deference in matters involving exercise of statutory powers by the RBI. In *Pattem Surya Prakash Rao*, the Court justified its refusal to intervene with the orders of the RBI on the basis of the administrative law principle of proportionality or the 'Wednesbury Rule'. The Court stipulated that it was not for the Court to substitute its decision to that of the administrator, RBI in the present case, unless the decision was illegal or suffered from procedural impropriety or was irrational in the sense that it was in outrageous defiance of logic or moral standards.[26] Similarly,

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[21] 2014 (106) ALR 471.

[22] *Ibid* at Para 2.

[23] *Ashok Kumar and Co.* at Para 15.

[24] 2008 (6) ALD 57.

[25] *Ibid* Para 69, 70.

[26] *Pattem Surya Prakash Rao* (n 24) at Para 53, 61-63 & 69.

in *Ashok Kumar*, the Court refused to intervene on the ground that such intervention is only permissible "where the action which has been taken is wholly extraneous to the object and purpose underlying the conferment of the power or where ex-facie the decision is found to be perverse and contrary to binding statutory norms."[27] Likewise another decision[28], the Court while discussing the powers of the RBI u/s 21 and 35-A of the BR Act, 1949 observed that *the directions/circulars issued from time to time by the RBI deal with issues of economic importance and thus there is a duty on the Court to exercise deference since economic policy is the function of experts and it is not for the Court to sit in judgement over matters of economic policies which is the prerogative of expert bodies*[29]*, in the instant case, none other than the watchdog of the Indian economy – the RBI.*

Thus, these cases demonstrate that the Courts prefer adopting a non-interventionist approach when it comes to the exercise of powers by the RBI. The logic behind such outlook stands in the well-known principles of administrative law i.e. deference in matters, which are dealt with by expert bodies, and deference in matters concerning the economic and fiscal policy. The only event when such intervention is seen as legitimate is in the event of unreasonable, arbitrary or *mala fide* exercise of power, procedural impropriety or exceeding the statutorily or judicially recognized scope of power.

4. Imposition of penalties as reflected in the press releases

An analysis of recent RBI Press Releases (in the years 2014 and 2015) reveal that there has been imposition of penalties under the heads of cancellation of license,[30] cancellation of certificate of registration[31] and issue of directions.[32] Illustrative grounds for imposition of monetary penalty include non-adherence with KYC Norms, non-adherence to instructions on monitoring of transactions in customer accounts, non-adherence Anti-Money Laundering (AML) standards and violation pertaining to sanctioning unsecured loans despite operational restriction imposed on it under section 36(1) of BR Act, 1949. As per newspaper reports, RBI has on several occasions directed banks to freeze/partially freeze accounts of customers, specifically those who do not comply with KYC norms issued by the RBI from time to time.[33] RBI has also issued instructions to banks to desist from certain practices which deter customer

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[27] *Ashok Kumar and Co*. at Para 14.

[28] *Punjab & Sind Bank v. Debts Recovery Appellate Tribunal and Ors.*, (2008)149PLR203.

[29] *Ashok Kumar and Co*. at Para 21.

[30] S. 22(4), BR Act

[31] S. 45-IA (6), Reserve Bank of India Act, 1934

[32] S. 35-A, BR Act

[33] Atmadip Ray, "ET in the Classroom: Freezing of Bank Accounts", *The Economic Times* (15th Feb., 2013), available at <http://articles.economictimes.indiatimes.com/2013-02-15/news/37119507_1_bank-accounts-account-holder-idle-accounts>, last visited on 20th May, 2015; See also "Partially freeze KYC non-compliant accounts: RBI", *The Hindu* (21st Oct., 2014), available at <http://www.thehindu.com/business/Industry/rbi-suggests-partial-freesing-of-kyc-noncomplaint-accounts/article6524008.ece>, last visited on 20th May, 2015.

protection (issuance of certain financial products, pricing practices etc.)[34] which may be categorized as the power of the RBI to ban certain financial products.[35]

5. Learning from SEBI Jurisprudence

An analysis of SEBI jurisprudence enables culling out the expansive ambit for the exercise of powers by the RBI u/s 35-A of the BR Act, 1949, especially when it comes to providing remedy to aggrieved consumers of financial products. Focus needs to be directed to Section 11 and Section 11-B of the Securities Exchange Board of India Act, 1992 ("**SEBI Act**") which provide for the functions of the SEBI Board and the power to issue directions, respectively. Given the diverse and constantly evolving nature of economic offenses, it is not plausible for the legislator to provide for an exhaustive set of powers to regulators like the SEBI, or the RBI. Thus a progressive reading of the existing statutory provisions is mandated. In fact the SAT has recognized the need for a liberal interpretation of the provisions of SEBI Act in the case of *Bank of Baroda v. Securities and Exchange Board of India*[36], wherein it held that the powers which have been conferred by section 11 and 11B to issue directions are of widest possible amplitude[37] i.e. "in context of the objects sought to be achieved by the [SEBI] Act and the duty cast on them in achieving the same .. s. 11 and s. 11B give enormous authority to the [Board] as long as the power exercised under section 11B is subject to the provisions of the Act and well within the legal and constitutional framework, intended to achieve the purposes of the Act and subjecting the persons specified in the section, the power will sustain." In this context, SEBI's order of 2006 is very relevant.[38] Citing the case of *ITO v. Mohammed Kunhi*[39] which propounds that "... <u>It is a firmly established rule that an express grant of statutory power carried with it by necessary implication the authority to use all reasonable means to make such grant effective</u>…the express grant of statutory power conferred by section 11B carries the authority to use of reasonable means to make such power effective"[40], the order moves on to <u>discuss the power of disgorgement.</u> It goes on to stipulate that the equitable relief of disgorgement i.e. a method of forcing a defendant to give up the amount by which he or she was unjustly enriched falls within the ambit of the Boards powers, even though not specifically mentioned in the statute as "The order of disgorgement would not prejudice the right of the regulator to take such further administrative, civil and criminal action as the facts of the case may warrant."

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[34] Reserve Bank of India ("RBI") Notification on Pernicious practices of select banks deterring customer protection and accounting integrity (17th Sept., 2013), available at <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=8461&Mode=0>, last visited on 20th May, 2015.

[35] Vivina Vishwanathan, "RBI bans zero per cent interest scheme", *LiveMint* (25th Sept., 2013), available at <http://www.livemint.com/Industry/N75DZVGbm1LatmlA7CFs2L/RBI-bans-0-interest-scheme.html>, last visited on 20th May, 2015

[36] 2000 (038) CLA 226 SAT.

[37] Appeal No. 2/2000 & 4/2000, Decided On: 27.07.2000.

[38] SEBI Order under Sections 11 And 11B of the Securities and Exchange Board of India Act, 1992 : In the Matter of Investigation into Initial Public Offerings, available at <http://www.sebi.gov.in/cmorder/IPO.html>, last visited on 20th May, 2015.

[39] AIR 1969 SC 430.

[40] *Ibid.*

There are also a bunch of case laws which discuss the ambit of the SEBI's power, and are important to understand the jurisprudence therein.

In *Sterlite Industries (India) Ltd. v. Securities and Exchange Board of India*[41] the SAT held that the measure of restricting a person from accessing the capital markets is penal in nature and such a punitive action does not fall within the ambit of Section 11B of the SEBI Act. In *Anand Rathi v. Securities and Exchange Board of India*[42] the same judge as in above case held that a measure to prohibit a broker from holding a position in the capital market is not a punitive action and thus falls within the ambit of Section 11B of the SEBI Act. In the case of *Bank of Baroda* , SAT held that an order to refund money falls within the ambit of Section 11B of the SEBI Act. [43] Post these judgments, Section 11 of the SEBI Act has been specifically amended to add sub-section 4 to it, which *inter alia* allows the SEBI to restrain persons from accessing the capital market, prohibit any office bearer from holding position in stock exchange, impound and retain the proceeds or securities in respect of any transaction which is under investigation etc., thereby explicitly clarifying the wide scope of powers which were being exercised implicitly by the SEBI.

An important judgment on this aspect is of the Gujarat High Court[44], where the division bench while upholding the power of the SEBI to impound money received by stock exchange, held the following –

> *"As and when new problems arise, they call for new solutions and the whole context in which the SEBI had to take a decision, on the basis of which impugned orders were passed, cannot be said to be without authority of law in face of the provisions contained in Section 11 and Section 11B. As the language of Section 11(1) itself shows and as the matters for which the measures can be taken are provided in Sub-section (2) of Section 11. It is clearly made out by the plain reading of the language of the section itself that the SEBI has to protect the interests of the investors in securities and has to regulate the securities market by such measures as it thinks fit and such measures may be for any or all of the matters provided in Sub-section (2) of Section 11 and in due discharge of this duty cast upon the SEBI as a part of its statutory function, it has been invested with the powers to issue directions under Section 11B.... Thus, so far as the authority of law in the SEBI to issue such directions is concerned, such authority to take measures as it thinks fit is clearly discernible on the basis of the provisions contained in Section 11 read with Section 11B of the SEBI Act.*
>
> *...We have to therefore, consider and interpret the power of SEBI under the provisions so as to see that the objects sought to be achieved by Act is fully served, rather than being defeated on the basis of any technicality.*
>
> *...The duty and function had been entrusted to take such measures as it thinks fit and in order to discharge this duty, the power is vested under Section 11B.*

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[41] Appeal No. 20 of 2001, Decided On: 22.10.2001.

[42] Appeal Nos. 52, 53 and 54/2001 (Appeals arising out of the order dated 9.11.2001 made by the Securities and Exchange Board of India), Decided On: 28.02.2002.

[43] *Bank of Baroda* (n 36).

[44] Securities and Exchange Board of India v Alka Synthetics Ltd (1999) 19 SCL 460 (Guj)

...The authority has been given under the law to take appropriate measures as it thinks fit and that by itself is sufficient to cloth the SEBI with the authority of law'.

One has to view the powers of the respondent under the provisions of the Act in the context of the objects sought to be achieved by the Act and the duty cast on them in achieving the same. Section 11 and Section 11B give enormous authority to the respondent in this regard. As long as the power exercised under Section 11B is subject to the provisions of the Act and well within the legal and constitutional frame work, intended to achieve the purposes of the Act and subjecting the persons specified in the section, the power will sustain. Since the exercise of power is subject to the provisions of the Act and the purposes for which it can be exercised and the persons to whom it can reach has been specified in the section, it cannot be said that the power is unguided or unlimited. It is a wholesome provision designed to achieve the objectives of the Act."

Also, the later judgment of *Karvy Stock Broking Ltd. v. Securities and Exchange Board of India*[45] of the SAT makes the scope of Section 11 and 11B very clear. It holds that –

- "The introduction of Sub section (4) in Section 11 and various other provisions like Section 11B is indicative of the legislative intent. These provisions are meant to arm the Board with authority so as to be able to effectively exercise power and achieve the declared objectives of the Act.
- The provisions of the Act are basically intended to protect the interests of the investors and to promote the market. However, *the Act as initially enacted provided primarily for taking promotional or protective measures. The power to take preventive or punitive measures was implicit. Now it has been expressly extended to taking even the preventive or punitive measures. Without doubt, these, too, are ultimately aimed at achieving the basic objectives of investor protection and promotion of the development and regulation of the securities market as contained in the preamble*."

Utilizing the above jurisprudence, it can be safely argued that a similar expansive reading of Section 35-A of the BR Act, 1949 may be taken. This analogy is strengthened by the fact that s. 11B and s. 35-A allow for issue of directions for similar ends, for instance, in the public interest / interest of investors, in the interest of the banking policy / securities market, to prevent the affairs of any company / intermediary being conducted in a manner detrimental to the interests of the depositors, to secure the proper management of any such company / intermediary etc. Thus one can utilize SEBI jurisprudence to argue that Section 35-A can be read to include powers akin to that of the SEBI Board i.e. make an order of disgorgement and perhaps powers such as issuance of orders for refund of moneys or return of real property, restitution, compensation for unjust enrichment, payment of damages or other monetary relief, civil money penalties etc., without the threat or possibility of judicial and legal challenge.

Therefore, a critical reading of the above data demonstrates that the scope of power of the RBI under the BR Act, 1949 as well as the RBI Act is substantial and expansive. The open-endedness of the provisions in the statutes seems to be an intentional exercise to allow for the RBI to effectively deal with the constantly evolving conditions of the economy of India. Additionally, the judiciary has been fairly benevolent by adopting a non-interventionist stand

[45] [2007] 73 SCL 261 (SAT).

whenever the legitimacy of the directions of RBI has come to be challenged. The only event in which the Judiciary has agreed to interference is in the event of violation of well-recognized principles of administration law as elucidated upon above.

Also, the trends in exercise of enforcement/penalty powers by the RBI in the event of violation or non-compliance with the law/norms/directions of the RBI are not challenged and in the event they are, the Courts fall back into the above-elucidated discourse when taking a call on the legitimacy of the RBI's actions. The empirical data is especially useful because it demonstrates a fairly non-questioned trend of imposition of penalties by the RBI and also brings to light the provisions under which the same are exercised and the grounds for exercise.

Lastly, taking cue for the judicial discourse in relation to the SEBI's power, it can be stated without much doubt that like the SEBI, the RBI also has expansive powers in issuing directions to protect the ever-evolving economy through innovative and reasonable methods and the statute is blessed with the inherent flexibility to do so.

The consumer protection measures that have been proposed in the following chapters of this report are aimed at enhancing the quality of the consumer protection environment as prevalent in India, and given the wide scope of the RBI to issue directions under Section 35-A of the BR Act, 1949, the measures suggested under chapters relating to disclosures, business practices, dispute resolution and consumer education and the related enforcement measures can be put into practice by the RBI under its present rule-making powers.

3. INSTITUTIONAL FRAMEWORK

A. BACKGROUND

Every regulatory function to be executed requires an appropriate institutional structure through which such function may be executed. In terms of consumer financial protection measures, there has been always been a debate whether it is beneficial for it to be circumscribed within the prudential function of the regulator or outside it. At the outset it may be noted that prudential regulation refers to regulating financial institution's solvency and liquidity and its financial health, and market conduct regulation (of which consumer protection regulation is a part) includes regulation of conduct of business, design and price of the firms' products, and the treatment of customers.

It becomes important herein to examine the pros and cons of the separation of the prudential supervision and consumer protection supervision functions (which form a part of the market conduct regulation) of the oversight body. The arguments in favour of a separation of the prudential and consumer protection supervision are: first, as per certain reports, the resilience from the economic meltdown / global financial crisis in 2008 in Australia, Canada[46] and Netherlands[47] was attributed to the twin peak model (where prudential regulation (focusing on the long-term view of market performance) is assigned to one regulator and market conduct regulation (focusing on the day-to-day operation of the market) to another[48]) and some economies transitioned into the twin peak model post the global financial crisis, and the biggest example in this regard is the UK.[49] Second, when housed together, it has been observed that the prudential supervision functions gets much more focus than the consumer protection / market conduct function[50] which results in dismal and unsatisfactory focus on the implementation of the consumer protection functions. When conflicting objectives arise, for instance, if it is viewed that the consequences of sanctioning a financial institution or requiring it to compensate consumers for breach of consumer protection regime will adversely affect the soundness (or public perception thereof) of the financial institution, the regulator may opt to avoid making a decision on the consumer protection issues. Lastly, both the functions require separate monitoring and implementation tools.[51] To elaborate, the tools required for prudential supervision are basically focused on the assessment of the 'performance' of the institutions.

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[46] Please see at <https://www.financialstabilityboard.org/publications/r_111026a.pdf>, last visited on 22nd May, 2015.

[47] Kremers, Jeroen and Dirk Schoenmaker, "Twin Peaks: Experiences in the Netherlands." LSE Financial Markets Group Papers, Special Paper 196 (2010), available at <http://www.lse.ac.uk/fmg/workingPapers/specialPapers/PDF/SP196.pdf>, last visited on 22nd May, 2015.

[48] James K. Jackson, "Financial Market Supervision: Canada's Perspective", Congressional Research Service (2013), available at <https://www.fas.org/sgp/crs/misc/R40687.pdf>, >, last visited on 22nd May, 2015.

[49] Laura Cox et al, "United Kingdom regulatory reform: emergence of the twin peaks", Compliance Officer Bulletin, 2012 ("**Laura Cox**")

[50] "World Bank, "Global Survey on Consumer Protection and Financial Literacy: Oversight Frameworks and Practices in 114 Economies" (2014), available at <http://responsiblefinance.worldbank.org/~/media/GIAWB/FL/Documents/Publications/CPFL-Global-Survey-114econ-Oversight-2014.pdf>, last visited on 22nd May ("**World Bank Global Survey Report**").

[51] *Ibid.*

However, consumer protection supervision requires tools focused on active monitoring of financial markets and interaction with consumers and includes nuanced tools like - monitoring financial institutions websites and advertisements, collecting and monitoring complaints, operating hotlines, conducting interviews, operating price comparison websites for improving transparency and competition and mystery shopping.[52]

The argument disfavoring the separation are that supervisory agencies which combine the two functions find dealing with consumer complaints a reliable indicator of the trend in the financial product market and this helps in highlighting the facets which require more attention, thus providing an early warning signal and resulting in amendment of the regime to best fit to the prevalent scenario.[53] The twin peak model as discussed above may be implemented in other variant forms as well, and the alternative structure could be the formation of a dedicated team or unit within the regulator which supervises the consumer protection implementation with allocation of dedicated staff and resources, such that the functioning is adequate and results in effective implementation of consumer protection regime.[54] Hence, the consumer protection department may be under a different reporting structure from that of the prudential supervisor[55] to achieve the variant model.

Each country has an institutional structure based on the nature of its financial markets and the resources available. The common perspective is that financial regulators often lack systems and processes for overseeing consumer financial protection and to resolve this problem (i) there should either be a separation of the prudential and consumer protection function by housing them in separate institutes to give enhanced focus to consumer protection or (ii) the allocation of resources between the two functions is such that it results in effective implementation of the consumer protection regime and may be done through separate departments with allocated resources and separate reporting structure.

Regardless of the institutional structure, (i) a dedicated allocation of resources, (ii) choosing the most effective model for compliance monitoring and (iii) effective coordination mechanism between the prudential supervision staff and financial consumer protection staff need to be devised.[56]The G20 Principles throw some light on the appropriate role of the oversight bodies (or the regulatory bodies responsible with the implementation of the function of consumer financial protection) and states they require clear and objectively defined responsibilities and appropriate governance; operational independence; accountability for their activities; adequate powers; resources and capabilities; defined and transparent enforcement framework; and clear and consistent regulatory processes.

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[52] World Bank Global Survey Report

[53] However, an effective co-ordination mechanism between the prudential staff and consumer protection staff may keep all relevant person informed of the trends in the financial market, and the aforementioned argument may not hold water.

[54] World Bank Global Survey Report

[55] Susan L. Rutledge, *Consumer Protection and Financial Literacy – Lessons from Nine Country Studies*, World Bank Policy Research Working Paper 5326 (June, 2010) ("**Rutledge**")

[56] *Ibid*

B. INTERNATIONAL OVERVIEW

In India, the consumer financial protection function has been integrated with prudential supervision within multiple sectoral financial supervisory authorities. In respect of the RBI, the RBI has a separate '**Consumer Protection and Education Department' ("CPED")**, however we have been given to understand[57] that the department's functioning falls within the domain of prudential functioning of the RBI.

In the UK, the twin peak model was adopted in 2012 post the global financial crisis wherein the Prudential Regulation Authority (an independent subsidiary of the Bank of England) regulates the micro prudential issues i.e. the risk taking behaviour of firms (banks, building societies, credit unions and insurance companies etc.) which is likely to have an effect on the stability of the economy and the Financial Conduct Authority (FCA) is responsible for the business conduct of all entities for all products (including those regulated by the PRA) in terms of consumer protection, integrity of the financial market and regulating competition therein and prudential regulation of all entities not regulated by the PRA.[58] Basically, retail consumer protection will be its most high-profile role[59] in addition to wholesale consumer protection.[60] These authorities are housed outside the Bank of England (BoE) which is the central bank, and the Financial Policy Committee in the BoE is responsible for macro prudential regulation i.e. ability and resilience of the financial system as a whole. The FCA is funded by the fee it charges to the entities it regulates and for the year 2013-14, the budget was 435.4 million pounds [INR 4277 crore]. It is an independent authority accountable to the HMT Treasury and through it, to the Parliament. The Financial Services Act, 2012 ("**FSA 2012**") does not lay down the specific departments etc. of the FCA, however, it mentions that arrangements should be made for the discharge of functions by the FCA by a committee, sub-committee, officer or member of staff of the FCA, subject to certain provisions.[61] Having said that, the functions of the FCA are clearly mandated and include making rules, preparing and issuing codes, giving of general guidance, determining the general policy and principles by reference to which it performs particular functions and supervision and taking enforcement actions in respect of entities regulated by it.

In its supervisory capacity, the FCA is required to adopt an interventionist / preventive approach, rather than a redressal approach, and thus, is required to make forward-looking judgments about firms' business models, product strategy and how they run their businesses, to enable the FCA to identify and intervene earlier to prevent problems crystallising.[62] In other

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[57] Meeting with the RBI dated 9th May, 2015

[58] James Perry et al, "The new UK regulatory landscape", Compliance Officer Bulletin, 2011.

[59] Laura Cox

[60] "The Financial Conduct Authority: An Overview", Allen & Overy (2013), available at <http://www.allenovery.com/SiteCollectionDocuments/The%20Financial%20Conduct%20Authority%20April%202013.pdf>, last visited on 22nd May, 2015. ("**Allen & Overy**")

[61] Schedule 1ZA, FSA 2012. On an overview of the available resources in relation to the departments set up under the FCA, it is unclear as to which department the consumer protection function is relegated to and how it functions, and thus the same has not been discussed in this report.

[62] SUP 1A.3.1 (1st April, 2013), FCA Handbook, available at <https://fshandbook.info/FS/html/FCA/SUP/1A/3>, last visited on 23rd May, 2015.

words, the present supervision model is judgment-led, intended to adhere to the spirit of the law, and thus, is a shift from the compliance based supervision which was characterised merely by ticking of the box[63]. The supervision is based on three pillars -

- Proactive supervision – by undertaking business model and strategy analysis;
- Reactive supervision – dealing with problems that are emerging or have emerged, and securing customer redress or other remedial work where necessary;
- Thematic review – thematic work on sectors of the market or products within a sector that are putting or may put consumers at risk, basically involves research and studies on a range of topics.

It is to be noted that complaint handling and consumer education are not the primary functions of the FCA. In countries like Belgium and Netherlands, a similar twin peak model is prevalent, however the prudential supervision agencies are housed within the central bank.

Other variants of the twin peak model are also prevalent, for instance in Mexico, wherein there is a specialized agency responsible only for consumer protection function, and not for the broader market / business conduct operations of the financial institutions (like the FCA). The rest of the business conduct operations and the prudential supervisory function is undertaken by a separate authority.

In the US there is a specialized agency called the Consumer Financial Protection Bureau ("**CFPB** or the **Bureau**") created under the Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010 ("**Dodd-Frank Act**") housed at the Federal Reserve for financial consumer protection and market conduct across various financial services[64] and the prudential regulation is split across various regulators. The funding of the CFPB is as per the dedicated budget allocated by the Federal Reserve and for the year 2013-14, the budget allocation was $ 307.3 million [INR 1970 crore]. The director of the CFPB is appointed by the President, by and with the advice and consent of the Senate. The CFPB is a statutorily autonomous body wherein the Federal Reserve is not required to approve or review the order or rules of the CFPB and it is mandated not to cause delay in issuance of the same. Further the board of governors of the Federal Reserve cannot interfere in any proceedings before the director or appoint, direct, or remove any officer or employee of the CFPB or merge or consolidate the CFPB, or any of the functions or responsibilities of the CFPB, with any division or office of the Board of Governors or the Federal reserve bank. Also, the CFPB shall not be liable under any provision of law for any action or inaction of the Board of Governors, and the Board of Governors shall not be liable under any provision of law for any action or inaction of the CFPB. It may be mentioned here that it appears that the CFPB lacks the requisite amount of oversight from the Federal Reserve or Congress and possesses unconstrained powers.[65]
The main objective of the CFPB as encapsulated in Section 1021 of the Dodd-Frank Act, is to seek to implement and, where applicable, enforce federal consumer financial law

[63] Allen & Overy

[64] Which include mortgages, bank loans, credit cards, or payday lending—as well as on payment services and some forms of savings. The bureau is not authorized to address issues involving auto lending, securities investments, pensions and other employee fringe benefits, or insurance, although the bureau does undertake research related to consumer finance and financial literacy.

[65] Hester Peirce and James Broughel, *Dodd-Frank: What It Does and Why It's Flawed*, Mercatus Centre, George Washington University (2012), available at <http://mercatus.org/sites/default/files/publication/dodd-frank-FINAL.pdf>, last visited on 23rd May, 2015.

consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive. The Director has the discretion to fix the number of employees to be recruited (as per the Dodd-Frank Act) and attorneys, compliance examiners, compliance supervision analysts, economists, statisticians, and other employees as may be deemed necessary to conduct the business of the CFPB. The Director of CFPB is required to establish functional units for different purposes such as –

- **Research** - This unit shall research, analyse and report on several matters such as market developments for consumer financial products and services, consumer awareness, consumer behaviors regarding financial products.

- **Community Affairs**-This unit shall provide information and guidance to people and communities that have been traditionally undeserved.

- **Complaints**-This unit shall provide a single toll free number, a website and a database, to hear and address consumer complaints. Complaints shall be routed to other Federal and State agencies where appropriate. A report comprising all such complaints in the previous year shall be presented by the Director to the Congress every year. The CFPB shall share consumer complaint information with prudential regulators, the Federal Trade Commission, other Federal agencies, and State agencies in order to facilitate preparation of reports. These agencies will also share information relating to consumer complaints regarding consumer financial products and services with the Bureau.

The Director is also required to establish the following offices -

1. **Office of Fair Lending and Equal Opportunity:** Enforcement of federal laws to provide credit access for individuals and communities in a fair, equitable and non-discriminatory manner, coordinating fair lending efforts of the CFPB with other federal and state agencies and working with other agencies and private industry, civil rights advocates etc. to promote fair lending and education. It has to provide a report to the Congress every year regarding the work undertaken by it to achieve its mandate. An assistant Director shall be appointed for this office.

2. **Office of Financial Education** to develop initiatives towards improving consumer financial education and awareness that will help consumers make an informed choice. It shall consult with the Financial Literacy and Education Commission, and make strategies consistent with the National Strategy for Financial Literacy. It shall also coordinate with the research unit and community affairs unit of the Bureau. Its activities shall be targeted at providing financial counseling, reducing debt, improving the financial status of the consumers etc. The reports have to be submitted by the Director to the Committee on Banking, Housing, and Urban Affairs of the Senate; and the Committee on Financial Services of the House of Representatives. The Comptroller General of the US shall study and report upon the technical feasibility of a certification program for the people providing financial education, effective methods for providing financial education etc.

3. **Office of Service Member Affairs** to develop initiatives for service members (member of Armed forces, National Guard or Reserves) and their family members relating to financial consumer protection in respect of financial products and services used by them, increasing consumer awareness and education, monitoring and addressing complaints made by them etc. For this purpose, this Office shall coordinate with

other Federal and State agencies. In addition, the Director may enter into agreements with the Department of Defence for this purpose.

4. **Office of Financial Protection for Older Americans** to improve financial literacy among seniors (individuals over 62 years of age), especially regarding protection from unfair and deceptive practices, the financial choices available to them, long term savings and planning for retirement. It shall also provide one-on-one financial counseling and monitor the certification of the people who advise the Seniors. The office is also required to provide a report to the Congress concerning recommendations regarding information dissemination and ways in which a senior can chose an appropriate financial advisor and verify his credentials. In addition, it shall also conduct research to identify the best practices for financial education of seniors and coordinate its consumer protection efforts with other federal and State agencies and work with community organizations, non-profit organizations, and other entities that are involved with educating or assisting seniors (including the National Education and Resource Center on Women and Retirement Planning).

The Dodd-Frank Act also provides for a Consumer Advisory Board to be established by the Director. It shall work with the CFPB and provide information on emerging practices in consumer financial products and services industry. This Board shall comprise of experts in financial consumer protection, consumer rights advocates, representatives of communities that have been impacted by high mortgage rates. The CFPB shall coordinate with the Commission, the Commodity Futures Trading Commission, the Federal Trade Commission, and other Federal agencies and State regulators, as appropriate, to promote consistent regulatory treatment of consumer financial and investment products and services. The Bureau shall provide a report to the President, the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services and the Committee on Energy and Commerce of the House of Representatives. This report may also be provided to Committee on Commerce, Science, and Transportation of the Senate. This report shall include a discussion of the problems faced by consumers while shopping for financial products and services, an analysis of consumer complaints, all the significant initiatives undertaken by the CFPB as well as the significant actions undertaken by State attorney Generals and State Regulators to further the financial consumer protection. Public meetings are frequently held in which persons of the general public can also attend to discuss trends and themes in consumer financial markets on various financial products.[66]

In practice, the requirements of the several divisions and offices of the CFPB have been fulfilled through the structure of six divisions under the director with the offices under him [67] –

- Consumer Education and Engagement – office of financial education, consumer engagement, older Americans, service members, students, financial empowerment
- Research, Markets and Regulations - office of research , regulations and other markets
- Supervision, enforcement, fair lending and equal opportunity – office large bank and non-bank supervision, enforcement and fair lending and equal opportunity
- Chief operating officer – *inter alia* office of consumer response, procurement

[66] Please see at <http://www.consumerfinance.gov/blog/category/consumer-advisory-board/>, last visited on 5th June, 2015.

[67] "Consumer Response Annual Report", Consumer Financial Protection Bureau (2014), <http://files.consumerfinance.gov/f/2012/01/Congressional_Report_Jan2012.pdf>, last visited on 23rd May, 2015.

- External affairs – *inter alia* office of consumer advisory board, media relations, community affairs
- General counsel

The functions performed by the CFPB in a nutshell are – conducting financial education programs; collecting, investigating and responding to consumer complaints; collecting, researching, monitoring and publishing information relevant to the functioning of markets of consumer financial products and services to identify risks to consumers and the proper functioning of the markets; supervising covered persons and taking appropriate enforcement action to address violations of federal consumer financial law; issuing rules, orders, and guidances implementing federal consumer financial law etc.

In Australia, the Australian Securities and Investments Commission ("**ASIC**") is the principal regulator for market conduct regulation. On account of the twin peak model in Australia, the ASIC is not primarily responsible for the function of prudential regulation, since the Australian Prudential Regulation Authority ("**APRA**") is vested with that responsibility. The APRA performs the function of ensuring that financial institutions are able to honour their commitments when they fall due. It also promotes the safety and soundness of deposit-taking institutions, life and general insurance companies, and larger superannuation funds. However, there are various avenues for intersection between the functions performed by the ASIC with those performed by the APRA. On account of such intersections, the ASIC and the APRA have entered into a Memorandum of Understanding (MoU) for allocation of their functions, for the purpose of cooperation and for the effective and efficient performance of their respective financial regulation functions.[68] Under the MoU, the APRA shares the wide range of information it gathers on entities that it prudentially supervises, and the ASIC shares the extensive information that it collects through its role in monitoring and promoting market integrity and consumer protection in the financial market in Australia.

The ASIC is set up under the Australian Securities and Investments Commission Act 2001 ("**ASIC Act**"), and is an independent Commonwealth Government body carrying out most of its work under the Corporations Act, 2001 ("**Corporations Act**") and the National Consumer Credit Protection Act, 2009 ("**Consumer Credit Act**"). The key functions performed by the ASIC include (1) the financial market supervision and regulation; (2) investor and consumer protection; and (3) registry and licensing services for entities in the financial market.[69] Being funded through the Commonwealth budget, the ASIC received $347 million (INR 1647 crore) as its appropriation revenue (allotted revenue from the government) and $5 million (INR 23 crore) as its other revenue (which includes revenues from government and revenue from other sources such as goods and services) in the year 2013-2014.[70] The consumer protection function of the ASIC encompasses superannuation, insurance and deposit taking, along with additional

[68] Memorandum of Understanding between the Australian Prudential Regulatory Authority and Australian Securities and Investments Commission (2010), available at <http://download.asic.gov.au/media/1340876/MOU-APRA-and-ASIC-May-2010.pdf>, last visited on 23rd May, 2015.

[69] Please see the section on 'What we do', ASIC website, available at <http://asic.gov.au/about-asic/what-we-do/>, last visited on 23rd May, 2015.

[70] ASIC Annual Report 2013-2014, available at <http://download.asic.gov.au/media/2227467/asic-annual-report-2013-14.pdf>, last visited on 24th May, 2015 ("**Annual Report of the ASIC**").

functions of regulating trustee companies, consumer credit and finance broking and supervising trading on Australian licensed equity, derivatives and futures markets.[71]

The ASIC has several divisions - 'Investors and Financial Consumers', 'Markets' and 'Registry and Licensing Services'. In its division on 'Investors and Financial Consumers', the ASIC performs the function of (1) engaging with stakeholders through continuing dissemination of information, that is reflected in the range of meetings and events conducted for the benefit of the stakeholders; (2) undertaking extensive surveillance to monitor the activities of individuals and entities through a risk based assessment of those entities that pose the greatest threat and through the identification of significant strategically important industry participants; (3) releasing guidance and setting the rules, standards and expectations in the financial sector for better regulation; (4) hosting literacy forums for the community, the government and the business sectors; (5) taking strong enforcement action against violations through litigation, administrative actions, investigations and criminal proceedings, in order to maintain the confidence of investors and financial consumers; and (6) taking an active part in the development of regulatory policy and in its implementation nationally and internationally.[72] The ASIC is headed by a Chairman and a deputy chairman and in the aforementioned division (and other divisions as well), one Senior Executive Leader is appointed for each stakeholder team within the division. Currently, the break-up of the stakeholder team in the Investors and Financial Consumers division is - the Investment Banks team, the Investment Managers & Super Funds team, the Financial Advisers team, the Deposit Takers & Insurers & Credit Services team, the Stakeholder Services team, and the Enforcement team (for financial services).[73] In the year 2013-2014 specifically, the ASIC undertook the following tasks[74] (and the staff structure for each of the functions was as given below) [75] -

1. For deposit-takers, credit and insurers, the ASIC Staff of 68 persons -
    a. ensured deposit takers, credit providers, intermediaries and trustee companies are complied with the law; and
    b. implemented national consumer credit reforms.

2. For financial advisers, the ASIC Staff of 28 persons -
    a. ensured that financial advice licensees, insurances brokers and their representatives complied with the law;
    b. oversaw the ASIC approved external dispute resolution schemes; and
    c. conducted projects on topical consumer protection issues.

3. For financial literacy, the ASIC Staff of 31 persons (includes consumer credit)-
    a. led the financial literacy strategy, supporting the Financial Literacy Board;
    b. provided consumer and retail investor guidance, tools and education.

4. For investment banks, the ASIC Staff of 25 persons -

[71] Please see the section on 'How we operate', ASIC website, available at <http://asic.gov.au/about-asic/what-we-do/how-we-operate/>, last visited on 24th May, 2015.

[72] Annual Report of the ASIC

[73] Annual Report of the ASIC

[74] Annual Report of the ASIC

[75] Data on the number of persons in Staff is indicative. See Annual Report of the ASIC (n 70). The data excludes Strategy and Policy, Corporate Affairs, Operations, People and Development, and statutory bodies.

a. ensured that investment banks, hedge funds, private equity providers, over the counter derivative providers and credit rating agencies comply with the law;

5. For investment managers and superannuation, the ASIC Staff of 39 persons -
    a. ensured that responsible entities, superannuation trustees and custodians complied with the law;
    b. registered and regulated managed funds, listed and unlisted property trusts, mortgage funds, infrastructure schemes and agribusiness schemes (managed investment schemes)
    c. regulated financial product disclosure and marketing material issued by responsible entities and super trustees
    d. regulated exempted foreign financial service providers and foreign collective investment schemes and operators; and

6. Enforcement powers of the ASIC (with a staff of 110 persons[76]) in financial services (including consumer credit) comprise:
    a. investigation of suspected misconduct and enforcement of penalties to achieve criminal convictions (via Commonwealth Director of Public Prosecutions);
    b. imposition of civil penalties or administrative sanctions for violations; and
    c. focus on financial and credit products and advice.

The Hong Kong Monetary Association (HKMA) is the prudential and market conduct regulator of the financial market and as per Section 7(1) of the Banking Ordinance the principal function of the HKMA is to "promote the general stability and effective working of the banking system". The HKMA adopts a risk-based supervisory approach through on-site examinations, off-site reviews, prudential meetings, co-operation with external auditors and sharing information with other supervisors.[77] The banks in the Hong Kong economy diversified from their traditional banking function into the securities market, and thus the informal requirement of adhering to the Securities and Futures Commission (SFC) norms was formalized, and they required being licensed by the SFC and complying with the SFC norms, to provide a level playing field to the intermediaries regulated by the SFC and the banks. In April 2010, the HKMA established a 'Banking Conduct Department' to provide greater focus to its work in this area. The department is responsible for the implementation of the 'treat customers fairly charter' which was signed up by all the retail banks, and the authorized institutions are also required to comply with the Code of Banking Practice which was issued by the industry associations and endorsed by the HKMA, and circulars and guidelines issued by the HKMA from time to time. The Banking Conduct Department is responsible for consumer protection which includes supervision of the business conduct of authorized institutions including the conduct of banking, investment and insurance business. The HKMA is headed by one chief executive with 3 deputy chief executives under him. Under one of the said deputy chief executive, there is one executive director for banking conduct and two heads for banking

[76] Plus an additional staff of 119 that provided enforcement support services and legal counsel.

[77] Section on 'Regulatory Framework', website of the Hong Kong Monetary Authority, available at <http://www.hkma.gov.hk/eng/key-functions/banking-stability/banking-policy-and-supervision/regulatory-framework.shtml>, last visited on 24th May, 2015.

conduct under him.[78] Thus, this is a good example of where the reporting structure for the banking conduct department is separated from other departments which are responsible for prudential regulation, when the banking conduct department is housed within the prudential regulator.

C. RECOMMENDATIONS

On an overview of the functions and scope of the 33 departments within the RBI[79], it appears that the main focus is prudential regulation. The market conduct, and especially the consumer protection functions appear to be minimal , fragmented and different departments (other than the consumer protection and education department) are responsible for such functions, for instance (i) the department of non-banking regulation is responsible for laying down market conduct guidelines for NBFCs etc, (ii) the department of non-banking supervision is responsible for their consumer protection, (iii) the department of co-operative banking regulation is responsible for issuing directions for depositor protection for co-operative banks, (iv) the focus of the department of banking regulation and department of economic and policy research seems to be predominantly prudential regulation and consumer protection doesn't seem to be covered, (v) the department of Financial Inclusion and Development is responsible for the financial education and literacy of the productive sectors of the economy including rural and MSME sectors. The mandate of the Consumer Education and Protection department is diluted because of many of its functions being carried out by the other departments, and the mandated function of the CPED seem to be complaint redressal, enforcement of ethical behavior, consumer education and only dissemination of instructions/information relating to customer service and grievance redressal by banks and the Reserve Bank of India. The mandate is lacking in respect of the powers (the list is only indicative) to issue / formulate directions related to consumer protection, oversee or review consumer related provisions present in directions formulated or implemented by other departments, use supervisory tools to assess the implementation of consumer protection regime by the banks etc., to carry out research or be involved in research in relation to the consumer financial protection issues.

In light of the aforementioned discussion, the first alternative proposed is that the Consumer Protection and Education Department of the RBI should be made more robust, effective and aggressive in exercise of its functioning and implementation of consumer protection measures. The World Bank Data shows that there has been a move by various economies towards a dedicated consumer protection department within the regulator, being separate from prudential supervision function.[80] Thus, the following features should be a part of the revamped structure of the Consumer Protection and Education Department of the RBI –

- *There should be a clear mandate for the CPED for its functioning and it should include the functions which are at present lacking from the CPED's mandate for instance, to issue / formulate directions related to consumer protection, oversee or review/ vet consumer related provisions present in directions formulated or implemented by other departments, use supervisory tools to assess the implementation of consumer protection*

[78] Section on 'Organisational Chart', website of the Hong Kong Monetary Authority, available at <http://www.hkma.gov.hk/eng/about-the-hkma/hkma/organisation-chart.shtml>, last visited on 24th May, 2015.

[79] Section on 'About Us', website of the Reserve Bank of India, available at <https://www.rbi.org.in/scripts/AboutUsDisplay.aspx?pg=Depts.htm#CEPD>, last visited on 24th May, 2015.

[80] Out of 72 economies with dedicated teams or units for financial consumer protection, 39 (54%) are separate from prudential supervision, 26 (36%) are part of prudential supervision, World Bank Global Survey Report (n 50), pg. 8.

regime by the banks etc., to carry out research or be involved in research in relation to the consumer financial protection issues and to exercise enforcement powers (issues relating to the enforcement powers of the RBI are discussed in detail in Section II of this report). The list of functions mentioned here is not exhaustive. The functions discharged by the CPED should be purely consumer protection functions, and should not overlap with the prudential functions of the RBI in light of the discussion above;

- *There may be several sub-departments created under the CPED for the purposes of each focus area, and for the discharge of the multifarious powers like in the CFPB in the US, such that there is clarity in the functioning of the CPED;*
- *A proper co-ordination mechanism between the CPED which shall be responsible for the consumer protection functions, and the other departments of the RBI which focus on the prudential regulation should be developed, such that there is mutual awareness of the trends in the financial market for the purposes of facilitating requisite amendments in the relevant regulations and policy;*
- *There should be allocation of adequate resources to each sub-department for the effective implementation of the consumer financial protection measures;*
- *With the creation of sub-departments under the CPED as suggested above, there should be a dedicated management and staff for exercise and implementation of the consumer financial protection function like in the Investors and Financial Consumers division of the ASIC, which has close to 330 people working as staff for implementation of the consumer protection functions only;*
- *The reporting structure of the consumer financial protection staff should be separate from the prudential staff like in Banking Conduct Department of the HKMA;*
- *Training should be provided for the consumer financial protection staff to be able to handle all the required functions on a mandatory and regular basis;*
- *The department should have effective supervisory tools like monitoring financial institutions websites and advertisements, collecting and monitoring complaints, operating hotlines, conducting interviews, operating price comparison websites for improving transparency and competition and mystery shopping. The range of the tools that may be utilized increases with the dedicated unit being allocated more staff and resources and thus there should be flexibility to add more tools as and when required, in accordance with the development of the financial markets.*
- ***Efforts must also be made to raise the profile of CPED as a premier consumer protection agency of the RBI (through advertisement campaigns, etc.)***

The above restructuring can be achieved under the RBI's existing rule-making powers. Also, as noted above, the breadth of the enforcement powers of the RBI (and the extent to which CPED could be empowered for such enforcement) is discussed in Section II of this report.

The second alternative is to create a separate consumer protection agency (by introducing appropriate amendments to the RBI Act) which will be responsible for consumer protection functions in relation to financial products governed by the RBI, such that there is a clear statutory separation of prudential and consumer protection supervision. It is proposed that this separate agency functions as a subsidiary of the RBI and the internal structuring could be on the lines of the CFPB in its substantive powers and features, however, the autonomy and independence of this separate agency may not be as broad as the CFPB.

4. Consumer Disclosures

A. Background

The financial service providers and authorized agents should provide the consumers with key information that informs the consumers of the benefits, risks and terms of the service / product.[81] There are many aspects of the information that require being disclosed both at the time of introducing / selling a financial service or product and also, the periodical disclosures that are required to be made such that the consumer is aware of the changes made in the terms and conditions of the service / product purchased by him.

In this section, the requirement of providing disclosures in respect of the benefits, risks and terms of the financial service / product is emphasized upon to obviate information asymmetry which is caused because of the following reasons – (i) financial products are inherently complex and majority of the consumers may not understand the complexities unless they are refined and broken down into simple terms; (ii) since the level of consumer education in India is low, the consumers may not even be aware that they are required to understand the terms and conditions of the financial service / products they are purchasing to safeguard themselves from any potential risks; (iii) if the information disclosed to the consumers is simple and easy to understand, the laxity observed in respect of transactions relating to financial products may be mitigated and the consumers may ask follow up questions, making them better aware and willing to learn (which if coupled with the 'teachable moment' strategy as discussed in Chapter 7 of this report, may produce better results).

As per the Good Practices, the following disclosure requirements should be adhered to –

- Consumers should receive a short one or two page summary statement in a legible font and written in plain language, describing the key terms and conditions, including recourse mechanisms. The information provided should be such that it is easy to compare the features across similar services and products provided by different service providers.
- Customers should be provided with a written copy of the financial institution's general and specific terms and conditions that apply to the products or services.
- Customers should be notified of changes in interest rates, fees and charges or other key terms and conditions of their financial products or services as early as possible.
- The financial institutions prepare regular statements for each consumer account containing the transaction details and confirmation of the terms and conditions for each transaction.

The preferable approach should be to focus on the disclosure standards for 'products / services' rather than developing standards for each institution.[82] It is logical to assume that a harmonization in the disclosure standards, including the format to be utilized, the design to be adopted, the language to be used may attract consumers to make themselves aware of the 'fine print' information, which is largely left unread due to its complexity in terms of its components

[81] G20 Principle 4 in "Effective Approaches to Support The Implementation of the Remaining G20/OECD High-Level Principles on Financial Consumer Protection", G20/OECD Task Force on Financial Consumer Protection (2014), available at <http://www.oecd.org/daf/fin/financial-education/G20-OECD-Financial-Consumer-Protection-Principles-Implementation-2014.pdf>, last visited on 24th May, 2015.

[82] World Bank Global Survey Report pg. 21-22

and the format of disclosure and also enable them to compare the features of similar products across different service providers, to make an informed decision. Consumer testing results in various countries have been helpful in determining the disclosure policy in terms of the content, language, and layout of disclosures[83] and it is advisable that India also undertakes such testing to better understand the needs of the consumers and design the disclosure policy accordingly.

B. International Overview

In the UK, the disclosure requirements to be adhered by the relevant entities are encapsulated in the FCA Handbook[84] ("**Handbook**") which contains binding rules and non-binding guidance. The Chapter on Business Standards ("**COBS**") encapsulates *inter alia* the requirements for preparing certain product information and thereafter providing such information to the client for firms which carry out the following activities, to name a few - (i) investment business or long term insurance business in relation to life policies (ii) insurance mediation activity (iii) home finance activity (iv) activity of accepting deposits from banking customers.

With respect to the firms falling in category (i), they are required to prepare (a) a key features document and (b) a key features illustration document.[85] The said documents should be of at least the same quality and standard as the sales or marketing material used to promote the relevant product.[86] The Handbook also describes in detail the contents of the above-mentioned documents. The 'key features document' should necessarily contain the benefits, risks, and enough information about the nature and complexity of the product and how it works, any limitations and the minimum standards in respect of the product to enable a client to make an informed decision.[87] It should also spell out the complaint handling process, whether a right to cancel the product exists and the details regarding the same, and also the compensation that may be available if the service provider becomes insolvent. A 'key features illustration' should include information describing projected performance and the effect of charges in relation to the product to be borne by the client.

In respect of firms falling within the category (iv) above, which relates to firms providing banking services, the FCA has formulated the *'appropriate information rule'* which has several ingredients of disclosure in it. It is applicable to retail banking services and applies both, before and after banking customer is bound by the terms of the contract. The appropriate information should be made available to the banking customers in good time, in an appropriate medium and in easily understandable language and in a clear and comprehensible form, so as to make

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[83] Jeanne M. Hogarth and Ellen A. Merry, "Designing Disclosures to Inform Consumer Financial Decision-making: Lessons Learned from Consumer Testing," Federal Reserve Bulletin 3, Vol. 97 (August, 2011).

[84] "The FCA's approach to advancing its objectives", FCA (July, 2013), available at <http://www.fca.org.uk/static/documents/fca-approach-advancing-objectives.pdf>, last visited on 24th May, 2015; See generally Handbook of the FCA, available at <https://fshandbook.info/FS/html/handbook>, last visited on 24th May, 2015.

[85] COBS 13.1.1, FCA Handbook

[86] COBS 13.2.2, FCA Handbook

[87] COBS 13.3.1, FCA Handbook

an informed decision.[88] The requirements of the said rule are met if the following information is disclosed by the firms to the customers[89] –

1. Information relating to the firm;
2. The range of retail banking services / products offered by the firm which share the features of the banking service/product requested by the customer, unless the customer has expressly indicated not to receive such information;
3. The terms and conditions of the contract for a retail banking service and any changes to them;
4. The rate of interest payable, how and when it is calculated and applied and any changes thereto;
5. Any charges payable in relation to the banking services and any changes thereto;
6. The time at which the funds placed with the bank will be made available to the customer;
7. Customer's right to cancel a contract for retail banking service;
8. Complaint making mechanism;
9. Compensation scheme in the event of the firm's insolvency;
10. Information about the basic bank accounts and timescales for clearance of cheque at each stage.

The firms is also required to provide or make available regular statements of accounts to the customers as periodic disclosures.[90] The Handbook also provides a separate detailed list of disclosures in respect of distance marketing activities i.e. activities carried on in relation to a contract of financial services with exclusive use of distance communication (like phone, e-mail etc.), which are at par with the disclosures to be made otherwise.

In respect of firms carrying out 'designated investments' business (as defined in the Handbook) for retail clients, there are a certain set of disclosure requirements to be adhered to for a range of products like derivatives, warrants, pensions, insurance etc. The relevant chapter (COBS 6.1) requires the firm to provide information under the following heads prior to provision of the services, unless otherwise provided for- the general information to be disclosed to the customer for eg. Name and address, method of communication etc.[91], information to be disclosed if the firm proposes to manage investments for a retail client[92], information regarding safeguarding of specific investments[93], information on costs and associated charges[94], information to keep the client updated in terms of changes in relation to the financial services / products offered and information regarding the applicable compensation scheme.

Before a firm provides basic advice to a retail client or makes a personal recommendation to a retail client in relation to a retail investment product, it is required to mention whether its advice

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[88] BCOBS 4.1.1, FCA Handbook

[89] BCOBS 4.1.4, FCA Handbook

[90] BCOBS 4.2.1, FCA Handbook

[91] COBS 6.1.4, FCA Handbook

[92] COBS 6.1.6, FCA Handbook

[93] COBS 6.1.7, FCA Handbook

[94] COBS 6.1.9, FCA Handbook

is 'independent' i.e. it is based on a comprehensive and fair analysis of the relevant market; or whether the advice is 'restricted' i.e. it is based on an analysis of limited types of products, or products from one company or a limited number of companies.[95] The said disclosure is required to be in a *standard format* - services and costs disclosure document or a combined initial disclosure document , which includes in addition to the disclosure regarding the nature of advice, disclosures in relation to the fee payable, complaint mechanism, compensation scheme coverage, range of products covered etc. In the European Union, the consumer has a right to disclosure of the key terms in relation to a credit information in the Standard European Consumer Credit Information form[96] from all service providers, enabling comparison of terms across all providers in member countries. Disclosure requirements are also included in other EU directives such as Markets in Financial Instruments Directive (Directive 2004/39/EC i.e. MiFID), Directive on Payment Services (PSD) and Insurance Mediation Directive (IMD).

Further, specifically in relation to the manner in which a firm is remunerated for its services, the UK has set standards in the form of rules on inducement.[97] The basic rule is that a firm should accept remuneration if (i) it does not impair compliance with the firm's duty to act in the best interests of the client; (ii) the existence, nature and amount of the fee, commission or benefit, or, where the amount cannot be ascertained, the method of calculating that amount, is clearly disclosed to the client, in a manner that is comprehensive, accurate and understandable, before the provision of the service; and (iii) the payment of the fee or commission, or the provision of the non-monetary benefit is designed to enhance the quality of the service to the client. The FCA penalized Sesame Ltd. which has the largest network of financial advisers in the UK for violation of the rules on inducement because *inter alia* its selection process for selecting service providers was influenced by the volume and value of services that providers would purchase and the firm also failed to disclose to its clients the existence, nature and amount of the payments made.[98]

In the US, the disclosure requirements are even more refined in terms of the disclosure content and more so in terms of the disclosure format. In respect of credit card application and solicitation disclosures, it is statutorily required to disclose certain terms in a tabular form which is now called the '*Schumer Box'*. It was found that the Schumer box was very effective in combating information overload by succinctly disclosing critical information about the terms and fees of credit card products in a one-page table format.[99] It disclosed terms like the annual percentage range, variable rate information, grace period, finance calculation method, finance charges, annual fee and other fee (transaction fee, late fee etc.).[100] Regulation Z (Truth in

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[95] COBS 6.2A.5, FCA Handbook

[96] "Standard European Consumer Credit Information", European Union, available at <http://ec.europa.eu/consumers/citizen/my_rights/consumer-credit/documents/130522_ec_ccd_secci_en.pdf>, last visited on 24th May, 2015.

[97] COBS 2.3, FCA Handbook

[98] 'Regulatory Investigations Update: UK Recent Decisions', Linklaters (Dec., 2014), available at <http://www.linklaters.com/Insights/RI/Regulatory-Investigations-Update-December-2014/Pages/UK-Recent-Decisions.aspx>, last visited on 25th May, 2015.

[99] Kenneth J. Benton, "The Regulation Z Amendments for Open-End Credit Disclosures: Part Two", Consumer Compliance Outlook (Second Quarter, 2009).

[100] Joseph Audette, "How to Read the Schumer Box", available at <http://www.nerdwallet.com/blog/nerdscholar/read-schumer-box/>, last visited on 25th May, 2015.

Lending)[101] also provides for detailed requirements for account-opening disclosures, periodic statement disclosures, change-in-terms notices etc. for open end credit, closed end credit, private education loans, mortgage etc. It specifies *inter alia* the following aspects of disclosure –

- whether a certain disclosure should be in a tabular format;
- content of the disclosure;
- mode of disclosure (whether written or not);
- the terminology to be used (and which words should be more conspicuous than others);[102]
- the scheme for grouping of certain disclosures;
- the timing for specific disclosures;
- the language of the disclosures ;
- the content of the oral disclosures required to be made in response to a consumer's inquiry.

As discussed previously, mandated disclosure of information by financial service providers addresses the problem of information asymmetry and ineffective decision-making. **In Australia**, the Corporations Act regulates activities regarding the provision of financial products and services, including financial product advice, while the Consumer Credit Act contains the National Credit Code, which regulates entities that provide credit to individuals for (wholly or predominantly) personal, domestic or household purposes, or for purchasing, renovating or improving residential property for investment purposes. Banks fall within the regulatory framework of both the aforementioned legislations.[103]

Each entity (including banks) that carries on a 'financial service' in Australia is required to hold an Australian Financial Service License ("AFSL"). 'Financial service' in this context includes the provision of financial product advice, dealing in a financial product and making a market for a financial product, where the terms of 'financial product', 'dealing' and 'making a market' are widely defined to include many banking products and services.[104]

The Australian financial services regime has extensive disclosure requirements that endeavour to protect the rights of investors and consumers. The three primary disclosure documents include[105] –

- the Financial Services Guide (FSG),

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[101] Electronic Code of Federal Regulations, available at <http://www.ecfr.gov/cgi-bin/text-idx?SID=546f18bcdc1550487913cbf9a0abb717&mc=true&node=pt12.9.1026&rgn=div5#se12.9.1026_127>, last visited on 25th May, 2015.

[102] §1026.5(2)(ii) on General disclosure requirements for open end credit - For home-equity plans subject to §1026.40, the terms *finance charge* and *annual percentage rate*, when required to be disclosed with a corresponding amount or percentage rate, shall be more conspicuous than any other required disclosure.

[103] 'Consumer Basics', website on Smart Banking: Know Your Banking Rights and Responsibilities, available at <http://www.bankers.asn.au/know-your-banking-rights/consumer-basics.html>, last visited on 25th May, 2015; See also Gail Pearson, "Risk and the Consumer in Australian Financial Services Reform", 28 Sydney L. Rev. 99 2006 ("**Gail Pearson**")

[104] 766A, Corporations Act, 2001 ("Corporations Act"), See also Chapter XX by Louise McCoach and David Landy in *The Banking Regulation Review* (4th Edition), Rafael A. Morales (2013), available at <http://www.claytonutz.com/docs/banking_regulation_review_4th_edition.pdf>, last visited on 25th May, 2015.

[105] Gail Pearson

- the Product Disclosure Statement (PDS) and
- the Statement of Advice (SOA).

It is important to note that the disclosures mentioned above vary with the nature of advice being provided. The advice may be personal in nature if the provider of advice has considered the objectives, financial situation and needs of the consumer or where a reasonable person may expect it to have considered such factors, and all other instances fall under the ambit of general advice.[106] For personal advice, all three disclosures are required to be made, however, for general advice, the SOA requirement is not there, however, a warning label that the advice is general is required.[107]

The procedure and requirement for all the disclosure obligations are provided under the Corporations and the Consumer Credit Act. The ASIC has also issued guidance notes on the contents of each disclosure document for the benefit of the consumer.[108]

The FSG has to be provided to 'retail' clients by the financial services licensees or their authorised representatives before a transaction is entered into but when it is likely to be entered into. It is designed to assist the consumer in deciding whether to deal with the provider or not.[109] The 'retail clients' include all the clients that are not professional or wholesale investors[110]. The contents of the FSG in relation to an AFSL holder (or providing entity), must include the following[111] -

1. who will provide the service;
2. the kinds of financial services offered;
3. information about who the service provider is acting for when providing the financial service;
4. information about the means by which the service provider is remunerated for the services being offered to the retail client including details of commissions; and
5. details of any associations or relationships that might be expected to influence a service provider in providing the service.

Generally, an FSG must be given before providing the financial service.[112] The SOA needs to be given when the financial service is the *personal* advice to help the consumer make an

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[106] See ASIC Regulatory Guide 244, 'Giving information, general advice and scaled advice', available at <http://download.asic.gov.au/media/1247129/rg-244.pdf>, last visited on 25th May, 2015; See also Section on 'Giving financial product advice', website of the ASIC, available at <http://asic.gov.au/regulatory-resources/financial-services/giving-financial-product-advice/>, last visited on 25th May, 2015.

[107] *Ibid.*

[108] Please see: ASIC Regulatory Guide 90 for SOA, available at <http://download.asic.gov.au/media/1239911/rg90-published-20-august-2013.pdf>, last visited on 25th May, 2015; ASIC Regulatory Guide 175 for FSG, available at <http://www.afr.com/rw/2009-2014/AFR/2011/11/09/Photos/e6ab4de4-0b2a-11e1-88ea-6d846017b615_Prospectus%20Regulatory%20Guide.pdf>, last visited on 25th May, 2015; ASIC Regulatory Guide 168 for PDS, available at <http://download.asic.gov.au/media/1240931/rg168-published-28-october-2011.pdf>, last visited on 25th May, 2015 (referred to as "**ASIC Regulatory Guide 90 for SOA**" and "**ASIC Regulatory Guide 175 for FSG**" respectively)

[109] Gail Pearson

[110] The Corporation Act does not specifically mention the disclosure obligations for wholesale clients.

[111] ASIC Regulatory Guide 175 for FSG

[112] *Ibid.*

informed decision whether to act on the advice given or not.[113] The SOA should be provided when advice is given otherwise than in an SOA format, and must be provided to the client at the same time as, or as soon as practicable after the advice is provided.[114] The contents of an SOA include the following[115]:

1. a statement setting out the advice and an explanation of the basis on which it was given, including a warning if the advice is based on incomplete or inaccurate information;
2. who has provided the advice;
3. any remuneration or other benefit that a service provider or an associate may receive in connection with the advice that could influence the service provider;
4. any other interests of the service provider or an associate that could influence the service provider; and
5. any associations or relationships between the service provider or an associate and product issuers that could influence the service provider.

It is important to note that as the SOA requires the provider to disclose the details from the client's personal and financial profile that are relevant to the advice being provided[116] as a component of the basis of the advice being provided, and thus the requirement of compliance of the 'best interests principle' as envisaged in the Corporations Act, and discussed in Chapter 5 of this report has to be complied under this part of the SOA.

A PDS on the other hand, provides a description of the particular financial product and helps consumers in understanding the product and has to be prepared on behalf of the seller or the issuer of the product.[117] It should be provided before a recommendation is made to the customer to buy the product or an offer is made to issue the product or an offer for sale is made. Briefly, the contents of the PDS include the following[118]:

1. fees payable in respect of a financial product;
2. risks of a financial product;
3. benefits of a financial product; and
4. significant characteristics of a financial product.

There is also a requirement for continuing disclosure to disclose information that is not generally available and that if made available to a reasonable person, would in the opinion of such person, have a material effect on the price or value of the financial product.[119] It is pertinent to mention that it is possible to combine one or more disclosure documents as long as the contents of the document along with the other requirements have been met. This procedure is of immense help for entities that are credit licensees as well as Australian financial

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[113] ASIC Regulatory Guide 90 for SOA

[114] ASIC Regulatory Guide 90 for SOA

[115] ASIC Regulatory Guide 90 for SOA

[116] ASIC Regulatory Guide 90 for SOA

[117] ASIC Regulatory Guide 168 for PDS

[118] ASIC Regulatory Guide 168 for PDS

[119] See Speech by ASIC Commissioner, John Price, delivered at the Chartered Secretaries Australia (CSA) 2012 Annual Conference (2012), available at <http://asic.gov.au/about-asic/media-centre/speeches/continuous-disclosure/>, last visited on 25th May, 2015.

services (AFS) licensees that have disclosure obligations under the Corporations Act and the Consumer Credit Act.[120] An omission to disclose results in civil and criminal penalties as provided under the two aforementioned Acts.

One of the disclosure requirements set-out in the Consumer Credit Act relates to pre-contractual disclosures, where a credit provider cannot enter into a credit contract unless the he or she has given the debtor a pre-contractual statement setting out the (1) Credit provider's name; (2) Amount of credit; (3) Annual percentage rate or rates; (4) Calculation of interest charges; (5) Total amount of interest charges payable; (6) Repayments; (7) Credit fees and charges; (8) Changes affecting interest and credit fees and charges; (9) Statements of account; (10) Default rate; (11) Enforcement expenses; (12) Mortgage or guarantee; (13) Commission; (14) Insurance financed by contract; (15) Provisions for person other than debtor to occupy reverse mortgaged property; and (16) any other information required under the regulations under the Consumer Credit Act.[121] The pre-contractual disclosure also requires the credit provider to provide an information statement in the form required in relation to the debtor's statutory rights and statutory obligations.[122] In addition to pre-contractual disclosures, the credit licensees and their representatives have to abide by the responsible lending disclosure obligations under the Chapter 3 of the Consumer Credit Act. These obligations lay out similar duties as the one provided under the FSG, PDS and the SOA, where the credit licensee or a credit representative have to provide the consumers with the following documents[123]:

1. A credit guide that provides preliminary information about the credit licensee to a consumer including his name, contact details and credit licence number and information about the internal (IDR) and external (EDR) dispute resolution procedures (as discussed in the chapter on dispute resolution);
2. A quote that discloses the approximate cost for using the services of the credit licensee for the benefit of the consumer;
3. A proposal document that provides the details of the costs that will be incurred by the consumer after using your services, including any commission that may be payable to the credit licensee; and
4. A written assessment (preliminary or final) wherein the suitability of the consumer lease or credit contract in relation to a particular consumer is analysed. A copy of the written assessment can be provided to the consumer free-of-cost at his or her request within seven years of entering into the credit contract.[124]

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[120] See Section on 'Complying with your obligations if both credit licensee and AFS licensee', website of the ASIC, available at <http://asic.gov.au/for-finance-professionals/credit-licensees/your-ongoing-credit-licence-obligations/complying-with-your-obligations-if-both-credit-licensee-and-afs-licensee/>, last visited on 26th May, 2015.

[121] See Section on 'Credit disclosure: Transitional arrangements', website of the ASIC, available at <http://asic.gov.au/regulatory-resources/credit/credit-contracts-and-disclosure/credit-disclosure-transitional-arrangements/>, last visited on 25th May, 2015.

[122] *Ibid.*

[123] *Ibid.*

[124] ASIC Regulatory Guide 209 on Credit licensing: Responsible lending conduct, available at <http://download.asic.gov.au/media/2243019/rg209-published-5-november-2014.pdf>, last visited on 26th May, 2015.

C. RECOMMENDATIONS

Presently, in respect of the products governed by the RBI, there exists an understanding on the requirements and the components of the disclosure of the 'most important terms and conditions' (MITC) of products like credit cards, derivatives etc., however, there appears to have been no consumer testing done to prove the effectiveness of such disclosure. Consumer testing is necessary to understand the consumer's perspective on the effectiveness of the disclosure regime presently, and also to gauge the level of understanding required to provide them with the adequate information to help them make informed decisions.

An overview of disclosures present on a few banks' websites reveal that they are complicated, verbose, not in a standard or uniform format and thus not easy to compare. In light of these stated deficiencies, and with an intent to make good the same, the following international practices may be adopted into the Indian regime, to plug in the deficiencies and make the disclosure regime robust and effective, because the key to real consumer protection is making the consumer aware of the features of a financial product, enough for them to make an informed decision. Please note that the standard of care required in making such disclosures are discussed in the next chapter.

- *RBI should on its own, or employ an agency to conduct consumer testing in terms of the disclosure standards present in the Indian financial consumer protection regime, and delineate the ingredients which need improvement in relation to the consumers' understanding of the quality and quantity of disclosure and bring about amendments to have the disclosure documents rectified line with the deficiencies indicated in the findings;*
- *The disclosure should be three layered as in Australia, at each stage of the investment process, to facilitate uniformity, brevity and comparison –*
    a. *Disclosure 1 which relates to what service is being provided - A disclosure document akin to the Financial Services Guide which is to be provided to the consumer before a financial service is provided as this document describes the financial service proposed to be provided to the customer. It should contain sufficient information to enable customers to decide whether to obtain financial services from the providing entity (including the manner of payment of remuneration, adhering to rules similar to the rules on inducement in the UK as discussed above), and thus the information includes the background of the financial service provider including information regarding its services, remuneration structure and its functioning etc.;*
    b. *Disclosure 2 relates to what advice is being provided – This is applicable only in case of personal advice being rendered, as discussed above. A disclosure document akin to the Statement of Advice wherein the service provider provides a summary of the personal advice in relation to a financial product and reveals the basis of the advice (which would take into account whether the advice is independent or restricted, and it may be specifically mentioned so, as understood under the UK law discussed above), will help the customer to take an informed decision whether to act on the advice or not. It is to be provided when advice is given otherwise that in an SOA format , and must be provided to the client at the same time as, or as soon as practicable after, the advice is provided; and*
    c. *Disclosure 3 relates to the product being bought - A disclosure document akin to the Product Disclosure Statement which is to be provided when any financial service provider is in discussions with the customer to sell a financial product, or in other words a point-of-sale document, as it contains the key features of the*

product, and should be provided before a recommendation or offer for sale in respect of a financial product is made. It needs to be provided before the product is sold to the consumer.

- *The abovementioned documents should be simple to read and not very lengthy. However, to make the disclosure even more effective, standardized formats spanning 1-2 page encapsulating a summary understanding of the key features of the abovementioned disclosures should be placed at the beginning of each disclosure, to facilitate a quick understanding of the contents of the disclosure.*
- *The standard formats for the three 'disclosure documents' and their 'key-features summary' should be formulated by the RBI and disclosure based on them should be mandated to facilitate comparison and uniformity for similar financial products.*
- *The content of each disclosure document mentioned above should be thorough (as required by the industry practice) and should cover all features that a consumer should consider before deciding to purchase the product, including provisions for (i) notification of change in the key terms within the specified time period and (ii) understanding on periodic disclosures;*
- *In the formulation of the formats for the disclosures, nuanced details in addition to the content to be incorporated should be incorporated to facilitate the efficient disclosure of information. Further, additional guidance may be provided as guidance notes in the annexure of the formats. The details to be taken into consideration include –*
    1. *the terminology to be employed and the terms that are required to be given more visibility;*
    2. *the timing of various kinds of disclosures,*
    3. *the mode of disclosure required;*
    4. *the scheme for grouping of certain disclosures;*
    5. *the language of the disclosures should be clear and concise;*
    6. *graphics and illustrations may be utilized;*
    7. *Details relating to the content of the oral disclosures required to be made in response to a consumer's inquiry may be elaborated upon in the guidance notes.*

5. Regulation of Business Practices

A. Background

The business practices in terms of carrying out the business of financial products have a great impact on the consumers, as they form the foundation of the manner in which a transaction is undertaken on part of the lender / adviser. It is recommended that the following business practices should be entrenched in the regulations governing the financial institutions and should form a pervasive feature of the culture of the financial institutions –

(i) the customers should be treated fairly;

(ii) the financial institutions should assess the suitability of the consumer in relation to the financial product; and

(iii) the staff of the financial institutions should be adequately informed, competent and trained to handle complex financial-product related transactional requirements.

In this chapter, the first principle will be discussed from the perspective whether unfair practices are defined in various jurisdictions, and if so, what are the standards applicable. The second principle encompasses the ingredients of assessment of 'suitability' of the product or service being recommended to the customer which leads to responsible lending. The last principle is in relation to the building of the competence of the staff responsible for discharging the aforementioned principles.

B. Fair Treatment

Principle 3 of the G20 High Level Principles on Financial Consumer Protection states that "all financial consumers should be treated equitably, honestly and fairly at all stages of their relationship with financial service providers." This concept is elaborately discussed under the Dodd-Frank Act **in the US**. The said act lays down in clear terms that the CFPB is responsible for preventing a covered person or service provider (both terms are defined therein) from committing or engaging in an *unfair, deceptive*[125], *or abusive*[126] act or practice under federal law in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service.[127] Half of all CFPB enforcement actions have alleged violations of the "unfair, deceptive and abusive acts and practices" ("**UDAAP**") provision of the Dodd-Frank Act, a language that is not tied to any specific statute or regulation. The loose definitions of these terms gives the CFPB wide powers to challenge business activities that it finds suspicious, even if those actions do not violate the federal law.[128] The contours of the UDAAPs are as discussed below.

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[125] The terms "unfair" and "deceptive" originated in the Federal Trade Commission Act, and the CFPB Examination Manual indicates that the decisions of the FTC may inform the CFPB.

[126] This is a new requirement added under the Dodd Frank Act, in addition to unfair and deceptive act or practice.

[127] Section 1031(a), Dodd Frank Act.

[128] John Niemann, "'Abusive Acts and Practices' language key to CFPB enforcement", CFPB Journal (2015), available at <http://cfpbjournal.com/issue/cfpb-journal/article/abusive-acts-and-practices-language-key-to-cfpb-enforcement>, last visited on 26th May, 2015. ("**John Niemann**")

1) An '*unfair'* practice is a practice-

- which causes substantial injury to the consumer, usually gauged in terms of monetary harm. Emotional impact will not be covered under this, unless it falls in the category of unreasonable debt collection harassment, for instance. Also actual injury is not required and a significant risk of a concrete harm is sufficient.
- which could not have been reasonably avoided by the consumer, for instance, if a material information regarding a product is withheld till or modified after the consumer has purchased the product or injuries which could have been avoided only by spending large amount of resources by hiring an independent expert to test the financial product in advance ; and
- the benefits of which do not outweigh the harm caused

To give an example[129], an enforcement action was brought against a mortgage servicer when it refused to release the lien on the borrower's property even after the borrower made the full and final payment. All the three factors stated above were satisfied as the borrower suffered from economic injury due to non-release of the lien, the borrower could not have reasonably known that the servicer would not release the lien even after making the full payment and no benefit resulted out of the act of the servicer.

2) A representation, omission, act or practice is '*deceptive'* when

- It misleads or is likely to mislead the reasonable consumer. The four Ps to assess whether the representation, omission, act or practice is misleading or is likely to mislead are – the prominence of the statement for the consumer to notice, the presentation is easy to understand, the placement is appropriate and misleading information is in close proximity to the claims; and
- It is material i.e. it is likely to affect the choice or conduct of the consumer and in general relates to the central characteristics of the financial product like costs, benefits or end use. The intent to deceive is not necessary.

For example[130], in a TV advertisement, in respect of a vehicle lease signing, it was portrayed that there was zero down payment, however, later it was discovered that a significant amount of fee was payable which was reflected in the end of the advertisement in a blurred and unreadable print. There was an enforcement action against the company as a material term was deceptively portrayed in a manner such that the consumers are misled into believing that there is nil down payment.

3) An '*abusive'* act or practice

- Materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
- Takes unreasonable advantage of – (i) A lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service; or (ii) The inability of the consumer to protect its interests in selecting or using a consumer

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[129] *FTC v. Capital City Mortgage Corp*., Civil No. 98 CV-237 (D.D.C. Feb. 2005), available at <http://www ftc.gov/opa/2005/02/capitalcity.shtm>, last visited on 26th May, 2014.

[130] In the matters of Mazda Motor of America, Inc.; Mitsubishi Motor Sales of America, Inc.; American Honda Motor Company, Inc.; General Motors Corporation; American Isuzu Motors, Inc.

financial product or service; or (iii) The reasonable reliance by the consumer on a covered person to act in the interests of the consumer.

As can be deduced from the definition of an abusive act or practice, the determination thereof is highly subjective and depends on the understanding of the consumer. Therefore, this standard shifts the focus of the CFPB on the perception of the consumer, creating a "suitability" standard, potentially with the burden on the financial institution to demonstrate what the consumer actually understood at the time of the transaction.[131] In a recent case[132] the CFPB characterized the actions of a payday lender as abusive when it created a false sense of urgency in the minds of the delinquent borrowers, pressurizing them to take new loans to pay old loans, generating new fee with each renewal, thus trapping them into a cycle of debt. In addition, illegal debt collection practices by the lender wherein they made excessive number of calls, repeatedly called the customers' employers and relatives and disclosed details of the debt, directly contacted consumers who are represented by an attorney and falsely threatened to sue the customers were pronounced as unfair and deceptive.

In summary, an unfair practice causes injury, a deceptive practice is due to false representation and an abusive practice causes confusion to the consumer.[133]

It is to be noted that the CFPB though the Dodd-Frank Act is allowed to enforce various financial services statutes, it relies more on the UDAAPs as its primary enforcement tool as the penalties are drastic and it is broadly worded.[134] The CFPB has taken a stand that it will not be issuing rules to define the acts or practices deemed to be UDAAP, and will instead do so through enforcement and develop it in a cases by case basis.[135] Therefore, the financial services companies are expected to adhere to the standards laid down by the CFPB, by reading the tea leaves, however some guidance is provided through publications of the CFPB in their enforcement actions, consent orders, instances cited in the examination manual[136] and bulletins. In effect, there are two possibilities – (i) a UDAAP violation may also be a violation under the federal statute or (ii) a practice in compliance with the federal statute may still be categorized as a UDAAP.[137] Therefore, it serves as a catch-all provision, providing the CFPB with broad powers to regulate the financial market for a default of any nature and character which may fall

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[131] Donald C. Lampe, Nancy Thomas and James Nguyen, "United States: The CFPB & UDAAP: A "Know It When You See It" Standard?" (2014), available at <http://www.mondaq.com/unitedstates/x/321416/Financial+Services/The+CFPB+UDAAP+A+Know+It+When+You+See+It+Standard>, last visited on 26th May, 2015.

[132] See 'CFPB Takes Action Against ACE Cash Express for Pushing Payday Borrowers Into Cycle of Debt', website of the CFPB, available at <http://www.consumerfinance.gov/newsroom/cfpb-takes-action-against-ace-cash-express-for-pushing-payday-borrowers-into-cycle-of-debt/>, last visited on 26th May, 2015.

[133] John Niemann

[134] S. Raman, Austin K. Brown, "CFPB Defines 'Unfair,' 'Deceptive' and 'Abusive' Practices Through Enforcement Activity", Skadden LLP and Affiliates, available at <https://www.skadden.com/insights/cfpb-defines-unfair-deceptive-and-abusive-practices-through-enforcement-activity>, last visited on 26th May, 2015.

[135] Kate Davidson, "Trying to Stay Above Politics: A Conversation with Richard Cordray," The American Banker (Mar. 23, 2012).

[136] The instances discussed above have been taken from the Examination Manual of the CFPB

[137] "Unfair, Deceptive, or Abusive Acts or Practices", CFPB Consumer, available at <http://www.cfpaguide.com/portalresource/Exam%20Manual%20v%202%20-%20UDAAP.pdf>, last visited on 26th May, 2015.

within the ambit of a UDAAP. While improved market discipline and a professional code of conduct are critical elements in restoring investors' trust, the introduction of statutory obligations sends a clear and positive signal that financial advisers must put their clients' interests first and foremost.[138]

In Australia, several legislations contain provisions mandating fair treatment of consumers and penalising false or misleading practices that lure consumers into making wrong decisions in relation to financial products. Section 12D of the ASIC Act states that a person must not, in trade or commerce, engage in conduct in relation to financial services that is 'misleading' or 'deceptive' or is likely to mislead or deceive. It further states that the public must not be misled as to the nature, the characteristics, the suitability for their purpose or the quantity of any financial services.[139] Under Section 12DB of the same Act, a person must not, in trade or commerce, in connection with the supply or possible supply of financial services, or in connection with the promotion by any means of the supply or use of financial services make a false or misleading representation in relation to *inter alia* price of the service, need of the service, standard, quality, value-grade etc. A violation of Section 12D and 12DB of the ASIC Act results in a criminal penalty. Conduct includes doing or refusing to do any act and can refer to actions such as[140]:

- silence (for example, not disclosing certain information)
- oral or written statements
- pictorial advertisements
- promotions
- quotations
- product labelling
- representations or impersonations made by a person.

The terms 'misleading' and 'deceptive' have not been defined in the ASIC Act or the Corporations Act (which also employs the same terminology), even broadly. Therefore the meaning thereof has to be culled out of the judicial precedents in this regard. Further, Section 912A of the Corporations Act requires a financial services licensee to do all things necessary to ensure that the financial services covered by the licence are provided 'efficiently, honestly and fairly'. In the leading case of *Australian* Securities and Investments Commission v Camelot Derivatives Pty Limited (In Liquidation)[141], the respondent company was in the business of providing financial services advice, and in course of providing advice in relation to options and promoting the trading scheme, the courts found that its real objective was to earn excessive brokerage, and instead of significant returns as were projected to the customers, the customers

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[138] Rajaretnam, Thilla et al, "In the best interest of clients? A reappraisal of the recent reforms in the regulation of financial advisors in Australia", International Company and Commercial Law Review (2015). ("**Rajaretnam, Thilla**")

[139] Section 12DF, ASIC Act

[140] Section on 'Debt collection guideline: for collectors and creditors', website of the Australian Competition and Consumer Commission, available at <https://www.accc.gov.au/publications/debt-collection-guideline-for-collectors-creditors/debt-collection-guideline-for-collectors-and-creditors/part-3-commonwealth-consumer-protection-laws/prohibition-of-misleading-and-deceptive-conduct>, last visited on 26th May, 2015.

[141] [2012] FCA 414

incurred significant losses. The learned judge concluded the activity to be a 'misleading and deceptive act' and defined the same as –

> *"Whether conduct was likely to mislead or deceive was a question of fact and that the conduct would be so characterised if it (i) led a person into error or induced or was capable of inducing error or leading to an erroneous assumption or misconception; and (ii) caused, or was likely to cause, a person to misinterpret, or be deluded as to, the relevant facts. It is not necessary that the conduct actually misled or deceived anyone, but the possibility should be a real one, and not remote."*

Further, the company was held liable under Section 912A of the Corporations Act, and the judge interpreted[142] that the requirement to act efficiently, honestly and fairly as imposing a requirement of competence when providing advice and complying with relevant statutory obligations. The term 'efficiently' required that a licensee's performance must produce the desired effect and be capable, competent and adequate and it was noted that inefficiency could be established by demonstrating that the performance of a licensee's functions fell short of the reasonable standard of performance that the public was entitled to expect. A conduct to be dishonest has to be proved to be a conduct which is morally wrong in a commercial sense (and not criminal), and when used in conjunction with the word 'fairly' tends to give the flavour of behaviour that is not only honest, but also ethically sound.[143]

Similar to Australia, **the UK law** also does not explicitly define prohibited acts and practices and reference has to be made to judicial precedents.

C. Assessment Of Suitability

The incidence of irresponsible lending is very common across the globe. However, the biggest example of the same was the sub-prime mortgage crisis which demonstrated the impact of the occurrence of irresponsible lending originating in the US, but spreading across several countries. Such irresponsible lending also leads to household over-indebtedness, which can have an adverse effect on the economy. . Irresponsible lending occurs when the lender provides advice and products / services to the borrower/consumer which are not commensurate to the profile, circumstances and requirements of the borrower, the intent to lend irresponsibly not being necessary. In a nutshell, the lending is not objective and is driven by vested interests, or sheer irresponsibility towards the best interests of the consumer and the suitability of the product to the consumer.

Principle 6 of the G20 Principles states that financial services providers and authorized agents should have as an objective to work in the best interest of their customers and be responsible for upholding financial consumer protection. Depending on the nature of the transaction and based on information primarily provided by customers, financial services providers should

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[142] "Misleading or deceptive conduct – a warning in difficult times", Cooper Grace Ward – Lawyers, available at <http://www.cgw.com.au/publication/misleading-or-deceptive-conduct-a-warning-in-difficult-times/>, last visited on 26th May, 2015.

[143] Harry New, Pamela McAlister, John Bassilios and Eugene Chen, "Australia: Federal Court cracks down on misleading and deceptive conduct in financial services", available at <http://www.mondaq.com/australia/x/189708/Financial+Services/Federal+Court+cracks+down+on+misleading+and+deceptive+conduct+in+financial+services>, last visited on 26th May, 2015.

assess the related financial capabilities, situation and needs of their customers before agreeing to provide them with a product, advice or service. The Good Practices also recommend that before a financial institution makes a recommendation to a consumer regarding a specific financial product or service, it gather sufficient information from the customer to ensure that the product or service is likely to meet the needs and capacity of that customer.

In the US, the requirement for responsible lending is read into the duty of the CFPB to prevent any 'abusive' act or practice under Section 1031(d) of the Dodd Frank Act. The determinants of an act or practice to be categorized as abusive are subjective in nature – the requisite degree of understanding of the consumer, the ability of the consumer to understand and the amount of reliance placed on the lender by the consumer. Therefore, as mentioned above, this standard marks a shift from the responsibility placed on the borrower to the banks to be overall responsible, and creates a 'suitability' standard.

The embedded responsible lending requirement in Section 1031 makes the banks responsible for[144] (i) the financial literacy of each of the customer i.e. the focus is not whether technically all information has been given to the customer, but whether the customer actually understands all the information and disclosures; (ii) suitability of the product or service being offered as per his financial circumstances and needs; and (iii) having the fiduciary duty to act in the interests of the customer, (even for traditional banking products which originally did not require the banks to discharge a fiduciary duty).

The above mentioned requirements are being incorporated into the financial system, for instance, the closed end residential mortgages must comply with a new suitability requirement[145] wherein the creditor is mandated to make a reasonable, good faith determination of a consumer's ability to repay any consumer credit transaction secured by a dwelling.[146]

In the UK, there is a statutory requirement for the firm to act in the best interests of the client.[147] The responsible lending requirement is set out in detail in COBS 9. The COBS 9 suitability requirements build upon Principle 9 of the FCA's Principles for Businesses which requires firms to take reasonable care to ensure the suitability of their advice and discretionary decisions for any customer who is entitled to rely upon their judgement. Principle 6 of the FCA's Principles for Businesses is also fundamental as it requires firms to pay due attention to the interests of their customers and treat them fairly. In the event a business is making a personal recommendation[148] to a customer i.e. where firms provide investment advisory or portfolio

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[144] John D. Wright, "Dodd-Frank's "Abusive" Standard: A Call for Certainty", 8 Berkeley Bus. L.J. 164 (2011), available at <https://www.law.berkeley.edu/files/bclbe/Dodd_Frank_Abusive_Standard_Paper.pdf>, last visited on 26th May, 2015.

[145] CFPB Final Rule: Ability to Repay/Qualified Mortgage Under Regulation Z, Minnesota Bankers Association, available at <http://www.minnbankers.com/files/public/QualifiedMortgages1video.pdf>, last visited on 26th May, 2015.

[146] See Section on 'Ability to Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z)', website of the CFPB, available at <http://www.consumerfinance.gov/regulations/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z/>, last visited on 26th May, 2015.

[147] COBS 2.1.1, FCA Handbook

[148] A recommendation is not a personal recommendation if it is issued exclusively through distribution channels (such as newspapers, magazines, radio or television broadcasts) or to the public.

management services[149] the firm must obtain the necessary information regarding the client so as to enable the firm to make the recommendation, or take the decision, which is suitable for him[150] –

(a) client's knowledge and experience in the investment field relevant to the specific type of products / service – this includes obtaining information on the type of products / services the client is familiar with; the nature, volume, frequency of the *client's* transactions and the period over which they have been carried out; and the level of education, profession or relevant former profession of the client;
(b) financial situation - this includes obtaining information on the source and extent of his regular income, his assets and his regular financial commitments; and
(c) investment objectives - this includes obtaining information on the length of time for which he wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment.
This is often referred to as "know your customer" (or KYC) information.[151] However, it is different than the KYC norms as generally understood in India in relation to opening of accounts. The firm should obtain that much information from the client which is necessary for the firm to understand the following -

1. essential facts about the client
2. a reasonable basis for believing, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, or entered into in the course of managing meet his investment objectives; is such that he is able financially to bear any related investment risks consistent with his investment objectives; and is such that he has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.

Thus the depth of the information required from the client depends on the nature and extent of the service provided and the kind of client to whom the information is being provided. For instance, when a personal recommendation is being made to a professional client, the firm is entitled to assume that, in relation to the products, transactions and services for which the professional client is so classified, the client has the necessary level of experience and knowledge for the purposes.[152] Therefore, the suitability requirement is slightly relaxed depending on the nature of the client. Also, for a transaction involving a complex financial product or advice to be given on an ongoing regular basis, a higher degree of information is required to be obtained. A firm is entitled to rely on the information provided by its clients unless it is aware that the information is manifestly out of date, inaccurate or incomplete.

There is also a requirement to provide a suitability report in certain instances capturing the suitability assessment on the factors stated above and the minimum contents should include (i) the client's demands and needs; (ii) explain why the firm has concluded that the recommended transaction is suitable for the client having regard to the information provided by the client;

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[149] 'FCA suitability requirements: COBS 9', Practical Law: Thomas Reuters Legal Solution, available at <http://uk.practicallaw.com/3-517-1189#a288354>, last visited on 26th May, 2015. ("**Practical Law: Thomas Reuters Legal Solution**")

[150] COBS 9.2.1, FCA Handbook

[151] Practical Law: Thomas Reuters Legal Solution

[152] COBS 9.2.8, FCA Handbook

and (iii) explain any possible disadvantages of the transaction for the client. The suitability assessment may be undertaken as against the template provided by the FCA which serves as a checklist[153], however, the risk profiling tools like questionnaires, allocation of weightage to question and answers etc. need to be properly designed.[154] The suitability report should be provided before the conclusion (life policies) of a contract or at the time of or immediately after the execution of the contract (life policy sold on phone) or shortly afterwards (other products), depending on the nature of the contract. The purpose is for the client to have a written record of the same.

The FCA Handbook also provides for a guidance on suitability[155], enumerating the activities / practices which may be unsuitable, for instance, churning and switching and factors to be borne in mind while assessing suitability of the different types of financial products, for instance, for income withdrawals and short term annuities, the client's investment objectives, need for tax-free cash and state of health; the current and future income requirements, existing pension assets and the relative importance of the plan, given the client's financial circumstances; and the client's attitude to risk, ensuring that any discrepancy is clearly explained between his attitude to an income withdrawal or purchase of a short-term annuity and other investments.

The FCA also has the power to make temporary product intervention rules (TPIRs)[156] which are rules made before consultation, where the FCA identifies a significant risk to consumers which requires prompt action. In practice, they will allow the FCA to take action such as restricting the use of certain product features, requiring that a product not be promoted to some or all types of customers, or – in the most serious cases – requiring that a product not be sold altogether.

Some of the instances in which the FCA might consider making temporary rules include -

- Where a product is in serious danger of being sold to the wrong customers, for instance where complex or niche products are sold to the mass market;
- Where a non-essential feature of a product seems to be causing serious problems for consumers; and
- Where a product is inherently flawed.

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[153] For more details please see <http://www.fca.org.uk/static/fca/documents/iapsd-assess-template.pdf>, last visited on 27th May, 2015.

[154] Finalised Guidance, "Assessing suitability: Establishing the risk a customer is willing and able to take and making a suitable investment selection", available at <http://www.fca.org.uk/static/documents/final-guidance/fsa-fg11-05.pdf>, last visited on 27th May, 2015; Factsheet No. 20: For investment advisers, Financial Conduct Authority, available at <http://www.fca.org.uk/static/documents/factsheets/fs020-assessing-your-customers-needs.pdf>, last visited on 27th May, 2015; Factsheet No. 21: For investment advisers, Financial Conduct Authority, available at <http://www.fca.org.uk/static/documents/factsheets/fs021-knowing-your-customer-and-assessing-their-needs.pdf>, last visited on 27th May, 2015.

[155] COBS 9.3, FCA Handbook

[156] Section on 'FSA confirms approach to using temporary product intervention rules that will be used by the FCA', website of the Financial Conduct Authority, available at <http://www.fca.org.uk/news/press-releases/fsa-confirms-approach-to-using-temporary-product-intervention-rules-that-will-be-used-by-the-fca->, last visited on 27th May, 2015; "The FCA's use of temporary product intervention rules", Policy Statement PS13/3, Financial Service Authority (2013), available at <http://www.fca.org.uk/static/documents/consultation-papers/fsa-ps13-03.pdf>, last visited on 27th May, 2015.

FCA used this power for the first time when it used it to restrict firms from distributing contingent convertible instruments (CoCos) to the mass retail market for a 12 month period.[157]

In Hong Kong the assessment of the risk profile of the customer is done by non-sales staff and the customer is to be provided with a copy of the risk profile to remove any perception of potential conflict. [158] Further, it has been mandated that the risk profile assessment process and the sales process should be audio recorded to reduce or remove grounds for subsequent dispute.[159] In countries like the US, UK, Australia, Hong Kong and Singapore, a mandatory pre-investment cooling off period is provided in relation to certain products (mainly used for long term savings) to off-set high pressure sales tactics, where the consumer can cancel any resulting signed contract without penalty during a period of specified number of days. The customer has time for reflection which may mitigate concerns about investors not having time to read and understand the disclosures. However, the financial institution can recover any processing fee incurred. This requirement of having a cooling off period is also in line with the Good Practices.

The 'best interests' duty and related obligations in relation to personal advice given by the financial advisers **in Australia** are contained in Division 2 of Part 7.7A of the Corporations Act 2001. As per the provisions under Division 2, the best interest duty applies to all forms of personal advice that an individual offers to a consumer, including advice that is comprehensive in its scope and advice that is of limited scope. The main obligations that are to be followed include the following[160]:

- act in the best interests of their clients, where a reasonable advice provider would believe that the client is likely to be in a better position if the advice is followed or adhered to (section 961B);
- provide appropriate advice (section 961G). The test for assessing if an advice is appropriate includes the following criteria
    - whether it is fit for the present purpose for which it is sought including the current circumstances of the client; and
    - whether the client is likely to be in a better position in the future financially if he or she follows that advice
- warn the client if advice is based on incomplete or inaccurate information (section 961H); and
- prioritise the client's interests in the instance the advice provider is aware of or reasonably ought to know while giving the advice, that there is a conflict between the interests of the client and the interests of the advice provider or related entities. (section 961J)[161]

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[157] "UK FCA proposes temporary product intervention rules for CoCos", Herbert Smith Freehills (2014), available at <http://hsfnotes.com/fsrandcorpcrime/2014/08/05/uk-fca-proposes-temporary-product-intervention-rules-for-cocos/>, last visited on 27th May, 2015.

[158] 'Consumer Corner - HKMA's Work in Relation to Strengthening Financial Consumer Protection',Report of the Hong Kong Monetary Authority on Issues Concerning the Distribution of Structured Products Connected to Lehman Group Companies, available at <http://www.hkma.gov.hk/media/eng/key-functions/banking-stability/consumer-corner/strengthening-financial-consumer-protection/>,doc/other-information/lehman_report.pdf>, last visited on 27th May, 2015.

[159] *Ibid.*

[160] ASIC Regulatory Guide 175 for FSG (n 109).

[161] These entities may include all or any of the following: (1) the advice provider; (2) an associate of the advice provider; (3) the advice provider's AFS licensee; (4) an associate of the advice provider's AFS licensee; (5) an authorised representative who has authorised the advice provider to provide financial services (or a financial service) on behalf of an AFS licensee; or

In relation the last criteria, the advice provider is not required to make inquiries to determine whether a conflict exists, however to comply with Section 961J, an advice provider must identify the best interest he and other related parties have in the matter.[162] In certain cases, it may not be reasonable for an advice provider to recommend a financial product to a client in light of the subject matter sought, and by conducting reasonable investigation it may recommend another product or some other strategy which may satisfy the objective of the client. Therefore, in cases where it is not reasonable to recommend a product, it may[163] –

- provide the client with advice that is not product-specific (which may include advice for the client to do nothing);
- advise the client to dispose of a financial product; or
- advise the client to make an increased investment without acquiring new financial products.

While implementing the best interest principle, the ASIC is guided by whether a reasonable advice provider would believe the client is likely to be in a better position if the client follows the advice. The advice providers may demonstrate that they have complied with the best interest principle if they have undertaken the following assessments[164] :

- the position the client that would have existed had the advice not been followed, which is to be assessed at the time the advice is provided;
- the prevailing facts at the time the advice was given, which were in the knowledge or ought to have been in the knowledge of the advice provider;
- the subject matter of the advice sought ;
- the client's objectives, financial situation and needs, since many clients endeavour to seek advice with the objective of improving their financial position. Although a client's objectives, financial situation and needs may also encompass other things, such as:
    - improving a client's understanding of their financial position;
    - aligning their financial position with their appetite for risk;
    - reassuring them that that they do not need to change their strategy or product holdings as a result of a review; or
    - Increasing their confidence to spend or donate their money.
- Where the relevant product features that the client particularly values have been provided after the client has been made aware of the cost of such features and prepared to pay such costs; and
- the client receives a financial benefit that is more than trivial.

(6) an associate of an authorised representative who has authorised the advice provider to provide financial services (or a financial service) on behalf of an AFS licensee.

[162] ASIC Regulatory Guide 175 for FSG

[163] ASIC Regulatory Guide 175 for FSG

[164] ASIC Regulatory Guide 175 for FSG

While assessing the 'better position' of a client the aforementioned factors and circumstances are considered to be of relevance[165] what is required of advice providers is not 'perfect advice' but rather advice that furthers the best interest duty to the benefit of the consumer.

In addition to the aforementioned criteria, the Corporations Act also endeavours to define what would reasonably be regarded 'in best interest of the client' under Section 961E.[166] As per this section, the best interest of the client is served if - a person with a reasonable level of expertise in the subject matter of the advice sought by the client, exercises due care and objectively assesses the client's relevant circumstances to decide upon what actions further the best interests of the client.

In relation to specifically 'basic banking products'[167], the best interest obligations are applicable only under two circumstances (i) the subject matter of the advice sought by the client is solely a basic banking product; and (ii) the provider is an agent or employee of an Australian Authorised Deposit Taking Institution ("ADI"), or otherwise acting by arrangement with an Australian ADI under the name of the Australian ADI. The best interest duty is applicable in a modified manner, i.e. it is satisfied if the actions under 1, 2 and 3 above are adhered to and the additional obligations to provide appropriate advice and warn the client if advice is based on incomplete or inaccurate information are satisfied. They do not need to comply with the requirement to prioritise the client's interests.[168] It may be noted that the requirement of complying with the best interest principle has been viewed to be costly and the criteria is considered to be highly prescriptive, rendering its treatment as a tick box compliance.[169]

D. Training And Competence Of Bank Staff

The Good Practices state that the staff of a financial institution who deals directly with consumers receive adequate training, suitable for the complexity of the products or services they sell. In particular, financial intermediaries are qualified as appropriate for the complexity of the financial product or service they sell.

In the UK, the FCA has specific rules relating to the training and competence of the staff of the banks/ financial institutions. Competence is defined to mean having the skills, knowledge and expertise needed to discharge the responsibilities of an *employee's* role which includes achieving a good standard of ethical behaviour.[170] The emphasis is on the firm ensuring that –

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[165] ASIC Regulatory Guide 175 for FSG

[166] Section on 'CP 182 Future of Financial Advice - Best interests duty and related obligations', website of the ASIC, available at <http://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-182-future-of-financial-advice-best-interests-duty-and-related-obligations-update-to-rg-175/>, last visited on 27th May, 2015.

[167] Under Section 961F of the Corporations Act: a basic banking product is each of the following:(a) a basic deposit product;(b) a facility for making non-cash payments (see section 763D) that is related to a basic deposit product;(c) an FHSA product of a kind mentioned in subparagraph (c)(i) of the meaning of FHSA in section 8 of the First Home Saver Accounts Act 2008 (first home saver accounts);(d) a facility for providing traveller's cheques;(e) any other product prescribed by regulations for the purposes of this paragraph.

[168] ASIC Regulation Impact Statement on Future of Financial Advice: Best interests duty and related obligations (2012), available at <http://download.asic.gov.au/media/2125918/rg175-ris.pdf>, last visited on 27th May, 2015.

[169] Rajaretnam, Thilla

[170] TC 1.1.4, FCA Handbook

- the staff hold the appropriate qualification[171] for the functions it is required to perform;
- assessing training needs at the outset and at regular intervals, and also assessing the quality and effectiveness of the training[172];
- regular and frequent review of the employee's competence and take appropriate action to ensure that they remain competent for their role.[173]The maintenance of competence should take into account factors like technical knowledge and its application, skills and expertise and changes in the market and to products, legislation and regulation. The firms may implement the same through a training and competence scheme.
- Specific requirements for a retail investment adviser to complete a specified number of hours of professional development[174] which may include attending seminars, participating in courses etc., and requirement on the firm to keep record of the same.
- Annual declaration[175] in respect of retail financial advisers by the firm of compliance with (i) the principles embodied in the FCA Handbook in relation to approved person i.e. entities approved by the FCA to carry out functions in the financial market, and (ii) the requirement for professional development.
- Requirement of independent verification[176] by an accredited body, in relation to retail investment advisers, of the qualifications possessed and professional development undertaken.
- Notifying the FCA[177] of occurrence of a significant event i.e. competence and ethics related issues in relation to retail investment advisers, for instance, when he is no longer considered competent, fails to attain an appropriate qualification in a prescribed time, performed an activity without demonstrating competence and without supervision, or has breached the statement of principles (fundamental obligations of FCA approved persons).
- Further, the firms which employ retail investment advisers need to notify each individual retail investment adviser's professional standards data to the FCA, to assist the FCA in its ongoing supervision, and enable the FCA to gain an understanding on the professional development of the adviser in the interests of protecting consumers.

The staff of the financial advisors and credit providers **in Australia** is required to be provided training in relation to their functions. Training structure differs for financial advisors and credit providers. The main aim of training for financial advisors is to ensure that -

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[171] A qualification is deemed to be appropriate if it appears in the table contained in TC App 4.1 in the FCA Handbook.

[172] TC 2.1.11 G, FCA Handbook

[173] TC 2.1.12 R, FCA Handbook

[174] TC 2.1.15 R , FCA Handbook

[175] TC 2.1.26 R , FCA Handbook

[176] TC 2.1.27 R , FCA Handbook

[177] TC 2.1.31 R , FCA Handbook

1. Those who provide advice are competent to do so to ensure that the consumers of financial advice are protected. This is usually done on account of the fact that retail clients not have the resources or the expertise to assess whether their financial adviser has a required level of competence to give financial advice.
2. licensees are assisted in complying with their legal obligations to ensure that they and their representatives are sufficiently trained and competent to provide the services that are covered by their AFS licence; and
3. industry associations, professionals and providers of training and education are assisted in understanding the regulatory requirements, so that they can develop suitable training modules.

In relation to the financial advisors, all natural persons who provide financial product advice to retail clients are required meet the training standards, unless they fall within the limited exemptions on account of the limited nature of their activities.[178] The ASIC has a minimum set of training standards for the advisers which have been elaborated below in detail and are met by satisfactorily completing the training courses listed in the ASIC Training Register relevant to their advisory activities, and as an alternative, experienced advisers can demonstrate their competence through individual assessment against the training standards by an authorised assessor.[179] The minimum set of training standards are -

- knowledge and in some cases[180] skill requirements that are required to be satisfied, at either the Tier 1 or Tier 2 education level, by all financial advisors before they give such advice. The Tier 1 products[181] require an education level which equivalent of a 'Diploma' level under the relevant qualification framework in Australia and Tier 2 products[182] require education level equivalent to a 'Certificate III' level. The knowledge and skill requirements and education levels vary depending upon (a) whether the adviser gives general or personal advice; and (b) what products the adviser gives advice on. To meet the training standards, the knowledge requirement has to be complied in terms of generic i.e. relevant to the products the advisers advises on and the markets in which it operates and specialist knowledge i.e. about the specific products the adviser advises on and the markets in which it operates.
- All licensees have an obligation to ensure that all advisors working for them undertake continuing training to maintain and update their knowledge and skills, appropriate for their activities.

Credit licensees (including credit providers and lessors, and other persons such as finance brokers) are not required to have any specific training requirement, although it is imperative that such licensees and their representatives are adequately trained and competent to carry out

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[178] ASIC Regulatory Guide 146 on Licensing: Training of financial product advisers, available at <http://download.asic.gov.au/media/1240766/rg146-published-26-september-2012.pdf>, last visited on 27th May, 2015.

[179] *Ibid.*

[180] In the instance of personal advice.

[181] All financial products except those listed under Tier 2.

[182] Tier 1 products include general insurance products except for personal sickness and accident, consumer credit insurance, basic deposit products, non-cash payment products etc.

the credit activities authorized under their credit license.[183] If an entity is an unlicensed carried-over instrument lender (i.e. a lender who entered into an agreement under the old Credit Code before the present Consumer Credit Act came into force), it is still required to ensure its representatives are adequately trained and competent to engage in the credit activities in relation to the carried over instrument. As per the ASIC a credit licensee or representative should at least do the following in order to keep up with the new developments in the industry[184]:

1. ascertain individually as to the appropriate initial and ongoing training required to ensure compliance with his or her representative training obligation; and
2. entrench the training required into his or her recruitment and training systems.

In relation to 'organisational competence', the Corporations Act as well as the Consumer Credit Act places responsibility on the financial service providers and credit licensees respectively to maintain the competences that are required of them under their AFS licence or credit license as applicable at an organizational level.[185] These expectations vary for financial service providers and credit licensees. For financial service providers it includes the following[186]:

- As a minimum, the service provider needs to nominate responsible managers who:
    a. are directly responsible for significant day-to-day decisions about the ongoing provision of the financial services;
    b. together, have appropriate knowledge and skills for all of the financial services and products; and
    c. individually meet one of the five options for demonstrating appropriate knowledge (qualification / training for instance – (i) meeting widely adopted industry standards, (ii) individual assessment reveals relevant knowledge equivalent to a diploma, (iii) holding a relevant university degree and having completed a relevant short industry course , (iv) hold a relevant industry- or product-specific qualification equivalent to a diploma or (v) a written submission by the provider to the ASIC that satisfies the ASIC that the manager has appropriate knowledge and skills and skills (number of years of experience).

For credit licensees, it includes the following[187]:

- appointment of responsible managers who have at least two years relevant work experience that is problem-free (i.e. not been marred by grave non-compliance issues) and:
    d. credit industry qualifications up to at least the Certificate IV level; or

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[183] ASIC Regulatory Guide 206 on Credit licensing: Competence and Training, available at <http://download.asic.gov.au/media/1241306/rg206-published-1-july-2014.pdf>, last visited on 27th May, 2015; ASIC Regulatory Guide 105 on Licensing: Organisational Competence, available at <http://download.asic.gov.au/media/1240103/rg105-published-17-july-2014.pdf>, last visited on 27th May, 2015 ("**ASIC Regulatory Guide 105**")

[184] *Ibid.*

[185] *Ibid.*

[186] *Ibid.*

[187] ASIC Regulatory Guide 105

e. a different general relevant higher level qualification (e.g. a diploma or university degree).

- If the business provides third-party home loan credit assistance, the responsible managers' qualifications should be at least a Certificate IV in Finance and Mortgage Broking.

The ASIC expects that in order to meet the requirements of organisational competence, institutions (financial service and credit providers) will undertake the following actions[188]:

1. review its organisational competence on a regular basis and whenever the responsible managers or business activities change;
2. maintain and update the knowledge and skills of the responsible managers; and
3. keep records showing that the institutions have reviewed their organisational competence and undertaken steps to maintain such competence.

E. RECOMMENDATIONS

For the purposes of preventing conflict of interest, draft guidelines were issued by the RBI for separation of the marketing / distribution and advisory operations of a bank.[189] Due to the overlapping of the stated functions, for instance, a bank acting as a distributor of a third party financial product would earn a commission from the third party for advising the customer to pick a certain product over the other. Hence, it was suggested that a separately identifiable or department or a separate subsidiary would carry out the advisory functions, and would be at an arm's length from the rest of the departments of the bank. The staff was required to hold a suitable professional qualification, and a system was to be developed (internal as well as external) for the continuous development and training of such persons so that they may understand the complexity of the product. However, the final regulations have not been notified till date.

Further, the first Bi-monthly Monetary Policy Statement released on April 1, 2014 stated that consumer protection is an integral aspect of financial inclusion and proposed to frame comprehensive consumer protection regulations based on domestic experience and global best practices. The Annual Report on Banking Ombudsman (2013-14) states that the proposed statutory framework will come with explicit rights the customers enjoy and the implicit duties that are cast on the banker and that in compliance with this announcement, in early September 2014, RBI has come out with a Charter of Customer Rights[190] encapsulating best practices in this area in relation to the Right to Fair Treatment, Right to Transparency, Fair and Honest Dealing, Right to Suitability, Right to Privacy and Right to Grievance Redress and Compensation. It is believed to have marked the shift from consumer-beware regime to a seller-beware regime. However, the charter lacks the enforceability part and needs to be given

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[188] *Ibid.*

[189] RBI Circular DBOD.CO.FSD.No./24.01.026/2012-13 (June, 2013), available at <http://rbidocs.rbi.org.in/rdocs/Content/PDFs/WM280613FL.pdf>, last visited on 27th May, 2015.

[190] RBI Press Release on 'RBI releases Charter of Customer Rights' (2014), available at <https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=32667>, last visited on 27th May, 2015.

teeth to be effective.[191] *In this regard it may be mentioned that the RBI has issued Suitability and Appropriateness guidelines for derivative products.*[192]

In light of the above, the following recommendations are proposed to strengthen the business practices as they currently exist in the Indian regime –

- *First and foremost, the RBI may clearly define the standards for acts or omissions in relation to financial products which are prohibited in the form of UDAAPs, as in the US. The specific definition is important for providing RBI the flexibility to penalise acts and practices falling within the ambit of the defined standards, as in the US in the form of UDAAPs under the Dodd-Frank Act. It should be intended to serve as a catch-all provision for regulating the infirmities in the financial market, and should be broadly worded to catch within its net various defaults which may evolve with the development and innovation in the financial markets. Once defined, the enforcement actions of the RBI may serve as guidance;*
- *Second, the RBI may populate the charter of rights in significant detail, with special focus on the Right to Transparency, Fair and Honest Dealing and the Right to Suitability by incorporating the concept behind the regulations relating to 'suitability' as developed by the FCA in the UK, as may be appropriate in relation to financial products governed by the RBI. Thus, the ingredients for fulfilling the suitably requirement may be suitably adapted for the various financial products governed by the RBI. The compliance thereof will feature in the statement of advice disclosure to be made (as discussed in the Chapter 4) and may essentially cover the following -*
  - *The three prongs to be assessed may be (i) the investment objective (ii) the financial situation and (iii) the knowledge and experience of the customer, subject to the aforementioned deliberation regarding the factors to be analysed within each prong;*
  - *There should be provision for inherent flexibility in the depth of the information to be obtained dependent on the nature and extent of the product or advice or service to be provided and the nature of the client to be catered to;*
  - *The suitability assessment tools should be adequately developed based on extensive research as to the kind and nature of tools which have proved to be more successful, giving positive outputs in terms of assessing the suitability of the customer;*
  - *The suitability assessment staff and the sales staff should be segregated, such that hard selling etc. which may occur due to the same staff having conducted the suitability assessment of the customer and also having the responsibility to sell financial products may be obviated to some extent;*
  - *The risk profiling process and the sales process should be mandatorily required to be audio recorded for the purposes of obviating subsequent disputes, and this will also result in creation of data for analysing whether the compliance requirements are being met or not. Having said that, we understand in practice the audio recording requirement may have certain challenges;*
  - *Suitability requirements which may be peculiar to certain products due to their nature, and which require being explicitly spelt out should be enumerated in the regulations itself;*

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[191] Monika Halan, "RBI takes the first step towards customer protection", LiveMint (26th Aug., 2014), available at <http://www.livemint.com/Money/dBO0oNh4g233jUoswYjL4N/RBI-takes-the-first-step-towards-customer-protection.html>, last visited on 27th May, 2015.

[192] Comprehensive Guidelines on Derivatives: Modifications (November 2011), available at <http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=6793&Mode=0>, last visited on 27th May, 2015.

- *One important ingredient that may be incorporated (as in Australia) is that when the financial advisor thinks it to be unreasonable to recommend a product in light of the subject matter of the advice being sought, it should have the flexibility and the responsibility to give non-product related advice or advice in relation to a better strategy which may pander to the requirements of the customer.*
- *A requirement for providing pre-investment cooling off period of 14 days should be built in for the consumer to reflect on the transaction it has entered into, by the end of which it can cancel the transaction, however the processing fee may be forfeited by the provider. The RBI may decide to implement the requirement of cooling off period for financial products, and the restrictions on the forfeiture of the processing fee as it thinks fit.*

➢ *Lastly, in relation to the competence of the staff of the financial institutions as well as the agents / intermediaries of the financial institutions whose function is to provide advice to the consumers, the following requirements may be built in the regulations –*
    - *The regulations should have a detailed knowledge (education level) and skills (number of years of actual practical useful experience) requirement set out with respect to each of the financial products governed by the RBI, such that there is no confusion regarding the competence requirements of the staff and the agents responsible for the handling of the financial product, and the same should be adhered to by the banks in their recruitment / appointment process to enhance the quality of the staff and agents as ultimately it is the staff and agents which are responsible for carrying out all the functions of the bank;*
    - *It is proposed that there is a mandatory requirement for the 'maintenance' of the competence of the staff and agents by regular training sessions and professional development, which focus on the quantitative as well as the qualitative aspects of training, to render the trainee well equipped to handle the requirements of the job on a continued basis. Therefore the RBI may develop robust training and competence schemes, which may be implemented by the banks on a quarterly basis, as it thinks fit.*

➢ *For retail investment advisers (in instances where the banks acts as one), in the event on review of the competence of the relevant staff by the bank it is found that a staff is no longer competent or has conducted himself in an unethical manner, in addition to the requirement of the banks to take corrective actions, an obligation should be cast on the banks to report the deviation to the RBI (for each instance) to enable RBI carry out its supervisory function. Further, systems for undertaking of independent verification by an accredited agency of the compliance of the competence requirements of the staff and agents, and reporting the same to the RBI on a quarterly basis should be developed.*

6. Dispute Resolution Mechanisms

A. Background

Principle 9 of the G20 Principles states that jurisdictions should ensure that consumers have access to adequate complaint handling and redress mechanisms that are accessible, affordable, independent, fair, accountable, timely and efficient. The Best Practices require that the dispute and complaint handling process should be two pronged - it should have an efficient complaint handling process within the financial institution as the first stage of the dispute resolution process, and if the same turns out be unsatisfactory for any reason, then there should be a mechanism whereby the aggrieved person can resolve his complaint under an alternative dispute resolution scheme, which is an out of court settlement procedure, bereft of the complexities of a court driven resolution process. The last stage would be a court process, in case of appeal of the decision made under the alternative dispute resolution scheme. Further, there should be an intrinsic mechanism of analysis of the consumer complaints to flesh out the trends prevalent in the financial market, so as to feed the critical factors into the risk-based market conduct supervision activities and to learn from the same to develop a robust consumer protection regime capable of dealing with the myriad consumer related defaults and issues.

B. International Overview

In the UK, the complaint process[193], the first step is the customer trying to settle the issues with the business itself, and if no final answer (as defined in the FCA Handbook) has been provided within 8 weeks, or the response provided is not satisfactory, the complainant can approach the Financial Ombudsman Service (FOS), which is an entity set up under Part XVI of the Financial Services and Markets Act 2000 ("**FSMA 2000**"), funded by the regulated persons.[194]

The FOS can be approached through telephone and the complaint can be filed orally by providing details[195], or a complaint may be filed online or by way of a form provided on the website.[196] The range of complaints that can be filed is very wide, from insurance, mortgage to credit cards and account related. There is no time frame for the resolution of the complaint and it depends on the facts and circumstances of the case. The service is free of cost and the FOS receives upto 20,00,000 complaints annually.[197] In 2013-14, the ombudsman handled 23,57,374 enquiries and complaints from consumers, almost 8,000 each working day out of

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[193] Section on 'How to complain', website of Financial Conduct Authority, available at <http://www.fca.org.uk/consumers/complaints-and-compensation/how-to-complain>, last visited on 27th May, 2015.

[194] This includes any authorized person, an electronic money issuer and a payment service provider.

[195] When filing a complaint through this mode, it is important to take note of the name of the person being interacted with, and their job title in addition to the date and time of the call. Please see <http://www.financial-ombudsman.org.uk/faq/answers/complaints_a1.html>, last visited on 27th May, 2015.

[196] Section on 'How to complain', website of Financial Ombudsman Service, available at <http://www.financial-ombudsman.org.uk/consumer/complaints.htm>, last visited on 27th May, 2015.

[197] "How can we help you help your constituents", Financial Ombudsman Service, available at < http://financial-ombudsman.org.uk/publications/pdf/MPMiniGuideJun15.pdf >, last visited on 7th July, 2015.

which 11,50,002 were through phone and 12,07,372 were written.[198] In 2014-15, the ombudsman handled 17,86,973 enquiries from consumers, around 5,000 each working day out of which 9,27,737 were through phone and 8,59,236 were written.[199] The FOS usually encourages people to file complaints on their own by simplifying the process and this has been achieved successfully by laying it clearly on the website and making it interactive and simple to understand through audio clips and videos.

Within the FOS, there is a two layered administrative structure, wherein the first level officers are the adjudicators, who record the complaint and undertake the mediation / investigation. In nine out of ten cases, the adjudicators resolve the issue, and the remaining matters require the involvement of the ombudsman. Also, if a complainant is not happy with the decision of the adjudicator, he can appeal to the ombudsman who reviews the decision. In the event the determination of the ombudsman is different from the adjudicator, the ombudsman will make a provisional decision before making a final decision, and take the views of the parties. Therefore the entire process is quite participative and allows the complainant to discuss and put forth what he desires as an outcome from the resolution process. It may be noted that the decision of one ombudsman can never be overturned by another ombudsman, however senior he may be. The final decision of the ombudsman is written in the form of a report, or summary points or any format which the ombudsman deems suitable, and is posted to the complainant and also put up on the website[200] sans the name of the complainant.

The FOS acts as a mediator and attempts to clarify any misunderstandings if any, and takes a fresh perspective on the dispute in hand, and provides an honest solution after hearing both the sides and analyzing the material available. It may ask the business to set right the default, or assist the parties in reaching a compromise or ask the business to pay a compensation upto 1,50,000 pounds i.e. approximately INR 1.5 crore (exclusive of the cost or interest). The hearing process[201] is not mandatory, as the FOS works differently from a court, and is based largely on paperwork. If the hearing is held, it is through phone and face to face hearings are rare. A party can also request for a hearing, and the FOS then decides on the need for the same. The determination of the FOS in relation to the complaint is binding on the parties once the complainant accepts it. The award can be in the nature of a money award, cost award, interest award or directions to the business that the FOS thinks are just and appropriate.[202]

The FOS may recommend a business to pay compensation above the limit prescribed in the statute, however, it cannot legally enforce the same and it may so happen that a willing business may pay up. In relation to the directions that may be issued by the ombudsman, the aim behind them is to put the consumer in the position they would be in now if the problem leading to the

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[198] Section on 'Annual Review 2013/2014', website of Financial Ombudsman Service, available at <http://www.financial-ombudsman.org.uk/publications/ar14/index.html>, last visited on 27th May, 2015.

[199] *Ibid.*

[200] http://www.ombudsman-decisions.org.uk/

[201] A quick guide by the Financial Ombudsman Service, available at <http://www.financial-ombudsman.org.uk/publications/technical_notes/QG3-hearings.pdf>, last visited on 27th May, 2015.

[202] DISP 3.7.1, FCA Handbook

complaint had never happened.[203] It may include directing the business to rectify incorrect information or it may be as simple as tendering an apology. A business refusing to comply with an ombudsman's award can be made to comply with it by involving the FCA, and if that also doesn't work, then by enforcement of the award by the court. If a complainant is not satisfied with the determination of the ombudsman, then he / the financial institution can go to the courts for judicial review.

The FSA 2012 contains Section 234C which enables designated consumer bodies (as decided by the Treasury) to make a super complaint to the FCA. The complaint that may be made is in relation to features of the market that may be affecting consumer interests.[204] Similarly section 234D enables regulated persons[205] and the FOS to make references to the FCA on broadly two grounds - (i) failure of a regulated person to carry on an activity resulting in loss to the consumers, in which case if legal proceedings are initiated, a remedy or relief would be available; (ii) conduct if reported to the ombudsman would result in a determination in favour of the complainant.

In the US, the dispute resolution mechanism is completely driven by the CFPB. The office of Consumer Response addresses consumer complaints, provides consumers with information, and connects them with additional resources where appropriate.[206] Since the commencement of acceptance of complaints on July 21, 2011 and through February 28, 2015, the CFPB has handled approximately 5,58,800 consumer complaints.[207] Between January 1, 2014 and December 31, 2014, the CFPB received approximately 2,50,700 consumer complaints.[208] The complaints can be filed through the website (majority of them are received through this route) or through telephone, mail, email, fax, and referral from other agencies.[209] Consumers submit complaints on the CFPB's website using complaint forms tailored to specific products. While on the website, consumers can chat with a live agent to get help completing the complaint form. The website is amenable to 180 languages and is also enabled to be used by the handicapped. There is also a provision for a status check of the complaint and review the company's response. The toll free number may be used to ask questions, submit a complaint, check the status of a complaint etc.[210]

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[203] Consumer Factsheet by the Financial Ombudsman Service, available at <http://www.financial-ombudsman.org.uk/publications/factsheets/compensation-over-100000.pdf>, last visited on 27th May, 2015.

[204] Finalised Guidance: Guidance for Designated Consumer Bodies on making a Super-Complaint under S. 234C, Financial Conduct Authority, available at <http://files.consumerfinance.gov/f/2012/01/Congressional_Report_Jan2012.pdf>, last visited on 27th May, 2015.

[205] This include any authorized person, an electronic money issuer and a payment service provider.

[206] Semi-Annual Report of The Consumer Financial Protection Bureau (July 21 - December 31, 2011), available at <http://files.consumerfinance.gov/f/2012/01/Congressional_Report_Jan2012.pdf>, last visited on 27th May, 2015.

[207] Annual Report of the CFPB, 2013-14, available at <http://files.consumerfinance.gov/f/201503_cfpb_consumer-response-annual-report-2014.pdf>, last visited on 27th May, 2015.

[208] *Ibid.*

[209] *Ibid.*

[210] Consumer Response Annual Report, CFPB (January 1- December 31, 2012), available at <http://files.consumerfinance.gov/f/201303_cfpb_Consumer-Response-Annual-Report-to-Congress.pdf>, last visited on 28th May, 2015.

The complaints received by the CFPB are screened to filter out complaints on the anvil of the primary enforcement authority of the CFPB, completeness of the complaints and duplication. Any complaint which concerns a product not within the CFPB's jurisdiction is referred to the appropriate regulator. The screened complaints are then forwarded to the concerned firm / company through a secured web portal. The company responds to the consumers via the secured company portal and the response includes description of steps taken or that will be taken, communication received from the consumer, any follow-up actions or planned follow-up actions and the response may fall within any of the following categories - closed with monetary relief, closed with non-monetary relief[211], closed with explanation, in progress or closed or some other administrative response.[212] A complaint is listed in the database after the company responds to the complaint or after the company has had the complaint for 15 calendar days, whichever comes first. The consumers can view the response through the consumer portal on the CFPB's website or call the toll free number, and are given the opportunity of disputing a company's response in cases where the response is closed with monetary relief, closed with non-monetary relief, closed with explanation or closed.

After requesting that companies respond to complaints sent to them and giving consumers the opportunity to review and provide feedback on company responses, the Office of Consumer Response prioritizes complaints for investigation based on a review of the complaint, the company's response, and the consumer feedback to seek to determine why a company failed to provide a timely response (if applicable) and whether the consumer's feedback of the company's response (if applicable) justifies additional review of the company's minimum required actions under the consumer financial protection laws within the CFPB's authority.[213] Once an investigation is completed, the Office of Consumer Response sends the consumer a summary of the outcome.[214] In the course of an investigation, the Office of Consumer Response may ask companies and consumers for additional information. In some cases, it may refer complaints to the CFPB's Division of Supervision, Enforcement, and Fair Lending & Equal Opportunity for further consideration / action. The investigation procedure in the enforcement division is undertaken under the section 1052 of the Dodd-Frank Act. It is initiated by the Assistant Director of the Office of Enforcement and the Deputy Assistant Directors of the Office of Enforcement, and is conducted by the Bureau investigators (any attorney or investigator employed by the Bureau who is charged with the duty of enforcing or carrying into effect any Federal consumer financial law).[215] The relevant details of the complaint, its status, time taken to resolve the complaint etc. are published on the website on a nightly basis.

The CFPB also has a 'Tell Your Story' feature on its website that gives consumers the opportunity to share their experiences – positive or negative – with consumer financial products

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[211] For instance, providing mortgage foreclosure alternatives that do not have direct monetary value to the consumer, but that help them to keep their home or stopping harassment from debt collectors etc.

[212] Available at <https://data.consumerfinance.gov/dataset/Consumer-Complaints/x94z-ydhh?>, last visited on 28th May, 2015 (the response categorized as 'closed' means that no relief – monetary, non-monetary or explanation was provided)

[213] CFPB Consumer Response Annual Report (2014), available at <http://files.consumerfinance.gov/f/201503_cfpb_consumer-response-annual-report-2014.pdf>, last visited on 28th May, 2015.

[214] *Ibid.*

[215] Electronic Code of Federal Regulations, available at <http://www.ecfr.gov/cgi-bin/text-idx?SID=b643d566852735f07b948b53b4d43b5a&mc=true&node=se12.9.1080_12&rgn=div8>, last visited on 28th May, 2015.

and services. These submissions, like formal complaints, are reviewed by CFPB staff to help the CFPB understand current issues in the financial marketplace. When the CFPB opened its doors on July 21, 2011, it began consumer response operations on the same day, accepting consumer complaints about credit cards. Since then, the CFPB has expanded its complaint handling to include complaints about: mortgages, bank accounts and services, private student loans, vehicle and other consumer loans, credit reporting, money transfers and virtual currency, debt collection, payday loans, prepaid cards, and other financial services in a phased manner.

Section 1013(5) of the Dodd Frank Act provisions for an ombudsman office, the duties being – (i) to act as a liaison between the CFPB and the affected person who may be facing any problem in relation to the regulatory activities of the CFPB and (ii) assure that safeguards exist to encourage complainants to come forward and preserve confidentiality. Thus, the main function of the Ombudsman is to act as an independent, impartial, and confidential resource to informally assist consumers, banks, and nonbanks in resolving issues with the CFPB.[216] It facilitates discussions, brainstorming session for evaluating options and resources, shares independent analysis, offers an impartial perspectives, engages in shuttle diplomacy, ensures confidentiality and provides recommendations.[217] It does not make decisions or legal determinations for the CFPB, however, the Ombudsman may make a recommendation on how the CFPB should address the issue. While doing so, it merely acts as a facilitator of the resolution process and an independent advisor, without having any binding powers of its own.[218] The CFPB's Ombudsman Office reports to the Deputy Director with access to the Director, which ensures their independence at the CFPB.

An entity may approach the CFPB Ombudsman when there has been no success with the existing CFPB processes or if the entity wants to keep the concerns confidential, however, as a first step, the complainant may resolve the matter with the CFPB. The CFPB Ombudsman receives complaints individually, or those highlighted in interactions with groups or as observed by itself. It looks into the individual and systemic issued in relation to supervisory activities of the CFPB, enforcement process, consumer complaints process, supervisory appeals and matters between agencies.

In 2012-13, the number of individual inquiries (which include complaints, questions, feedback etc.) received by the ombudsman was 1422 and the complaints received by the Office of Consumer Response were 1,44,000. In 2013-14, the figure was 1133[219] out of which 36% were complaints, largely through phone and then e-mail. The complaints received by the Office of Consumer Response were 2,40,600. The decline in the inquiries to the ombudsman office in 2013-14 was attributed to fewer consumers reaching the ombudsman office, due to more

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[216] Brochure of the CFPB, available at <http://files.consumerfinance.gov/f/201207_cfpb_brochure_ombudsmans_office.pdf>, last visited on 28th May, 2015.

[217] CFPB Annual Report to the Director, available at <http://files.consumerfinance.gov/f/201411_cfpb_report_ombudsman-office.pdf>, last visited on 28th May, 2015 ("CFPB Annual Report")

[218] *Ibid*. For instance, the in-reach meetings of the Ombudsman with the CFPB are held at regular intervals, where the former provides regular informal feedback to the CFPB on information it is hearing, offer feedback in conjunction with CFPB offices' proposed initiatives, share recommendations, and serve as a resource for external inquiries that cannot be resolved elsewhere. Issues highlighted to the CFPB by the Ombudsman range from inquiries relating to formal or informal nature of the CFPB blog postings , what to expect from the consumer complaint process to the need for understanding the intersection between the supervision and enforcement processes, such as how the two work together and what to expect or not expect.

[219] CFPB Annual Report

complaints being dealt by the CFPB.[220] Therefore, it reflects the trend of the burden on the ombudsman being reduced due to more complaints being efficiently handled by the CFPB.

Dispute settlement in the financial sector in Australia is divided into various processes, depending upon the subject-matter of the complaint. For example in relation to complaints against Australian financial services (AFS) licensees, unlicensed product issuers and unlicensed secondary sellers (regulated under the Corporations Act) and the Credit licensees and credit representatives (regulated under the Consumer Credit Act), the procedure for dispute resolution involves (i) an internal dispute resolution (IDR) procedure and (ii) an ASIC approved external dispute resolution (EDR) scheme.[221] The two mechanisms are required, as a minimum, to provide for a process for resolving complaints made by retail clients, although resolution mechanisms for complaints by wholesale clients could also be read into such processes.

Under the IDR process, all licensed financial services or credit providers are required to have in place an internal process to resolve disputes with consumers directly, in the first instance.[222] The process for filing a complaint under this mechanism is usually determined specifically by the financial service or credit providing entity, although every IDR process needs to comply with the general standards and requirements made or approved by the ASIC.[223] For this purpose, the Australian Standard Customer Satisfaction Guidelines for complaints handling along other such relevant documents are taken into consideration by the ASIC, while assessing the requirements and standards of an IDR in the context of a particular entity.[224] It is pertinent to mention in this context that under the general procedure for filing a complaint, the complaints or disputes are not required to be filed in writing and could be via phone (i.e. a toll-free or local call fee facility), email or through a letter to the complaint-desk of the entity. There are some additional features assisting the consumer in filing of complaints. For instance, there are specific tips provided to consumers, wherein user-friendly and everyday issues faced by a consumer while making a complaint are provided for the benefit of the consumer through general and specific guidance pointers. These pointers endeavour to assists the consumer in (1) identifying reasons for making the complaint; (2) organising his or her thoughts on his or her expectations from the dispute resolution process; and (3) reducing the chances of errors on the part of the consumer, while filing a complaint through simple tips of the complaint mechanism itself.[225]

Also, sample templates of complaint are provided for the benefit of the consumers, specifically indigenous consumers. These templates are helpful for filing complaints, as they provide the

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[220] CFPB Annual Report

[221] See Section on 'How to complain', website of Money Smart (ASIC Initiative for Consumer Accessibility), available at <https://www.moneysmart.gov.au/tools-and-resources/how-to-complain>, last visited on 28th May, 2015.

[222] ASIC Regulatory Guide 165 on Licensing: Internal and external dispute resolution, available at <http://download.asic.gov.au/media/1240913/rg165-published-13-june-2013.pdf>, last visited on 28th May, 2015 ("**ASIC Regulatory Guide 165**")

[223] *Ibid.*

[224] *Ibid.*

[225] See Section on 'You can complain', website of Money Smart, available at <https://www.moneysmart.gov.au/tools-and-resources/publications/you-can-complain>, last visited on 28th May, 2015.

consumer with general guidance on the individual details that he or she is required to put into a complaint, along with the structure and content of the complaint when filed in plain paper.[226]

The general time-frame under which a final response to the complaint is due to be made by the relevant entity to the complainant is 45 days, although in the case of traditional services complaints and certain types of credit disputes, such time frames vary.[227] The process of IDR is considered to be an important and necessary first step in the disputes handling process since it gives the financial service or credit provider, an opportunity to hear client concerns and address them genuinely, efficiently and effectively.[228] Through this process, the IDR mechanism can also assist in improving business systems and services, which form an integral part of a successful business venture.

In the instance that the consumer is dissatisfied with the outcome of the IDR process, he or she can seek help from an independent Ombudsman under the ASIC approved EDR scheme. The said ombudsman received 31,680 disputes in 2013-2014. [229] In the context of EDR, every financial service or credit provider is required to subscribe to one or more ASIC-approved EDR schemes that covers, or together cover, complaints and disputes made by in relation to the services they provide under the Corporations Act and the Consumer Credit Act respectively.[230] In this regard, it is pertinent to mention that some EDR schemes are limited in coverage to a particular industry, thereby requiring the relevant entity that is subject to the dispute resolution, to join more than one scheme to meet its EDR obligations.

The Financial Ombudsman Service (deals with financial services disputes including banking, credit, loans, general insurance, life insurance, financial planning, investments, stock broking, managed funds and pooled superannuation trusts), the Credit and Investments Ombudsman (CIO) (deals with financial services disputes credit unions, building societies, non-bank lenders, mortgage and finance brokers, financial planners, investment managers, debt services and a wide range of other financial services and product providers) and the Superannuation Complaints Tribunal (SCT) (deals with pensions) are the three main examples of the ASIC approved EDR schemes that function within a specific mandate as envisaged in their terms of reference.[231]

It is pertinent to mention that there can be instances where a particular scheme is not able to deal with a complaint because of the rules under which it operates. For example, if the value of a claim exceeds the amount that the scheme is allowed to deal with under its rules (e.g. under the CIO and Financial Ombudsman Service schemes, disputes that involve claims that exceed the scheme's monetary limit of $500,000 i.e. INR 3 crore fall outside the purview of both

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[226] See Section on 'Make a complaint', website of Money Smart, available at <https://www.moneysmart.gov.au/life-events-and-you/indigenous/make-a-complaint>, last visited on 28th May, 2015.

[227] ASIC Regulatory Guide 165

[228] ASIC Regulatory Guide 165

[229] Financial Ombudsman Service Annual Review 2013-2014, available at <http://www.fos.org.au/custom/files/docs/20132014-annual-review.pdf>, last visited on 28th May, 2015.

[230] ASIC Regulatory Guide 165

[231] See Section on 'Dispute resolution', website of the ASIC, available at <http://asic.gov.au/regulatory-resources/financial-services/dispute-resolution/>, last visited on 28th May, 2015.

schemes)[232] or a dispute relates to a business (commercial) decision of a financial services or credit provider – such as the decision to charge a certain interest rate and such other criteria. To tackle these issues, each scheme publishes its rules and information about how it decides if it can deal with individual complaint on its websites.

In the context of the EDR schemes certain complaints are liable to be rejected on account of the existence of both technical and general grounds. Certain degree of discretion is permitted to be exercised by the bodies operating under the EDR schemes for rejecting such complaints[233]. The general grounds for rejection of a complaint under some of the EDR schemes (mainly the Financial Ombudsman Service and the CIO) include the following grounds[234]:

- Issues or disputes regarding a cause of action that has been previously settled by either one of the ASIC approved EDR schemes or by Court or by an arbitrator;
- Claims that fall outside pecuniary limit of the relevant EDR scheme;
- Claims that are made after the elapse of the limitation period as determined under the relevant EDR scheme;
- Claims where the applicant is a member of a group of related bodies corporate, where the group has in excess of 20 employees (or 100 employees in the case of a manufacturing group) (ground before the FOS only);
- Claims are frivolous or vexatious or lacking in substance; or
- There is a more appropriate place to deal with the Dispute, such as a court, tribunal or another dispute resolution scheme or the Privacy Commissioner.

The aforementioned grounds are supplemented by technical grounds, wherein a complaint is liable to rejected if it pertains to a subject-matter that is not covered by the relevant EDR scheme or is covered under a different procedural framework in another sector.[235] Every scheme also uses different approaches to deal with an individual's complaint, which ranges from negotiation between the parties or conciliation or mediation that may lead the parties to find a mutually agreed resolution.[236] The resultant remedies of the dispute resolution process include a variety of actions depending upon the scheme in question. For example, in a dispute

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[232] Rules of the Credit And Investments Ombudsman, available at <http://www.cio.org.au/cosl/assets/File/CIO%20Rules%209th%20Edition%20(18%20December%202014)(1).pdf>, last visited on 28th May, 2015 ("**Rules of the Credit and Investments Ombudsman**");

Section on 'Terms of Reference', website of the Financial Ombudsman Service, available at <http://fos.org.au/custom/files/docs/fos-terms-of-reference-1-january-2010-as-amended-1-january-2015.pdf>, last visited on 28th May, 2015 ("**Terms of Reference of the Financial Service Ombudsman**")

[233] *Ibid.*

[234] ASIC Regulatory Guide 165; See also ASIC Regulatory Guide 139 on Approval and oversight of external dispute resolution schemes, available at <http://download.asic.gov.au/media/1240742/rg139-published-13-june-2013.pdf>, last visited on 28th May, 2015.

[235] *Ibid.*

[236] See Section on 'External dispute resolution - what to do if you are dissatisfied with a decision', website of ASIC, available at <http://asic.gov.au/about-asic/contact-us/how-to-complain/external-dispute-resolution-what-to-do-if-you-are-dissatisfied-with-a-decision/>, last visited on 28th May, 2015.

resolution process under the Financial Ombudsman Service, the ombudsman can ask the Financial Services Provider or the Applicant to undertake the following courses of action[237]:

- payment of a sum of money;
- forgiveness or variation of a debt;
- release of security for debt;
- repayment, waiver or variation of a fee or other amount paid to or owing to the Financial Services Provider or to its representative or agent including the variation in the applicable interest rate on a loan;
- reinstatement or rectification of a contract;
- variation of the terms of a Credit Contract in cases of financial hardship;
- meeting of a claim under an insurance policy by, for example, repairing, reinstating or replacing items of property; and
- In the case of a Dispute involving a privacy issue with an individual, the Financial Services Provider should not repeat conduct on the basis that it constitutes an interference with the privacy of an individual or should correct, add to or delete information pertaining to the Applicant.

In the dispute resolution process under the CIO, the ombudsman can ask the Financial Services Provider to undertake the following courses of action[238]:

- payment of a sum of money, including compensation;
- variation or waiver of a debt;
- entering into a payment arrangement to repay a debt;
- release or return of security for a debt;
- repayment, waiver or variation of a fee or other amount paid to or owing to the financial services provider or its representative or agent, including the variation of the applicable interest rate on a credit facility;
- discontinuation of enforcement action against the complainant;
- In relation to a default judgment, staying the execution of the default judgment or not enforcing the default judgment;
- release of the complainant from a contract; and
- variation of the terms of a credit facility in cases of financial hardship.

The ASIC gets involved in enforcement action only in instances where the breaches of the law that fall within the purview of its competence, are brought to its attention through (1) reports of misconduct from members of the public; (2) referrals from other regulators; (3) statutory reports from auditors, insolvency practitioners and licensees; and (4) through ASIC's own

[237] Terms of Reference of the Financial Service Ombudsman

[238] Rules of the Credit and Investments Ombudsman

monitoring and surveillance work.[239] It is pertinent to note however, that the ASIC doesn't take follow-up action over each and every matter that comes to its notice. The criteria through which the ASIC decides to take follow-up action in a particular matter, ranges from (1) strategic significance of the matter (e.g. what is the extent of harm or loss?); (2) the larger benefits of pursuing such misconduct (e.g. is enforcement cost-effective?); and (3) issues specific to the case that include the seriousness of the misconduct (e.g. was it dishonest or deliberate, or did it lead to widespread public harm), the time elapsed since such conduct occurred and such other criteria.[240] In the instance that an alternative dispute resolution procedure is available through another agency, the ASIC is less likely to take up the investigation that would be better addressed by such agency. The remedies resorted to, for enforcement by the ASIC include punitive action (prison terms, court orders and financial penalties), protective action (disqualification from managing a corporation, revocation of a licence and public warning notices), preservation action, corrective action, infringement notices, compensation and negotiation.[241] For filing a complaint with the ASIC, the individual or entity has to report the misconduct through procedure as mentioned on the ASIC website.[242] Under this procedure, the complainant is required to answer questions surrounding the allegations of misconduct.

C. Recommendations

The dispute redressal process for financial products governed by the RBI is also two phased ations of misconduct. mentioned on the ASIC website.vestigation [243] , regional rural banks[244] and primary urban co-operative banks[245] are required to have in place an adequate grievance redressal mechanism, and then approach the banking ombudsman under the Banking Ombudsman Scheme, 2006[246] (applicable to commercial banks, regional rural banks and scheduled primary co-operative banks and NBFCs (for the loan part)) [247] in case of unsatisfactory or no response from the banks within the prescribed time limit. All banks have a system in place in respect of analysis of consumer complaints and its disclosure. However, a

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[239] ASIC Information Sheet 151 on ASIC's approach to enforcement, available at <http://download.asic.gov.au/media/1339118/INFO_151_ASIC_approach_to_enforcement_20130916.pdf>, last visited on 29th May, 2015.

[240] *Ibid.*

[241] *Ibid.*

[242] Section on 'Report misconduct to ASIC', website of the ASIC, available at <http://asic.gov.au/about-asic/contact-us/how-to-complain/report-misconduct-to-asic/>, last visited on 29th May, 2015.

[243] Master Circular on Customer Service in Banks, RBI/2014-15/72 dated 1st July, 2014, available at <https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=9008> last visited on 29th May, 2015.

[244] RBI Notification No. RPCD.CO.RRB.BC.No.100 / 03.05.33/2013-14, RBI/2013-14/589, available at <http://rbidocs.rbi.org.in/rdocs/notification/PDFs/FCRB1205014F.pdf>, last visited on 29th May, 2015.

[245] Master Circular on Customer Service – UCBs, RBI/2014-15/26 dated 1st July, 2014, and Available at <https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=8981> last visited on 29th May, 2015.

[246] Issued under Section 35A, BR Act

[247] RBI Banking Ombudsman Scheme, 2006, available at <http://rbidocs.rbi.org.in/rdocs/Content/PDFs/67933.pdf>, last visited on 29th May, 2015; Section on 'FAQs', website of the RBI, available at <http://rbi.org.in/scripts/FAQView.aspx?Id=24>, last visited on 29th May, 2015.

review of the complaint procedures of a few banks[248] reveal that in the period of one month of filing of a complaint with the bank in the first phase, almost all banks have created a three tier or sometimes a four tier procedure for resolution of complaints, meaning thereby that at the first level, a complaint can be filed by any mode (e-mail, online application, phone, visit, message) to the bank and a response is expected within 10 days, failing which usually a written application needs to be filed with the nodal officer and again a response is expected within 10 days, failing which a further application requires being made to the principal / regional nodal officer and if the response is not received within 10 days, the ombudsman may be approached. Such a multi-layered process is inefficient as it involves paperwork and duplication of effort on the part of the complainant, and may lead to dissatisfaction and frustration as it requires to make the same complaint thrice or even four times within a short span of 30 days, and if unresolved, make a complaint to the ombudsman again.
The Annual Report (2013-14) of the Banking Ombudsman states that 96% of the complaints received (approx. 76,500 complaints received) have been disposed of. Under the ombudsman scheme, complaints can be filed by consumers on 27 listed grounds which cover deficiencies in almost any banking service including issues related to credit cards, internet banking, deficiencies in providing promised services by both the bank and its sales agents, levying service charges without prior notice to the customers, non adherence to the fair practices code adopted by individual banks and non-adherence to BCSBI's code of bank's commitment to customers.[249]

As mentioned above, the complaint first has to be filed with the branch bank, and if no satisfactory response is provided or there is no response within a month of filing the complaint, then the banking ombudsman has the jurisdiction to entertain a complaint. The ombudsman is a designated senior officer (general manager or senior general manager of RBI) appointed by the RBI. Till date, there are 15 such ombudsmen in the country, and a complaint can be filed to them on a plain paper with all relevant information or the format contained in Annexure A of the Banking Ombudsman Scheme and sent through post/Fax/courier. For net-savvy bank customers the complaint can be sent through e-mail or lodged through online complaint form kept on the web site of the RBI. Complaints filed to the RBI or the central government directly are referred to the ombudsman and dealt by him. A very small number of complaints are also received through the Centralised Public Grievance Redress and Monitoring System (CPGRAMS) which is a universal grievance redressal system for general complaints in all spheres. It is pertinent to point out that an overwhelming number of complaints are from the metropolitan and urban areas i.e. 71% of the complaints in 2013-14.

The banking ombudsman first attempts settling the dispute through agreement between the bank and the customer through mediation and conciliation by a summary proceeding. If the same is not possible within the prescribed time limit, he can reject the complaint or give an award (i) giving direction to the banks for specific performance of its obligations and / or (ii) granting compensation. The maximum compensation that can be ordered is the actual loss as a direct consequence of the act / omission of the bank or INR 10 lakh, whichever is lower. In case of credit cards, an additional INR 1 lakh can be awarded for harassment / mental anguish.

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[248] The banks include Axis bank, ICIC bank, HSBC bank, HDFC bank and SBI.

[249] Annual Report of the RBI, 2013-2014, available at <http://rbidocs.rbi.org.in/rdocs/AnnualReport/PDFs/RBIARE210814_FULL.pdf>, last visited on 29th May, 2015 ("**RBI's Annual Report, 2013-14**").

Either of the party can appeal the award of an ombudsman, the appellate authority being the Deputy Governor, with the CPED being its secretariat.

It is important to note that the ombudsman can reject the complaint at any stage on the following statutory grounds –

- Complaint not covered under the 27 grounds;
- Complaint made to ombudsman has been made directly without exhausting the redressal mechanism directly with the banks;
- The relief asked for is beyond the pecuniary jurisdiction of the ombudsman;
- The complaint requires consideration of elaborate documentary and oral evidence which is not appropriate to be handled in proceeding before the ombudsman;
- It is not pursued by the complainant with reasonable diligence;
- in the opinion of the Banking Ombudsman there is no loss or damage or inconvenience caused to the complainant;
- Complaint made beyond a period of one year after unsatisfactory response from the bank, or where no response is give, complaint is made beyond one year and one month after the date of the representation to the bank;
- Frivolous or vexatious in nature;
- Is in respect of the same cause of action which was settled in a previous proceedings by the ombudsman or is pending as a legal proceeding before any court, tribunal, arbitrator or forum;
- Complaint is made beyond the limitation period under the Indian Limitation Act, 1963.

In *Jose v Indian Overseas bank*[250], a compensation to the tune of INR 1 crore was claimed for loss suffered by the petitioner on account of a default in relation to an overdraft facility. The complaint was rejected by the ombudsman as being outside the pecuniary jurisdiction, and the High Court of Kerala upheld the said rejection. The court stated that if the petitioner filed a fresh complaint within the four corners of the scheme, then it may be admitted by the ombudsman. In *Durga Hotels v Reserve Bank of India*[251] the Supreme Court held that the jurisdiction of an ombudsman is divested if at the time or even after filing of the complaint to the ombudsman, a legal proceeding is pending or initiated in any other forum. The rationale being that the ombudsman is an alternative to the adversarial system for resolution of disputes and the adversarial process stands on a higher footing, and thus the legislative intention appears to be to ensure that the relief an Ombudsman may give, may not conflict with a more comprehensive adjudication by a court, arbitrator, tribunal or forum with wider powers. Therefore, the courts also take a narrow interpretation of the powers of the ombudsman, and it is doubtful that the powers of the ombudsman as circumscribed by the scheme will be liberally interpreted to provide functional flexibility.

As per the latest annual report, 43% of the complaints were not maintainable due to the above stated reasons, and out of the 57% maintainable complaints, 56% of the complaints were rejected / withdrawn and the major reasons for rejection of maintainable complaints were[252] –

- The amount of compensation claimed was outside the pecuniary jurisdiction of the banking ombudsman;

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[250] WP(C).No. 20143 of 2011(P) dated 3rd August, 2011

[251] AIR 2007 SC 1467

[252] RBI's Annual Report, 2013-14

- The complaints required consideration of elaborate documentary and oral evidence and the proceedings before the banking ombudsman are not appropriate for adjudication of such complaints;
- complaints without sufficient cause;
- complaints where no loss or damage or inconvenience is caused to the complainant.

The most common reason for rejection in descending order were - the subject matter of the complaint not falling within the grounds envisaged under the scheme, first resort complaints, complaints without sufficient cause, complaints requiring elaborate evidence, outside territorial limits, beyond pecuniary jurisdiction, incomplete application etc.

With the multi-layered complaint redressal mechanism intrinsic to the banks and financial institutions, the delays and the inefficiencies increase, and the general non-responsiveness of banks to complaints does not paint a favourable picture in respect of the prevalent dispute resolution mechanism. Taking cue from the international practices as discussed above, the structure of the complaint redressal mechanism as allocated between the banks / financial institutions and the ombudsman requires an overhaul, giving greater prominence to the regulator's role i.e. the RBI in the process. The following complaint redressal mechanism is proposed and it is pertinent to mention that the requirement for having in place the below-mentioned complaint redressal mechanism should apply to all banks, including co-operative banks, which are presently excluded from such a requirement.

I. *The first point of contact for 'filing' of the customer complaint should be the RBI, as opposed to the banks / financial institutions. For this purpose, a complete refurbishment of the RBI's infrastructure in relation to complaint filing and handling may require to be undertaken on the lines of the CFPB. The incorporation of the following services / features will result in a hassle-free, easy to understand and smooth complaint filing process –*

   i) *<u>Modes of filing a complaint</u>*

      (1) *A toll free hotline telephone number(s) which may be utilized by the customers for inquiries as well as for filing complaints. The staff should be trained to capture the relevant information for recording and filing a complaint, or for assisting the customer in filing the complaint in any other mode. In the former scenario, where the complaint is being filed through the phone, the staff should be trained and the consumer should also be made aware of noting the name, designation of the staff taking the complaint, and the date and time and details of the complaint for future reference;*
      (2) *An online portal for filing complaint should also be created;*
      (3) *A simple one page complaint form should be placed on the website of the RBI for customers to file a complaint, which may be sent through e-mail, fax, mail etc. to a designated agency within the RBI;*
      (4) *There may be a provision for filing complaint in a plain paper format, guided by a sample complaint template along with clear concise pointers laying down the necessary information to be provided.*

   (ii) *<u>Additional features</u>*

      (5) *There should be a provision for a live agent on the website who can assist the complaints in the complaint filing related queries;*

(6) The website should provide tips to the consumer for the complaint filing process as in Australia;

(7) The website should have an option for local languages and English, and should have features enabling access for disabled and senior citizen (with an option for large prints, videos and audio clips);

(8) In general, the website should be made more interactive, and the complaint filing procedure, resolution procedure, summary of the annual report or other relevant publications should be available as audio and video clips in a simple, easy to understand format;

(9) The website can also provide for a 'tell your story' option like on the CFPB website, for consumers to share their experiences with banks, which may either be positive or negative, which will serve as a resource for RBI to understand the consumer trends in financial products complaints and also as a deterrent for banks etc. to refrain from being unresponsiveness or inefficient. There should be a screening mechanism before such videos / audios are uploaded on the website.

II. *1. A system for screening of the complaints filed with the RBI should be developed, where under the screening is done on primarily four grounds –*

(1) Whether the financial product with reference to which the complaint is filed falls within the domain of the RBI, and if there is a finding to the contrary, there is a mechanism to refer the complaints to the appropriate regulator.

(2) Whether the relevant information required for the completeness of a complaint have been provided. If not, then a rejection communication should be sent to the customer, clearly stating the areas where the complaint is deficient.

(3) Whether the complaint has been filed for the first time with the RBI or whether it is a duplication.

(4) If the complaint is in substance a query or a question regarding the financial product and not a complaint of a default as such, the staff responsible for the screening should be able to utilize an internal mechanism (which also needs to be put in place) of forwarding it to the staff responsible for consumer education, and thus, this opportunity could be used to educate the consumer in relation to his query as this would qualify as an important 'teachable moment'. This may prove to be a highly efficient and appropriate way to educate consumers.

2. Post the screening process, a system should be developed for the RBI to refer / forward the complaints to the relevant bank /financial institution, and provide the bank / institution with a time limit within which the written response to the consumer complaint needs to be filed with the RBI, either online or by e-mail, mail; or fax.

3. A system should be put in place such that the response by the bank / institution is accessible or communicated to the concerned complainant, and he is also given an opportunity to give his feedback on the response received. In the event, the consumer is not satisfied with the response of the bank / institution, he has the remedy to approach the ombudsman. Therefore, in substance, the principle of an ombudsman not dealing with first time complaints remains unaltered.

4. A consumer database should be maintained on a daily basis on the RBI's website in respect of the complaints filed with the RBI, in a tabular summary

form revealing only the non-confidential information relating to product, issue, resident state of the consumer, mode of submission, relevant dates (date of receipt by RBI, date of forwarding to the business), the name of the bank / institution, the nature of the bank / institution's response, whether the response was timely and whether it was disputed by the consumer.[253]

5. *There should be a provision for checking the status / tracking the complaint on the website or through phone (through the latter, it should be preferably recorded procedure where the consumer can punch in the complaint number and get the status information).*
6. *The Banking Ombudsman Scheme, 2006 should be made more robust and amenable to the increasing financial consumer related defaults and the following amendments may be carried out –*
    - *(1) The maximum limit of compensation that can be awarded by the ombudsman is currently INR 10 Lakh which was fixed in the year 2006. Given that considerable period of time has passed since 2006, and taking into account the increased instances of default and increase in complaints due to more consumer awareness, it is proposed that an upward revision of the maximum limit may be undertaken. This will also reduce the number of cases which are rejected by the ombudsman on this ground, and reduce the outflow of cases to the court driven procedure which is very expensive.*
    - *(2) The recommendations made in respect of mode of filing complaint and additional features in point II above, should be adopted mutatis mutandis for the ombudsman scheme.*[254]
    - *(3) On the rejection of a complaint by the ombudsman, the reasons for rejection should be provided. For instance, if a complaint is rejected for it being incomplete, the deficient portion should be highlighted such that the complainant can rectify the deficiency and make a full proof complaint. Also wherever applicable, it should be mandatory to provide the related financial education material to the consumer along with the rejection.*
    - *(4) The ground for rejection of a complaint on the basis that it requires elaborate documentary and oral evidence should be deleted from the scheme, as it leads to rejection of a substantial number of complaints, and instead, the ombudsman should be empowered to deal with such complex complaints. Additionally, the CPED should be empowered to provide assistance (technical and otherwise) to the ombudsman for such complaints.*
    - *(5) A provision for checking the status / tracking the complaint on the website or through phone (preferably recorded procedure where the consumer can punch in the complaint number and get the status information) should be created.*

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[253] Please see the CFPB consumer complaint database for further clarity. Available at <https://data.consumerfinance.gov/dataset/Consumer-Complaints/x94z-ydhh?>, last visited on 29th May, 2015.

[254] Except the system which are already present under the Banking Ombudsman Scheme, 2006.

7. FINANCIAL EDUCATION

A. BACKGROUND

It is very important to understand that the most effective and immediate consumer protection is self-protection in the form of consumer education.[255] The moment a consumer is in a position to take responsible and informed financial decisions, the battle is half won. The G20 Principles and the Good Practices require promotion of financial education by all relevant stakeholders, development of appropriate mechanism, having in place a broad based financial literacy program and measurement of consumer literacy through regular surveys.

Financial education forms an essential part of the regime on consumer protection. It not only promotes financial inclusion but also demands stricter standards of accountability and transparency among financial institutions. A consumer who is financially educated makes sound decisions that protect his present and future financial interests and promote his financial growth. Hence, in light of the importance of the financial education, governments and financial sector regulators endeavour to implement comprehensive and rigorous systems of financial education in their respective jurisdictions. In this Chapter, we endeavour to bring to light innovative mechanisms of financial education that are implemented in several jurisdictions, which may of relevance for India.

B. INTERNATIONAL OVERVIEW

A review of the financial literacy efforts in jurisdictions like the UK, USA and Australia reveal that they have a national strategy in place with objectives being fundamentally similar as under the India strategy. Further, it has been noted that the basic issues in financial education for those already included in comparison to the financially excluded, are not different in most countries.[256] However, there are some relevant characteristics in the financial education strategies of the above mentioned jurisdictions and otherwise, which may be plugged into the Indian scenario, to make the regime even more robust and effective, which will be discussed below.

In the US and Australia, the approach of the regulator has been to provide the consumers education, tools and other relevant help when they are most willing and open to learn about financial decision making. The education initiatives have to be developed so as to reach the consumers at the key moments of their financial lives - going to college, retirement or buying a house / car, starting a business etc. The Action Plan 2014-17[257] in Australia also provides for taking actions that target people at key life stages or when their personal circumstances change. These may be referred as the 'teachable moments' and it is extremely important for the national

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[255] See Section on 'Consumer Financial Protection Bureau Unveils Approach to Financial Education', website of CFPB, available at <http://www.consumerfinance.gov/newsroom/consumer-financial-protection-bureau-unveils-approach-to-financial-education/>, last visited on 29th May, 2015.

[256] National Strategy for Financial Education dated 16th July, 2012 available at < https://www.rbi.org.in/scripts/PublicationDraftReports.aspx?ID=675> last visited on 3rd June, 2015

[257] ASIC National Literacy Strategy 2014-2017: Action Plan, available at <http://www.financialliteracy.gov.au/media/546588/report-404_national-financial-literacy-strategy-2014-17_action-plan.pdf>, last visited on 3rd June, 2015.

strategy of a country to be focussed on these teachable moments, as a consumer may not be as receptive to financial education in his or her day to day life.

The national strategies also provide for customised approach towards the vulnerable, underserved or minority sections of the society like senior citizens, women, tribals, students etc.

Additionally, in the US for instance, the CFPB has undertaken certain innovative step to increase consumer literacy by launching a nationwide effort in collaboration with national and local organisations to impart training to consumers based on customised online tool kits prepared by the CFPB which provide a detailed roadmap for the content (PPTs etc.) and the strategy (implementation guide, webinars, follow up resources in form of surveys) to be adopted for imparting financial education. The campaign is known as *'Your Money, Your Goals'* and requires the frontline staff and volunteers in social services, legal services organisation, community and faith-based organizations, non-profit organisations and worker organizations to provide help to their clients by sharing information and tools that build financial empowerment, by taking advantage of their unique position to do so. Separate tool kits for each category are available online free of cost[258], and the incentive being that the benefits of financial empowerment flow to the people served as it increases their financial stability, may help in the achievement of the goals of the organisation whose people are being trained, result in thriving communities and neighbourhoods and ultimately also helps the trainers themselves being financially educated and thus become competent to identify financial issues.[259]

CFPB has also launched customised toolkits called paying for college, owning a home, money smart for older adults, the name itself clarifying the target group. These toolkits help the target customers to plan ahead by providing for various tolls, for instance, in the case of paying for college, the tools address the entire lifecycle of financing college, from comparing college costs and financial aid offers, to shopping for a loan, through assessing options to repay student loan debt after graduation. The US regime also provides for a webpage with consolidated checklists that may be relevant for consumers as quick guides for documents to be made available when in an emergency (like natural disasters, hurricanes etc.), taking a car loan, preparing for college education, when recovering from identity theft / fraud etc.[260] It is also helping the customers ask questions on an online portal called 'AskCFPB'[261] which contains answers to1000 most commonly asked questions.

The CFPB has initiated *'Know Before you Owe'* project using interdisciplinary expertise, to make the costs, risks, and benefits of financial products and services easier for consumers to understand. For instance, in respect of mortgages, it combined the four key mortgage disclosures into two easier to use forms for application and closing stage by conducting

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[258] Section on 'Your Money, Your Goals', website of the CFPB, available at <http://www.consumerfinance.gov/your-money-your-goals/>, last visited on 4th June, 2015.

[259] "Your Money, Your Goals: An Implementation Guide", CFPB, available at <http://files.consumerfinance.gov/f/201504_cfpb_ymyg_implementation-guide.pdf>, last visited on 4th June, 2015.

[260] http://www.consumer.ftc.gov/media , last visited on 2nd June, 2015

[261] Section on 'ASK CFPB', website of CFPB, available at <http://www.consumerfinance.gov/askcfpb/>, last visited on 4th June, 2015.

extensive consumer and industry research, analysis of public comment, and public outreach for more than a year.[262] In respect of credit cards, it developed a prototype credit card agreement easier for the consumer to understand, and the student loans project which aimed at creating a financial aid shopping sheet which colleges and universities could use to help students better understand the type and amount of grants and loans they qualify for. It also could be used to help students easily compare aid packages offered by different institutions.[263]

In Australia, the ASIC's MoneySmart website is the hub for free impartial consumer education which attracts over 4,00,000 visitors a month, with 26% of the adult population being aware about the website. The use of social media platform by this website has been tremendous as is evident from the figures - over 26,000 facebook fans and more than 4,900 Twitter followers and in 2013–14, MoneySmart's 265 YouTube videos were viewed over 69,000 times.[264] In comparison to this, the website of National Centre for Financial Education ("NCFE") which is the agency in India responsible for implementation of the national strategy on financial education has only 8 videos on consumer education[265] and its presence on social media is dismal.

In other countries like China, consumer education initiatives were spread through contests, poker cards, advertisements on buses etc., and in Hong Kong, the HKMA designated a day as HKMA fun day where kiosks are put up, the audience is educated through humorous videos; stage performance by well known artists are used to disseminate educational messages in a lively and interactive manner and games are played with audience to bring out smart tips; information panels, game booths, audio kiosks and photo booths with interesting illustrations are also utilised.[266]

C. Recommendations

In relation to financial education in India, the banks were mandated to set up Financial Literacy and Credit Counselling centers (FLCCs) to be sponsored by a trust / fund formed by the respective banks at all levels (block, district, town and city) for urban and rural areas. However, due to various limitations in its functioning, such as lack of awareness of their existence, they being restricted to urban areas, the material provided for education being mostly marketing and

[262] CFPB Financial Literacy Annual Report (2014), available at <http://files.consumerfinance.gov/f/201407_cfpb_report_financial-literacy-annual-report.pdf>, last visited on 4th June, 2015.

[263] Section on 'Know Before You Owe: Student loans project', website of CFPB, available at <http://www.consumerfinance.gov/students/knowbeforeyouowe/>, last visited on 4th June, 2015.

[264] Annual Report of the ASIC (2013-2014), available at <http://download.asic.gov.au/media/2227467/asic-annual-report-2013-14.pdf>, last visited on 4th June, 2015.

[265] Section on 'Videos', website of the National Centre for Financial Education, available at <http://www.ncfeindia.org/videos>, last visited on 4th June, 2015.

[266] Hong Kong Monetary Authority Press Release on "HKMA Fun Day Educates the Public to be Smart Bank Consumers", available at <http://www.hkma.gov.hk/eng/key-information/press-releases/2014/20141017-6.shtml>, last visited on 4th June, 2015.

sponsoring material due to dependency of the centers on the banks for funding[267] , their activities not being outdoor in nature, it was modified providing for the following –

- Lead banks to set up 'Financial Literacy Centers' in each of the Lead District Manager (LDM) Offices and other locations as well[268] in addition to FLCCs.
- Financial literacy activities will also be undertaken by all the rural branches of Scheduled Commercial Banks including RRBs.
- Focus would be on conducting outdoor campaigns at least once a month, with focus on financially excluded population in rural areas, and such campaigns could be customized for urban areas as well.
- The compliance of the efforts taken towards achieving the above by the FLCs/branches shall be monitored by the Head/ Controlling Offices of the concerned banks through periodic reporting and surprise on site visits, and also a periodical (at least once a year) impact evaluation.
- A quarterly report on the functioning of the FLCs/branches shall be submitted by the business correspondents of the RBI to the regional office of the RBI in a prescribed format.

As of September 2013, there are 822 FLCs in the country. In pursuance of the above, the RBI came out with the Financial Literacy guide which provided for operational guidelines for holding outdoor camps[269], a financial diary which could be maintained by individuals to plan their finances[270] and various posters creating financial awareness.[271] On an overview of the regulations, it appears that the main agenda of the outdoor campaigns appears to be creating awareness on basic financial concepts, introducing the business correspondent to the people and most importantly encouraging the people open a bank account.[272] It is important to note here that as per the financial inclusion date figures of the World Bank of the year 2014[273], only 53% of the population in India has a bank account at a financial institution.

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[267] RBI Draft Report on Financial Literacy and Credit Counselling Centres (2008), available at <http://www.rbi.org.in/scripts/PublicationDraftReports.aspx?ID=526>, last visited on 29th May, 2015.

[268] Index to RBI Circulars: Financial Literacy Centres (FLCs) – Guidelines, available at <http://www.rbi.org.in/scripts/BS_CircularIndexDisplay.aspx?Id=7259>, last visited on 29th May, 2015.

[269] RBI Financial Literacy Guide (2013), available at <http://rbidocs.rbi.org.in/rdocs/content/pdfs/GUIDE310113_F.pdf>, last visited on 30th May, 2015.

[270] RBI Financial Diary (2013), available at <http://rbidocs.rbi.org.in/rdocs/content/pdfs/DIARYE310113_F.pdf>, last visited on 30th May, 2015.

[271] RBI Posters for Consumer Education, available at <http://rbidocs.rbi.org.in/rdocs/content/pdfs/POST310113_Full.pdf>, last visited on 30th May, 2015.

[272] RBI Notification on Financial Literacy activities conducted by Financial Literacy Centres and rural branches of banks – monitoring system (2014), available at <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=9089&Mode=0#a2>, last visited on 30th May, 2015.

[273] http://datatopics.worldbank.org/financialinclusion/country/india

Further, in 2012, the RBI came out with a National Strategy on Financial Education[274] which covered the ingredients of a financial education regime for a country, which would be monitored through the existing technical Group of Sub-Committee of Financial Stability Development Council on Financial Inclusion and Financial Literacy. The NCFE has been set up for implementing the national strategy which is fairly comprehensive, however, an implementation of the components therein in an aggressive manner will definitely lead to a jump in the financial education level in the country. The strategy provides for conduct of a nation-wide sample survey for assessing the state of financial inclusion and financial literacy which will assess the level of financial inclusion, level of financial awareness about various financial products, level of financial competency to make informed decisions, people's attitude towards money as well as their attitude towards risk taking[275], which is being conducted.[276] The RBI has implemented some innovative methods to create awareness like conducting RBI quiz on history and banking and finance related topics[277], opening permanent galleries on financial literacy (like in Chennai[278] which is digital in nature) etc., the NCFE conducted a national financial literacy assessment exam for school children to assess their literacy levels, and provides for games on its website to promote financial education, however the focus and the aggression required for better results for people in rural and urban areas still appears to be lacking as is evidenced from the lack in visibility of the NFCE in social media which is a very efficacious mechanism of awareness in this age.

Though the financial education strategy and programmes conducted by the RBI are robust, however, the following initiatives may be inculcated into the system to produce better results -

- *The national strategy should introduce in a clear manner the strategy (to be followed by the RBI as well as all the banks) to provide consumer education to consumers at the most opportune or 'teachable moments' to have the maximum impact i.e. co-inciding with the big financial decisions of a consumer's financial life. Such a focussed strategy requires (i) the RBI to have ready for public consumption financial education material relevant for such stages in a person's life on its website and otherwise, in the nature of customised tool kits as discussed above (for pay for college, owning a home , marriage , retirement etc.); and (ii) the banks to be efficient and responsible in providing the customers the relevant education material at the teachable moments as they would inevitably be foremost in being aware of the important decisions in a person's financial life.*
- *The strategy should also include an obligation to make the financial education material and the website of the RBI and banks to be disabled friendly, by having audio clips and information readily available in braille, so as to financially include not only senior citizens, students but also the disabled population.*

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[274] RBI Draft Report on National Strategy for Financial Education (2012), available at <http://www.rbi.org.in/scripts/PublicationDraftReports.aspx?ID=675>, last visited on 30th May, 2015.

[275] "National Strategy for Financial Education", Press Information Bureau of the Government of India (16 July, 2012), available at <http://pib.nic.in/newsite/mbErel.aspx?relid=85358>, last visited on 30th May, 2015.

[276] Please see at <http://www.ncfeindia.org/national-survey>, last visited on 30th May, 2015.

[277] "RBI sets up permanent gallery on financial literacy", Economic Times (5th Sept., 2014), available at <http://articles.economictimes.indiatimes.com/2014-09-05/news/53601944_1_financial-literacy-permanent-gallery-reserve-bank>, last visited on 4th June, 2015.

[278] *Ibid.*

- *The website of the RBI should become more interactive , as suggested in the previous chapters, and the related websites like that of the NCFE may become more qualitative in content by including the following initiatives - (i) a page containing checklist of financial information / documents to serve as ready reckoners for consumers to refer to when preparing for emergencies (natural disasters), taking a car loan, preparing for college etc. (ii) a project on the lines of the Know Before You Owe which provides for prototypes of financial documents like credit card agreement, mortgage agreements etc., has comparison features for loans, mortgages to aid financial shopping by making consumers aware of the amount, type and different financial products available for them (iii) provide for comprehensive self-help tool kits for managers of social organizations, legal organisations, worker organisations , community and faith based organisations to impart financial training, which should be free of cost, available online or otherwise readily available in all languages (iv) have more videos imparting financial educations on various topics like what do you do if you get a robocall, what if you're a victim of identity theft, dealing with debt collectors, job scams, phishing scams etc. (v) enhance the social media connectivity by having a presence on Facebook, Twitter, LinkedIn, YouTube and other social media platforms;*
- *The RBI and NCFE should utilize all modes of communication with the consumers, including (i) holding meetings on fixed days in fixed slots (which may be put up on the website, and which may be a permanent feature), wherein consumer may walk in to interact with designated people to increase their understanding or clarify doubts on various aspects of the consumer protection regime; (ii) holding consumer days like the HKMA as discussed above, incorporating the fun element to attract more consumers, including younger consumers; (iii) contests and quizzes on a regular basis; (iv) road shows etc. The agenda should be to leave no stone unturned to reach out to consumers and educate them financially, and thus get more aggressive in pursuing the goal of consumer education, with special focus on the underserved consumers.*

SECTION II

8. ENFORCEMENT POWERS

This Section makes a case for reforming RBI's enforcement powers. The discussion in this Section is not just relevant for the consumer protection regime, but for all matters subject to RBI's jurisdiction.

A. RESERVE BANK OF INDIA ACT, 1934

The Reserve Bank of India Act, 1934 ("**RBI Act**") sets out in its preamble, the objective of the RBI and lays down the formulation, framework and institutional structure that govern the RBI.[279] The RBI Act along with the BR Act is the umbrella act governing the RBI and banking and financial sector in India.[280]

Chapter V of the RBI Act lays down the penalties that can be imposed under the RBI Act. Under Section 58B (1) of the RBI Act, the wilful falsifying or omission of a material statement is subject to penalty, both by way of imprisonment extending up to three years and imposition of a fine.[281] Furthermore, Section 58B (2) of the RBI Act, provides that any person who fails to produce any book, account or document or fails to furnish any statement, information or particulars is liable to be punished with a fine which may extend to two thousand rupees in respect of each offence and a fine of one hundred rupees, for every day that the offence continues.[282] There are also specific penalty amounts and imprisonment sentences specified for contravention of certain other provisions under the RBI Act under Section 58B.[283] Section 58C of the RBI Act provides for the consequences of an offence committed by a company, including the individuals who may be held responsible for such contravention.

However in light of the 2012 amendments to the BR Act (discussed below), these provisions set out in the RBI Act seem to be inconsistent with the BR Act. Under Section 58B (1) of the RBI Act, no limit has been laid down with respect to the quantum of fine to be imposed whereas the 2012 amendment provides for stringent penalties for the same offence, which includes imprisonment for a term which may extend to three years or with a fine which may extend to one crore rupees or with both. Further Section 58B (2) is also inconsistent with respect to the quantum of fine to be imposed, the RBI Act lays down a penalty of two thousand rupees in respect of each offence and if the offence persists, a fine of one hundred rupees for each day the offence continues whereas the 2012 amendment provides for a penalty which may extend to twenty lakh rupees for each offence and if the offense persists, a fine of fifty thousand rupees.

Furthermore, Section 58E of the RBI Act provides that that no court shall take cognizance of any offence punishable under the RBI Act, except upon a complaint made by an Officer of the

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[279] "Communication Policy of the Reserve Bank of India", *available at* <http://rbidocs.rbi.org.in/rdocs/Content/PDFs/86806.pdf. > last visited on 10th July, 2015.

[280] "Reserve Bank of India: Functions and Working", available at <http://rbi.org.in/scripts/AboutusDisplay.aspx.> last visited on 10th July, 2015.

[281] Section 58B(1), RBI Act, *available at* <http://rbidocs.rbi.org.in/rdocs/Publications/PDFs/RBIA1934170510.pdf.> last visited on 10th July, 2015.

[282] *Id.*

[283] *See* Section 58B, RBI Act

RBI.[284] In light of Section 58E, it is necessary for the RBI to ensure that any and all offences and contraventions under the RBI Act are strictly enforced and the necessary complaint is made to the court. In this regard the RBI, may consider appointing an Officer in each Regional Office having expertise in both law and finance, for the purpose of bringing complaints of offences under the RBI Act before the court.

It should also be noted that Section 58G of the RBI Act provides for penalties to be imposed by the RBI directly on NBFCs for contraventions or defaults committed by the NBFCs under the RBI Act. However, the penalty for most of the defaults is only five thousand rupees with very few exceptional defaults, where a higher penalty can be prescribed.[285]

B. Banking Regulation Act, 1949

The BR Act was amended in 2012**,** wherein a significant enforcement power was granted to the RBI under Section 36ACA. The RBI is now empowered to supersede the Board of Directors of a banking company where the RBI, in consultation with the Central Government, is satisfied that to do so is necessary in public interest, to prevent the affairs of any banking company being conducted in a manner detrimental to the interest of the depositors or for securing the proper management of any banking company.

While elaborate procedures have been laid down whereby an experienced Administrator would be appointed to run the company until a new Board is reconstituted[286], in the instance there exists a vacant position in the office of a banking company that is likely to adversely affect the interests of the company, the RBI has the power to appoint the Chairman of the banking company.[287] In the interest of the company and in public interest, the RBI is also vested with the power to render advice or assistance to banking companies, impose specific directions on banking companies by means of an order in writing, and appoint and remove directors or managerial staff of the banking company under the circumstances listed in the BR Act.[288]

Under Section 46(1) of the BR Act, the penalty imposed for making wilful, false statements of material facts or wilful omissions of material fact is imprisonment which may extend to a term of three years or a fine which ay extend to one crore rupees, or both. Subsections (2) & (3) of Section 46 also specify penalties leviable for other violations such as failure to furnish books and accounts as well as accepting fresh deposits when prohibited from doing so.[289] Section 47A of the BR Act, post the Amendment, lays down the powers of the RBI to impose penalties for violations of subsections (2), (3) as well as (4) of Section 46[290] but does not allow the RBI to impose penalties with respect to Section 46(1). In this regard, the RBI's powers could be further enhanced by also allowing it to impose the penalty specified under Section 46(1). Further, the one crore rupee maximum penalty imposed could be linked to the proportion of profits realized from the contravention so as to ensure that the penalty acts as a deterrent and does not lead to situations wherein the benefits derived from the contravention are in excess of the maximum

[284] Section 58E, RBI Act

[285] *See* Section 58G(1), RBI Act

[286] Section 36ACA, BR Act

[287] Section 10-BB, BR Act

[288] Sections 36, 36-AA and 36-AB of the BR Act.

[289]Section 46, BR Act

[290]Section 47A, BR Act

penalty imposed. The RBI's powers also extend to the suspension of business and initiating winding up if certain conditions are satisfies. It can apply to the Central government for suspension of business by a banking company and to prepare a scheme of reconstitution or amalgamation in certain circumstances.[291] The scope of RBI's enforcement powers under Section 35A has been discussed in Section I of this report.

C. Foreign Exchange Management Act, 1999

The RBI's enforcement powers under the Foreign Exchange Management Act, 1999 ("**FEMA**") are well defined. A penalty of up to 3 times the sum involved is leviable in case of violations involving quantifiable amounts and a penalty of up to **two lakh r**upees is leviable in case the amounts are not quantifiable.[292] A show cause notice is to be sent to the alleged contravener who is entitled to produce documents and other evidence before the Adjudicating Authority in order to contest the allegations against him. A Directorate of Enforcement ("**ED**") has been established under FEMA for investigating the aforementioned contraventions.[293] The processes relating to investigation and search and seizure are also fairly robust and elaborate under the FEMA. An area where wider penal powers can be granted to the RBI is in the realm of Foreign Direct Investment ("**FDI**"). Two reasons underlying the restriction imposed on allowing foreign investment in particular sectors is to encourage growth and development in that particular sector domestically as well as security concerns.[294] There have been several instances where overseas funding is obtained with respect to a sector in which FDI is permitted but such funds are then transferred to another entity and used in a sector where FDI is not permitted.

The RBI can be empowered to recommend the imposition of criminal sanctions or higher penalties in order to cut out such practices including the ability to blacklist both the entities providing as well as the entities receiving such funds and using them in this manner, from the Indian market for a specified period of time. However, due caution should be exercised when doing so as to not affect the inflow of foreign investments in India by restricting such penalties to exceptional circumstances, a list of which can be prepared by the RBI.

D. Reforms suggested by the Financial Sector Legislative Commission

In March 2013, the Financial Sector Legislative Commission proposed a draft Indian Financial Code ("**Code**"). This draft law, among other clauses, also had detailed provisions relating to enforcement actions and offences.[295] It specifically identifies what enforcement actions can be initiated by a regulator, including issuance of a private warning, a public statement, a direction requiring the person to correct the violation, imposition of a monetary penalty, and variation,

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[291] Section 45, BR Act

[292] Section 13(1), Foreign Exchange and Management Act, 1999.

[293] "Directorate of Enforcement", *available at* <http://www.ceib.nic.in/ed.htm.>last visited on 10th July, 2015.

[294] "Participation of Developing Countries in World Trade: Overview of Major Trends and Underlying Factors", Committee on Trade and Development, World Trade Organization, *available at* <http://www.wto.org/english/tratop_e/devel_e/w15.htm.> last visited on 10th July, 2015.

[295] *See* Part XIII, Indian Financial Code, Report of the Financial Sector Legislative Commission, Vol. II (March 2013), *available at* <http://finmin.nic.in/fslrc/fslrc_report_vol2.pdf.> last visited on 10th July, 2015.

cancellation or suspension of any authorisation or registration granted.[296] It also enlists factors to be considered for taking an enforcement action, including the nature and seriousness of the violation; the consequences and impact of such violation; the conduct of the person after the violation; and prior offences committed by the person.[297] There are three tiers of penalties that may be imposed under this Code, depending on the culpability of the violator, with the penalties being a factor of the amount of loss caused or unfair advantage gained.[298] The Code also allows for the regulator to compensate persons affected by the violation[299] as well as an opportunity for the offenders to compound their offences on their own violation[300], similar to the FEMA structure currently in place. Finally, the Code also deals with criminal offences briefly, including offences by bodies corporate.[301]

The Code makes a laudable attempt at addressing some of the current issues in the penal provisions spread across various acts, including the low thresholds of penalties that can be imposed on huge institutions such as commercial banks. However, it does not address some of the specific concerns that may arise in relation to violations caused by financial institutions, such as imposition of a penalty for each day of continuing violation, or detailed provisions to hold senior officials of such institutions individually responsible, not only by virtue of monetary sanctions, but also banning them from working in the sector in the future to deter the mindset of such penalties just being a "cost of doing business".

The following sections discuss some international best practices.

E. UNITED KINGDOM

In the UK, the FCA is responsible for enforcement of the consumer protection regime in relation to financial products. Its approach to enforcement focuses on ensuring that consumers are protected, financial crime is deterred, and awareness of regulatory standards is heightened through publication of enforcement outcomes. There are a number of principles underlying the FCA's use of its enforcement powers.[302] They are: (i) the effectiveness of regulation depends on maintaining an *open and cooperative relationship* between the authority and the institutions being regulated (ii) the FCA seeks to exercise its enforcement powers in a way that is *transparent, proportionate, responsive* to the issue, and *consistent with its publicly stated policies* (iii) the FCA seeks to ensure *fair treatment* when exercising its enforcement powers (iv) the FCA aims to change the behaviour of the person who is the subject of its action, to *deter future non-compliance* by others, to *eliminate any financial gain* or benefit from non-compliance, and where appropriate, to *remedy the harm* caused by the non-compliance. It is valuable for the regulator to articulate these principles, because it sends a message that

[296] Section 407, Indian Financial Code, Report of the Financial Sector Legislative Commission, Vol. II (March 2013),*available at* <http://finmin.nic.in/fslrc/fslrc_report_vol2.pdf.> last visited on 10th July, 2015. ("**Indian Financial Code**")

[297] Section 408, Indian Financial Code

[298]Section 409, Indian Financial Code

[299]Section 410, Indian Financial Code

[300]Section 411, Indian Financial Code

[301]Sections 415-418, Indian Financial Code

[302] Financial Conduct Authority, "The Enforcement Guide" (1 April 2014), para 2.2 (hereafter, 'FCA Enforcement Guide').

enforcement is intended to deter financial crime, without discouraging investment.

The FCA emphasizes that every breach of the relevant legal requirements by firms or individuals does not prompt disciplinary or enforcement action.[303] In many cases, it decides against taking formal disciplinary action on the expectation that the firm will take remedial measures to address the regulator's concerns. The FCA conducts thematic work on certain priority industry areas, and concentrates its enforcement action in these areas.[304] However, it also pursues enforcement action in cases that fall outside its priority areas when it believes that such action is necessary to ensure deterrence against financial crime.[305] In the context of unauthorized activities carried out by firms, the FCA's focus is on using its investigation and enforcement powers to protect the interests of consumers.[306]

The FCA may be informed of possible contraventions by referrals from the public, firms, or other statutory authorities; or through its own enquiries. Further, firms may bring their own contraventions to the FCA's notice.

1. Use of information gathering and investigation powers

The FCA has several powers to gather information and appoint investigators. Under section 165 of the FSMA, 2000 it can require firms to supply information and documents to support its supervisory and enforcement functions. It also has the power to require a firm and certain other persons to provide a report by a skilled person. It may also appoint a skilled person itself to produce such a report.[307] The FCA encourages firms to conduct their own investigations in anticipation of the enforcement action and share the outcome with the FCA.[308] This is something that the FCA may take into account in deciding what action to take, if any. However, in some circumstances (such as criminal investigations, where suspects could be alerted), the FCA prefers for the firm not to commission its own investigation.[309]

2. Conduct of investigations

In certain situations, the FCA is statutorily bound to give notice of the appointment of investigators to the person or firm being investigated.[310] In some cases (such as investigations into insider dealing and market abuse), the investigator may not know the identity of the perpetrator. Here, the FCA will give an indication of the nature and subject matter of its investigation to those who are required to provide information to assist with the

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[303] FCA Enforcement Guide, para 2.4.

[304] For instance, the FCA recently conducted a thematic review into how small wholesale insurance intermediaries manage their bribery and corruption risk. Available at <http://www.fca.org.uk/news/tr14-17-managing-bribery-and-corruption-risk-in-commercial-insurance-broking>, last visited on 10th July, 2015.

[305] FCA Enforcement Guide, para 2.8. This is in relation to the FCA's enforcement action against Firms and approved persons, market abuse cases and listing matters.

[306] FCA Enforcement Guide, para 2.13.

[307] FSMA 2000, s 166.

[308] FCA Enforcement Guide, para 3.17, 3.18.

[309] FCA Enforcement Guide, para 3.23.

[310] FSMA 2000, s 170.

investigation.[311] The FCA has the power to apply for a search warrant to enter premises where documents or information is held. This may be done when a person on whom an information requirement has been imposed fails to comply with it, or where there are reasonable grounds for believing that if an information requirement were to be imposed, it would not be complied with, or that the documents or information to which the information requirement relates, would be removed, tampered with or destroyed.[312] Before the FCA sends a report to the Regulatory Decisions Committee, a preliminary findings letter and preliminary investigation report is sent to the firm being investigated.

3. Settlement

The FCA resolves a large segment of its cases through settlements with parties. Settlement decisions may take place during any part of the enforcement process so long as the parties agree to do so.[313] Senior management of the FCA take decisions on settlements.[314] However, as the FCA notes in its enforcement guide, these settlements are not identical to 'out of court' settlements in a commercial context.[315] When deciding whether to offer a settlement, the FCA bears in mind its statutory objectives, whether the settlement would produce an acceptable regulatory outcome, and the interests of the consumers. It is important to note that FCA settlements normally give rise to a final notice or supervisory notice, which receives some degree of publicity. In this way, such settlements can *contribute to the objective of general deterrence, while preserving the resources of the enforcement authority.*

Further, the FCA does not engage in detailed settlement discussions unless it has a sufficient understanding of the nature and gravity of the alleged misconduct, so that it can make an assessment of the appropriate outcome.[316] This is also important from the point of view of deterrence, in order to ensure that the penalty is commensurate with the harm perpetrated. The FCA is also open to entering into mediation with firms in cases where settlement might not otherwise be easily achieved.

4. Publicity

The FCA does not normally make public the fact that it is (or is not) investigating a particular matter.[317] It also does not publish the findings of its investigation. However, in terms of regulatory action, it is statutorily required to publish supervisory notices that have taken effect, decision notices, and final notices, in the manner that it considers appropriate. Quite controversially, it also has the power to publish warning notices (where it is proposing to suspend, censure, fine, or restrict an individual or firm). The FCA is permitted to publish information about the matter to which the warning notice relates, unless to do so would be:

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[311] FCA Enforcement Guide, para 4.4.

[312] FCA Enforcement Guide, para 4.28.

[313] Financial Conduct Authority, "Decision Procedures and Penalties Manual" (April 2015), para 5.1.3 ("**FCA DPP Manual**").

[314] FCA Enforcement Guide, para 5.9.

[315] FCA Enforcement Guide, para 5.3.

[316] FCA DPP Manual, para 5.1.3.

[317] There are some exceptions: see FCA Enforcement Guide, paras 6.2-6.5.

unfair to the person with respect to whom action is proposed to be taken; or prejudicial to the interests of consumers; or detrimental to the stability of the financial system.[318]

Publishing information concerning a warning notice has many advantages, including: (i) consumers, firms, and other market users will be able to *understand what behavior the FCA considers unacceptable* at an early stage (ii) it *enhances confidence* in the regulatory system (iii) it increases *respect for the enforcement process* (iv) it aligns the stage at which publicity is given in regulatory proceedings with the stage at which publicity is given in civil and criminal proceedings.[319] Thus, publicity of warning notices is looked upon as an important cog in the overall deterrence strategy of the FCA.[320] If after consulting the persons to whom notice is given, the FCA considers it appropriate to publish the information which is the subject of a warning notice, it will do so in the form of a statement that includes a brief summary of the facts that gave rise to the violations.[321] The FCA sometimes considers it appropriate to identify the subject of a warning notice.

It should also be noted that the provisions allowing for the publication of information concerning warning notices have come under criticism from several quarters. It has been argued that serious reputational damage is caused to firms that face warning notices but are later able to establish that no regulatory misconduct occurred.[322] Publishing information, it has also been argued, in relation to a warning notice breaches the principles of natural justice.[323] This publicity policy also bears the potential of having a counterproductive impact on settlement negotiations between firms and the FCA. The argument on the one hand is that firms are likely to wish to settle promptly in order to avoid negative publicity. On the other hand, however, with publicity at an early stage, it may also drive firms against settling, since much of the reputational damage is done fairly early in the process.[324] Finally, it could also have a detrimental impact on market stability, since it entails the early publication of information without the specific details required to understand its real impact on the market.[325] One way of striking the right balance may be by keeping a publicity policy of this nature in place, while providing for appropriate safeguards. These could include: (i) giving firms a statutory right to comment on notices (ii) requiring the regulator to publish a summary of the firm's defense (iii) requiring the regulator to publish guidelines or a code of practice covering the drafting of the statement.[326]

As stated earlier, the FCA also generally publishes information concerning decision notices and final notices. Although the person to whom the decision notice is given has a chance to make representations against such publicity, the FCA will not decide against publication solely

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[318] Lexis PSL, 'FCA Enforcement Action – Process'("**Lexis PSL**")

[319] FCA Enforcement Guide, para 6.7D.

[320] Allen & Overy

[321] It should be noted, however, that the Warning Notice itself is not published.

[322] Nicholas Queree, "The Financial Conduct Authority consults on its new power to publish Warning Notices" Butterworths Journal of International Banking and Financial Law 290 (2013).

[323] Allen & Overy

[324] Linklaters, "FCA Enforcement Trends" (January 2014).

[325] Allen & Overy

[326] Allen & Overy (n 60).

because it will have a detrimental impact on the reputation of the person.[327] Needless to say, civil and criminal actions take place in public and are usually publicized by the FCA.

Prohibition orders against individuals and disciplinary measures against auditors may be also be included in the 'Financial Services Register'[328] in order to alert consumers.

5. Financial penalties, suspensions and public censures

The Decision Procedures and Penalties Manual articulates the FCA's philosophy underlying the imposition of financial penalties or issuance of public censures: 'The principal purpose of imposing a financial penalty or issuing a public censure is to promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches, and demonstrating generally the benefits of compliant behaviour. Financial penalties and public censures are therefore tools that the FCA may employ to help it to achieve its statutory objectives.'[329]

The FCA has a wide range of powers at its disposal that enable it to impose financial penalties, suspensions and public censures. For instance, it may impose an unlimited fine on any person that is engaging or has engaged in market abuse, or has required or encouraged another person to do so.[330] Relying on any of these measures shows that the FCA is upholding regulatory standards, and helps to maintain market confidence and deter financial crime.[331] In some cases, the FCA may consider it sufficient to issue a private warning, to make the person or firm aware that they came close to being subjected to formal regulatory action. The FCA's penalty regime is based on the following general principles: (i) *disgorgement* – a firm or individual should not benefit from any breach (ii) *discipline* – a firm or individual should be penalised for any wrongdoing (iii) *deterrence* - any penalty imposed should deter the firm or individual who committed the breach, and others, from committing further or similar breaches.[332]

The FCA considers a range of circumstances to determine whether to take action for a financial penalty or a public censure, including: (i) the nature, seriousness and impact of the suspected breach (ii) the conduct of the person after the breach (iii) the previous disciplinary record and compliance history of the person (iv) FCA guidance and other published materials (v) action taken by the FCA in previous similar cases (vi) action taken by other domestic or international regulatory authorities.[333] In cases of market abuse, the following additional factors may be considered: (i) The degree of sophistication of the users of the market in question, the size and liquidity of the market, and the susceptibility of the market to market abuse (ii) the impact, having regard to the nature of the behaviour, that any financial penalty or public censure may have on the financial markets or on the interests of consumers.[334] In market abuse cases, the

[327] FCA Enforcement Guide, para 6.8A.

[328] This is a public record of all firms and individuals in the financial services industry that the FCA regulates.

[329] FCA DPP Manual, para 6.1.2.

[330] Lexis PSL; See FSMA 2000, s 123(1).

[331] FCA Enforcement Guide, para 7.1.

[332] Lexis PSL

[333] FCA DPP Manual, para 6.2.1.

[334] FCA DPP Manual, para 6.2.2.

FCA does not impose a penalty on a person if there are reasonable grounds to be satisfied that: (i) the person concerned believed, on reasonable grounds, that his behaviour did not amount to market abuse or 'requiring or encouraging'[335] and (ii) the person concerned took all reasonable precautions and exercised all due diligence to avoid engaging in market abuse or requiring or encouraging.

The total amount payable by a firm or individual subject to enforcement action is made up of the *disgorgement* of benefit received as a result of the breach, as well as a financial *penalty* reflecting the seriousness of the breach.[336] These elements have been incorporated into a five-step framework.[337]

Step 1: the removal of any financial benefit received directly from the breach.

Step 2: the determination of a figure which reflects the seriousness of a breach. Based on the seriousness of the breach, the FCA determines the percentage of the revenue (in the case of firms) or income (in the case of individuals) that will form the basis of the penalty. For firms, this ranges from 0 to 20%. For individuals, this ranges from 0 to 40%.

Step 3: an adjustment made to the Step 2 figure to take account of any aggravating and mitigating circumstances.

Step 4: an upwards adjustment made to the amount arrived at after Steps 2 and 3, where appropriate, to ensure that the penalty has an appropriate deterrent effect.

Step 5: if applicable, a settlement discount will then be applied. This discount does not apply to disgorgement of any financial benefit derived directly from the breach.

In market abuse cases against individuals, the fine imposed by the FCA is the greatest of the following: (i) 40% of the individual's total gross employment benefits in the 12 months preceding the market abuse (ii) twice the profit made or loss avoided as a direct result of the market abuse (iii) GBP 100,000.[338] This effectively means that the lowest fine that is imposed for market abuse is GBP 100,000.

Overall, the size of penalties imposed by the FCA has steadily grown over the years, with the figure at GBP 474 million in 2013, and GBP 1.471 billion in 2014.[339]

Instead of (or in addition to) imposing a penalty for market abuse, the FCA may impose a 'suspension' or a 'restriction' on carrying out certain activities. The FCA does so when it believes imposing a suspension or restriction is a more effective and persuasive deterrent than the imposition of a financial penalty alone.[340] The following are examples of when suspensions or restrictions may be imposed: (i) where the FCA has taken previous disciplinary action

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[335] According to s 123(1)(b) of the Financial Services and Markets Act 2000, if the FCA is 'satisfied that a person (A)… by taking or refraining from taking any action has *required or encouraged* another person or persons to engage in behaviour which, if engaged in by A, would amount to market abuse, it may impose on him a penalty of such amount as it considers appropriate.'

[336] FCA DPP Manual, para 6.5.3.

[337] FCA DPP Manual, para 6.5.3.

[338] Lexis PSL

[339] Jane Tuckley and Stephen Paget-Brown, 'FCA enforcement action: themes and trends' (2015) Compliance Officer Bulletin 1.

[340] FCA DPP Manual, para 6A.2.3.

resulting in adverse findings against the person (ii) where the FCA has previously taken action in respect of similar breaches and has failed to improve industry standards (iii) where the person has failed properly to carry out an agreed redress package or other agreed remedial measures (iv) where the misconduct appears to be widespread across a number of individuals across a particular business area (v) where the person's competitive position in the market has improved as a result of the breach (vi) if the FCA considers that a proposed penalty would cause the subject of enforcement action serious financial hardship and that it is appropriate to reduce the proposed penalty.[341]

The Report of the Parliamentary Commission on Banking Standards notes that historically, the level of fines in the UK had done little to dent bank balance sheets. If one compared the level of a fine to the profitability of a business, it could be conceived as a 'cost of doing business'.[342] Further, the idea that banks were 'too big' or 'too complex' to sanction would run contrary to the public interest. However, since 2010, the level of fines imposed has been increased significantly to better reflect the goal of deterrence. The report emphasized upon the need to provide the regulator with greater flexibility in imposing fines, levying heavier penalties on firms that fail to cooperate with them.[343] Cooperation with the regulator should be a given, and firms that do not do so should be sanctioned accordingly.

6. Variation and cancellation of permission and imposition of requirements

The FCA has the power to vary or cancel an authorised person's Part 4A permission (permission granted by the FCA or the Prudential Regulation Authority to carry out regulated activities).[344] In addition, it can also impose requirements on an authorized person, as defined under the statute.[345]

When it considers how it should deal with a firm, the FCA has regard to the statutory objectives and the range of regulatory tools available to it. It also has regard to: (i) the responsibilities of a firm's management to deal with concerns about the firm or about the way its business is being run (ii) the principle that a restriction imposed on a firm should be *proportionate to the objectives* the FCA is seeking to achieve. The FCA's Enforcement Guide provides examples of situations in which it will consider varying a firm's Part 4A permission.[346]

7. Prohibition orders and withdrawal of approval

The FCA has the statutory power of prohibiting individuals who are not fit and proper from carrying out functions in relation to regulated activities.[347] In addition, it has the power to

[341] FCA DPP Manual, para 6A.2.3.

[342] Parliamentary Commission on Banking Standards, 'Changing Banking for Good' First Report of Session 2013-14 (HL Paper 27-II)(HC 175-II), p 493. ("**Parliamentary Commission on Banking Standards**")

[343] *Ibid* at p 496.

[344] FSMA 2000, s 55J.

[345] FSMA 2000, s 55L.

[346] FCA Enforcement Guide, para 8.5.

[347] FSMA 2000, s 56.

withdraw approval from an approved person, which prevents them from continuing to perform the controlled functions in relation to which the approval relates.[348]

In determining whether to take any of these two actions, the FCA considers all surrounding circumstances, including whether any enforcement action has already been taken against the person concerned and also, whether enforcement action has been taken against the person by other enforcement agencies or professional bodies.[349]

The FCA has given the following examples of types of behavior which have previously resulted in the issuance of a prohibition order or withdrawal of the approval of an approved person, as defined by the statute: (i) provision of false or misleading information to the FCA (ii) failure to disclose material considerations on application forms (iii) severe acts of dishonesty (iv) serious lack of competence (v) serious breaches of the 'statements of principle for approved persons'.[350]

Of course, there is a difference between having these provisions in place and employing them effectively. As the Report of the Parliamentary Commission on Banking Standards noted, '[e]nforcement action against Approved Persons at senior levels is as rare as hens' teeth.'[351] The report goes on to note that amongst the largest regulatory violations (such as the systematic mis-selling of PPI) did not result in enforcement action against senior bank officials. The utilitarian reason for which it is important for sanctions to focus on individuals, the report notes, is that those who work at senior levels of banks that fail, go on to work elsewhere.[352] If key individuals involved in wrongdoing were disallowed from carrying on activities elsewhere, further damage would be prevented. The report also considered the possibility of making interim prohibition orders pending the completion of an investigation.[353]

The report specifies that enforcement action against individuals usually takes place after the completion of enforcement action against the firm. This means that a protracted process of enforcement against the firm delays enforcement against individuals, which weakens the prospect of success and imposition of meaningful penalties, particularly since the individual concerned can continue to pursue lucrative work several years after the violation.[354]

8. Injunctions

Decisions about whether to apply to civil courts for injunctions are taken at a relatively high level in the FCA – they are made by the Chairman of the Regulatory Decisions Committee, or in an urgent case in which the Chairman is not available, the Deputy Chairman. A number of factors are taken into account to determine whether the FCA should apply for an injunction. These include: (i) the nature and seriousness of a contravention (ii) in case of market abuse, the nature and seriousness of the misconduct or expected misconduct (iii) whether the conduct in question has stopped or is likely to stop and whether steps have been taken or will be taken by the person concerned to ensure that the interests of consumers are protected (iv) whether

[348] FSMA 2000, s 63.

[349] FCA Enforcement Guide, para 9.3.

[350] FCA Enforcement Guide, para 9.12.

[351] Parliamentary Commission on Banking Standards at p 497.

[352] Parliamentary Commission on Banking Standards at p 498.

[353] Parliamentary Commission on Banking Standards at p 507.

[354] Parliamentary Commission on Banking Standards at p 497.

there are steps a person could take to remedy a contravention of a relevant requirement or market abuse (v) whether there is a danger of assets being dissipated (vi) the costs and benefits involved in applying for and enforcing an injunction (vii) the disciplinary record and compliance history of the person (viii) whether other disciplinary powers, such as public censure or financial penalties, would suffice (ix) whether another regulatory authority can address the matter (x) whether there is information to suggest that the person who is the subject of the possible application is involved in financial crime.[355]

9. Restitution and redress

The FCA also has the power to apply to a court for restitution orders. As is the case with injunctions, decisions about whether to apply for such orders are made by the Chairman of the Regulatory Decisions Committee, or in an urgent case in which the Chairman is not available, the Deputy Chairman. The FCA applies for restitution orders quite rarely.[356] Before doing so, it considers whether there are other ways in which redress may be obtained (and whether it would be more efficient to rely on these), as well as any proposals made by the person to offer redress to consumers or other persons who have suffered losses. In addition, other factors such as whether the profits secured by the firm are quantifiable, whether losses caused are identifiable, and the number of persons affected, are also taken into consideration.[357]

10. Prosecution of criminal offences

The FSMA 2000 establishes more than thirty criminal offences.[358] The FCA pursues criminal proceedings in cases where it is appropriate to do so. In cases where a criminal proceeding has commenced or will be commenced, the FCA also considers whether to pursue concurrent civil proceedings. The following factors are taken into account in making this decision: (i) whether the civil proceedings might unfairly prejudice the criminal proceedings (ii) whether the civil proceedings might unfairly prejudice the defendants in the criminal proceedings in the conduct of their defence (iii) whether it is appropriate to take civil proceedings, having regard to the scope of criminal proceedings and the powers available to criminal courts.[359]

In deciding whether or not to prosecute, the FCA applies the principles set out in the Code for Crown Prosecutors, according to which it needs to consider whether the evidence is sufficient to provide a realistic prospect of a conviction and, if so, whether prosecution in the public interest.[360] In some cases, the FCA opts to issue a formal caution, which can be accessed on the Police National Computer,[361] instead of pursuing the criminal prosecution.

After consulting a variety of stakeholders, the Parliamentary Commission on Banking Standards recommended the introduction of a new criminal offence of reckless misconduct in the management of a bank, carrying a sentence of imprisonment. In its view, 'the fact that recklessness in carrying out professional responsibilities carries a risk of a criminal conviction

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[355] FCA Enforcement Guide, para 10.3.

[356] FCA Enforcement Guide, para 11.1.

[357] FCA Enforcement Guide, para 11.3.

[358] Tony Woodcock, 'How the FCA makes enforcement decisions' (2014) Compliance Officer Bulletin 1, 3.

[359] FCA Enforcement Guide, para 12.4.

[360] Tony Woodcock (n 359)

[361] This is a national information database available to all police forces and law enforcement agencies in the UK.

and a prison sentence would give pause for thought to the senior officers of UK banks'.[362] According to the Commission, prosecution for this offence should be pursued only in the case of most serious failings, such as where a bank failed with substantial costs to the taxpayer, lasting consequences for the financial system, or serious harm to customers.[363]

11. Insolvency proceedings

In deciding whether to apply to a court for insolvency orders, the FCA takes account of the principle that insolvency is a course pursued for the benefit of creditors as a whole, and that the court has regard to the public interest in deciding whether to wind up a firm. Decisions on whether to initiate insolvency proceedings are made by the Chairman of the Regulatory Decisions Committee, or in an urgent case in which the Chairman is not available, the Deputy Chairman.

In deciding whether to apply for an administration order or a compulsory winding up order, the FCA has regard to various factors including: (i) the extent to which the financial difficulties are, or are likely to be attributable to the management of the company or partnership, or to external factors (ii) the extent to which the company or partnership may, through an administrator, be able to trade its way out of its financial difficulties (iii) the extent to which the company or partnership can lawfully and viably continue to carry on regulated activities through an administrator (iv) the extent to which the sale of the business in whole or in part as a going concern is likely to be achievable (v) the complexity of the business (vi) whether recourse to one regime or another is likely to result in delays in redress to consumers or an additional cost (vii) whether recourse to one regime or another is likely to result in better redress to consumers (viii) the adequacy and reliability of the company or partnership's accounting or administrative records (ix) the extent to which the management of the company or partnership has cooperated with the FCA (x) in the case of an unauthorised company or partnership carrying on a regulated activity as part of a larger enterprise, the scale and importance of the unauthorised activity in relation to the whole of the company's or partnership's business (xi) the extent to which the management of the company or partnership is likely to cooperate in determining whether one or more of the purposes of an administration order can be met (xii) in the case of an unauthorised company or partnership carrying on a regulated activity as part of a larger enterprise, the extent to which the company's or partnership's survival can be anticipated without the continuance of the unauthorised regulated activity (xiii) where an administrative receiver is in place, whether the debenture holder is likely to agree to an application for an administration order (xiv) where an administrative receiver is in place, whether the FCA has reason to believe that the debenture under which the administrative receiver has been appointed is likely to be released, discharged, avoided or challenged.[364]

[362] Parliamentary Commission on Banking Standards at p 516.

[363] Parliamentary Commission on Banking Standards at p 516.

[364] FCA Enforcement Guide, para 13.13.

12. Disqualification of auditors and actuaries

Provisions of several statutes and regulations[365] impose duties upon auditors and actuaries. The FCA has the power to disqualify auditors and actuaries if they breach these duties. It can also impose a financial penalty or public censure on auditors or actuaries in respect of a failure to comply with a duty imposed on the auditor or actuary by rules made by the FCA, or a failure to comply with a duty imposed under the statute to communicate information to the FCA.[366] Since the exercise of these disqualification powers have a serious impact on the relevant auditor or actuary, the FCA seeks to do so in a way that is proportionate, considering the seriousness of the breach of duty. If the FCA has concerns about the propriety of an individual auditor or actuary, it considers whether to make a prohibition order instead of (or in addition to) a disqualification order.[367]

An auditor or actuary may ask the FCA to remove the disqualification at any time after it has been imposed. The FCA will remove a disqualification if it is satisfied that the disqualified person will in future comply with the duty in question (and other duties under the Act).[368]

13. Disapplication orders against the members of the professions

The FCA has the power to make an order disapplying an exemption from the general prohibition in relation to a person who is a member of a designated professional body on the grounds that the member is not a fit and proper person to conduct exempt regulated activities.[369] The FCA may make a range of disapplication orders, depending on the circumstances of the case. Since a disapplication order has serious consequences for a member (not only in relation to the conduct by the member of exempt regulated activities, but also in relation to the other business carried on by the member), the FCA considers whether other action, such as a prohibition order, would be more appropriate in the circumstances.

14. Cancellation of approval as a sponsor or primary information provider

The FCA may cancel a sponsor's approval if the sponsor has failed to meet the criteria for approval. When deciding whether to cancel a sponsor's approval, the FCA will take into account the competence of the sponsor; the adequacy of their systems and controls; their history of compliance with listing rules; the nature, seriousness and duration of the failure to meet the criteria; and any other matter which the FCA can take into account if it were considering an application for approval as a sponsor.

The FCA may also cancel a primary information provider's approval if it has failed to meet the criteria for approval. Similar factors are taken into account by the FCA in determining whether to do so.

15. Summary of the FCA's enforcement powers

The following is a summary of the sanctions set out above and who they may be imposed by - whether the FCA itself or on an application to a court.

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[365] FSMA 2000, rules made under the FSMA 2000, and the OEIC Regulations 2000.

[366] FCA Enforcement Guide, para 15.1A.

[367] FCA Enforcement Guide, para 15.4.

[368] FCA Enforcement Guide, para 15.8.

[369] FCA Enforcement Guide, para 16.1.

Sanction	Imposed by
Settlement	FCA
Publicity	FCA
Financial penalties, suspensions, public censures	FCA
Variation and cancellation of permission and imposition of requirements	FCA
Prohibition orders and withdrawal of approval	FCA
Injunctions	Application to Court
Restitution and redress	Application to Court
Prosecution of criminal offences	Application to Court
Insolvency proceedings	Application to Court
Disqualification of auditors and actuaries	FCA
Disapplication orders against the members of the professions	FCA
Cancellation of approval as a sponsor or primary information provider	FCA

F. UNITED STATES

In the US, the Dodd-Frank Act confers upon the CFPB[370] rulemaking,[371] enforcement,[372] and supervisory[373] powers over many consumer financial products and services and the entities that deal in them. In addition to overseeing certain activities of banks and other financial institutions, the CFPB has authority over entities such as mortgage companies, payday lenders,

[370] The Dodd-Frank Act § 1011.

[371] The Dodd-Frank Act § 1022.

[372] The Dodd-Frank Act §§ 1052-1058.

[373] The Dodd-Frank Act §§ 1024, 1025.

and private education lenders[374] that were, until passage of the Dodd-Frank Act, unregulated or lightly regulated.[375] The Dodd-Frank Act also transferred to the CFPB primary rulemaking and enforcement authority over certain federal consumer protection laws that had already been enacted before the Dodd-Frank Act.[376]

The fundamental idea underlying the CFPB was that just as consumers are protected from being tricked into buying dangerous consumer products such as exploding toasters, they should be similarly protected from dangerous financial products– not only by tort law, but also by regulation.[377] Thus the CFPB's purpose, as has been mentioned in Section I of this report, is to "seek to implement and, where applicable, enforce federal consumer financial laws consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive."[378]

Having understood the overall purpose and objective of the CFPB, we now turn to consider the specific powers vested in the CFPB by the Dodd-Frank Act. These can be divided into three categories: CFPB's Rulemaking Power, CFPB's Supervisory / Examination Powers and CFPB's Enforcement Powers.

1. Rulemaking Powers

In addition to the standard notice and comment procedures required for rulemakings under the Administrative Procedure Act[379], the Dodd-Frank Act establishes additional procedures that the Bureau must follow. CFPB's rulemaking powers can be divided into general and specific rulemaking powers.[380]

A. General rulemaking power

[374] The Dodd-Frank Act § 1002, paragraphs 5, 6 and 15.

[375] Morgan, Lewis & Bockius LLP, White Paper on the CFPB titled, "The Consumer Financial Protection Bureau: What It Is and What to Expect" dated January 2012, *available at* http://www.morganlewis.com/pubs/LIT_WhitePaper_ConsumerFinancialProtectionBureau_Jan2012.pdf.

[376] Some examples of laws transferred to CFPB are: The Alternative Mortgage Transaction Parity Act of 1982; The Consumer Leasing Act of 1976; The Electronic Fund Transfer Act; The Equal Credit Opportunity Act; The Fair Credit Billing Act; The Fair Credit Reporting Act; The Home Owners Protection Act of 1998; The Fair Debt Collection Practices Act; Subsections (b) through (f) of Section 43 of the Federal Deposit Insurance Act, requiring disclosure when a depository institution lacks federal deposit insurance; Sections 502 through 509 of the Gramm-Leach-Bliley Act, protecting the disclosure of nonpublic personal information; The Home Mortgage Disclosure Act of 1975; The Home Ownership and Equity Protection Act of 1994; The Real Estate Settlement Procedures Act of 1974; The S.A.F.E. Mortgage Licensing Act of 2008; The Truth-in-Lending Act; The Truth-in-Savings Act; Section 626 of the Omnibus Appropriations Act, 2009, mandating a rulemaking on unfair and deceptive mortgage lending practices; and The Interstate Land Sales Full Disclosure Act.

[377] *See* Elizabeth Warren, *Unsafe At Any Rate*, DEMOCRACY, *available at* http://www.democracyjournal.org/5/6528.php?page=all. *See also* Oren Bar-Gill and Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 93 (2008); Adam J. Levitin, *The Consumer Financial Protection Bureau: An Introduction*, 32 REVIEW OF BANKING & FINANCIAL LAW 321, 334-335 (2012-13).

[378] The Dodd-Frank Act § 1021(a).

[379] 5 U.S.C. § 553.

[380] David H. Carpenter, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Title X, The Consumer Financial Protection Bureau*, Report of the Congressional Research Service (July 21, 2010) 11, available at <http://www.llsdc.org/assets/DoddFrankdocs/crs-r41338.pdf.> last visited on 20th June, 2015

The CFP Act authorizes CFPB to "prescribe rules and issue orders and guidance, as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof."[381] Before proposing a rule and during the comment period, the CFPB is required to consult with the appropriate financial regulators,[382] address any written objections by the other federal regulators[383] and carry out a cost-benefit analysis of the impact the proposed rule was likely to have.[384]

Once a significant rule or order has been made, CFPB is obliged to assess the effectiveness of such rule or order after five years of its passing and publish a report of its findings.[385] What rules or orders qualify as "significant" is undefined and hence left to the discretion of the CFPB.

B. Specific rulemaking powers

The CFPB is authorized to prescribe rules declaring acts or practices pertaining to consumer financial products or services to be unlawful if they are unfair, deceptive or abusive or UDAAPs (as explained in detail in Section-I of this report).

Before prescribing rules marking out practices as unfair, deceptive or abusive, however, the CFPB is required to consult with the appropriate federal financial regulators. Another check comes in the form of a veto held by the Financial Stability Oversight Council ("**FSOC**"), which comprises 10 voting members including US Treasury officials and US Federal Reserve Board. The FSOC is charged with monitoring the financial systems and identifying potential threats to financial stability. The FSOC has the authority to set aside final CFPB regulations if they would "put the safety and soundness of the U.S. banking system or the stability of the financial system of the U.S. at risk."[386]

2. Supervisory Powers

A. Overview

As part of its supervisory power, the CFPB can conduct examinations and require reports to (a) assess compliance with federal consumer financial laws, (b) obtain information about a regulated entity's activities and compliance systems or procedures, and (c) detect and assess risks to consumers and to markets for consumer financial products and services.[387]

[381] The Dodd-Frank Act § 1022(b)(1).

[382] The Dodd-Frank Act § 1022(b)(2)(B).

[383] The Dodd-Frank Act § 1022(b)(2)(C).

[384] The Dodd-Frank Act § 1022(b)(2)(A)(i).

[385] The Dodd-Frank Act § 1022(c).

[386] The Dodd-Frank Act § 1023(a).

[387] The Dodd-Frank Act § 1024(b), 1025(b).

The CFPB has supervisory authority over certain entities[388], empowering it to send in teams of examiners to look at the entity's books and records and inquire about its operations.[389] Such examinations and their findings are kept confidential[390] but the information gleaned by the CFPB serves as a valuable regulatory tool— allowing the CFPB to gather intelligence about market practices, spot regulatory problems and informally communicate concerns to regulated entities.[391]

3. CFPB's Supervision and Examination Manual

As a guide to the exercise of its supervisory powers, the CFPB published a comprehensive Supervision and Examination Manual ("**Manual**").[392] The Manual notes that examination of non-depository and large depository institutions would be carried out after assessing risks to consumers, extent of state oversight and coordination with those institutions' prudential and state regulators. Any examination would be preceded by advance notice to the concerned entity.[393]

When conducting examinations, the CFPB is required to first obtain internal approval for crafting a preliminary risk focus and scope for an onsite portion examination. Once obtained, its examiners are empowered to go onsite to observe, interview, and review additional documents and information.[394] After completing offsite and onsite examinations, examiners must arrive at preliminary conclusions about the entity's statutory and regulatory compliance, consult internally about possible follow-up corrective actions, which would form the basis of the draft examination report and obtain comments from prudential regulators on the course of action proposed by the report. Only then can the report be transmitted to the entity concerned and appropriate action can be taken, whether through informal agreements or formal enforcement actions.[395]

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[388] *See* 12 U.S.C. § 5514(a)(1). The CFPB has supervisory authority only "covered persons":

- Parties offering or providing residential mortgage loan origination, brokerage, or servicing;
- Parties offering loan modification or foreclosure relief services;
- Payday lenders;
- Private student lenders;
- "Larger participants" in a market for other consumer financial products or service; and
- Any party the CFPB has reasonable cause to determine is engaged in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services.

[389] 12 U.S.C. § 5515(b)(1) (Supp. V 2011).

[390] 12 C.F.R. §§ 1070.40–.48 (2012) (effective March 18, 2013).

[391] Adam J. Levitin, *The Consumer Financial Protection Bureau: An Introduction*, 32 REVIEW OF BANKING & FINANCIAL LAW 321, 356 (2012-13).

[392] *See* CFPB's Supervision and Examination Manual, available at <http://files.consumerfinance.gov/f/201210_cfpb_supervision-and-examination-manual-v2.pdf>, last visited on 10th July, 2015.

[393] *See* Morgan, Lewis & Bockius LLP, White Paper on the CFPB titled, "*The Consumer Financial Protection Bureau: What It Is and What to Expect*" dated January 2012, 6, available at <http://www.morganlewis.com/pubs/LIT_WhitePaper_ConsumerFinancialProtectionBureau_Jan2012.pdf>, last visited on 10th July, 2015

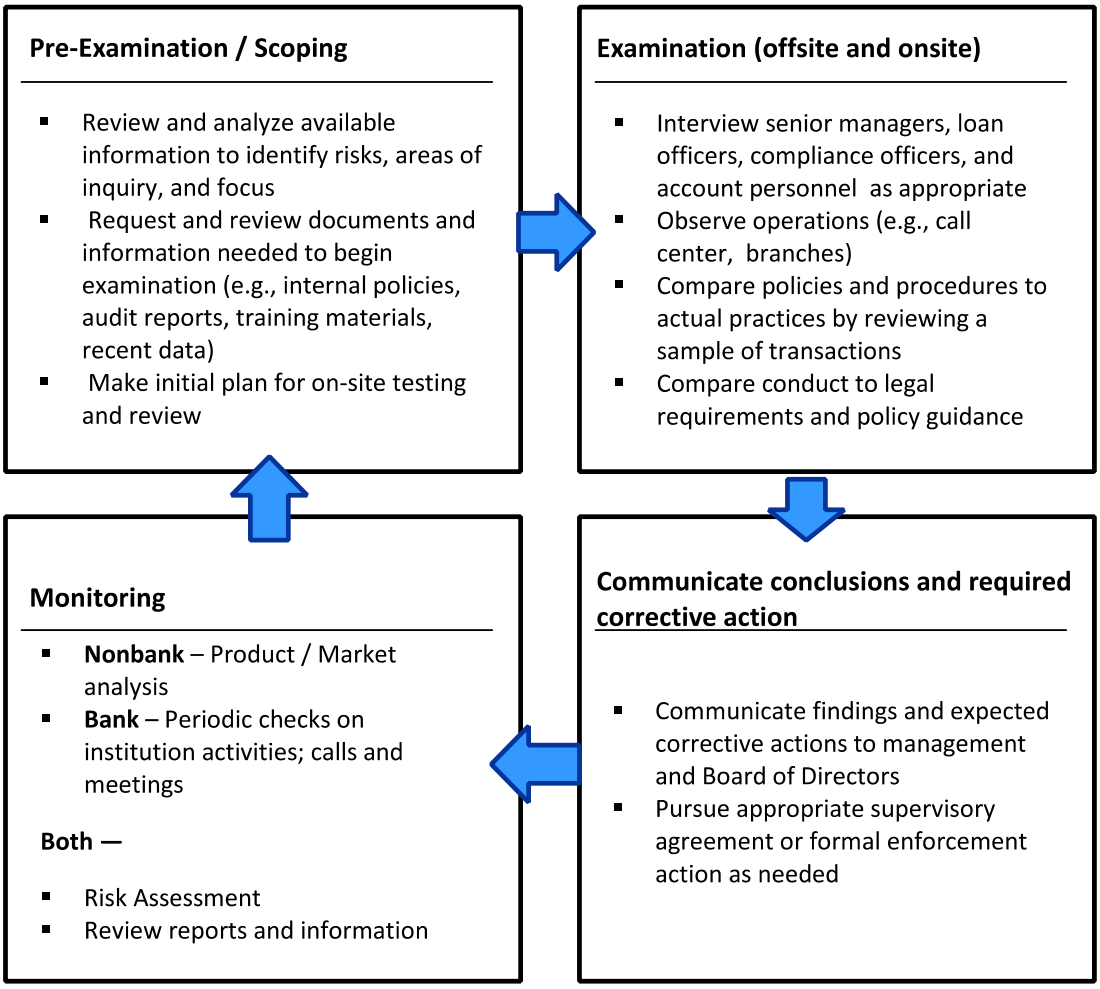
[394] *See* CFPB's Supervision and Examination Manual 5-6, available at <http://files.consumerfinance.gov/f/201210_cfpb_supervision-and-examination-manual-v2.pdf>, last visited on 10th July, 2015

[395] *Ibid*

The CFPB has interpreted its examination powers broadly, asserting that it was entitled to "full and unfettered access to information."[396] It has also asserted that supervised entities could *not* claim attorney-client privilege to refuse CFPB examiners access to documents.[397]

For ease of understanding, a pictorial representation of CFPB's examination process, as extracted from CFPB's Manual[398] is set out below.

The Supervision and Examination Cycle



[396] *See* Bulletin 12-01, available at <http://www.consumerfinance.gov/wpcontent/uploads/2012/01/GC_bulletin_12-01.pdf>, last visited on 10th July, 2015

[397] *Ibid.*

[398] *See* CFPB's Supervision and Examination Manual, 10, available at <http://files.consumerfinance.gov/f/201210_cfpb_supervision-and-examination-manual-v2.pdf>, last visited on 10th July, 2015

4. Enforcement Powers

A. Overview

The CFPB's enforcement authority is limited to bringing civil suit for violation of federal consumer financial law.[399] "Federal consumer financial law" covers both violations of the CFP Act and the enumerated consumer laws whose enforcement responsibility has been transferred to the CFPB.[400] The CFPB is prohibited, however, from bringing enforcement actions against smaller depositaries (those with less than $10 billion in consolidated net assets).[401] Instead, enforcement in such cases is the province of the appropriate prudential regulator.[402] For large banks, the CFPB has primary, but non-exclusive enforcement authority along with prudential regulators.[403]

If the CFPB believes that a party is violating federal consumer financial law, the agency may proceed in one of two ways:

- It may commence litigation in a federal district court;[404] or
- It may conduct an administrative adjudication before an administrative law judge.[405] Any orders from an administrative hearing must be taken to a federal district court for enforcement.[406]

The relief that the CFPB can obtain in an enforcement action is wide-ranging. It includes:[407]

- Rescission or reformation of contracts;
- Refunds or returns of money or real property;
- Restitution;
- Disgorgement or compensation for unjust enrichment;
- Payment of damages;
- Civil monetary penalties; and
- Injunctive relief.

Civil monetary penalties are prescribed by statute.[408] A simple violation has civil monetary penalties of a maximum of $5,000 per day. A reckless violation attracts a maximum of $25,000

[399] 12 U.S.C. § 5516.

[400] 12 U.S.C. § 5564(a).

[401] 12 U.S.C. § 5516(d).

[402] 12 U.S.C. § 5516(d).

[403] 12 U.S.C. § 5515(c).

[404] 12 U.S.C. §§ 5564(a), (f).

[405] 12 U.S.C. § 5563.

[406] 12 U.S.C. § 5563(d).

[407] 12 U.S.C. § 5565(a)(2).

[408] 12 U.S.C. § 5565(c).

per day, and willful violations attract penalties of up to $1,000,000 per day.[409] The penalties are not inflation adjusted. But penalties can be mitigated upon proof of the following:

- Size of financial resources and good faith of the entity charged;
- Gravity of the violation;
- Severity of the risks to or losses of the consumer, which may in turn depend upon the number of products or services sold or provided;
- History of previous violations;
- Other relevant matters as justice may require.[410]

B. CFPB's Early Warning Process

The CFPB has also adopted a procedure for providing notice to individuals and firms under investigation of potential enforcement action "to ensure that potential subjects of enforcement actions have the opportunity to present their positions to the [CFPB] before an enforcement action is recommended or commenced".[411] In a November 2011 bulletin,[412] the CFPB announced that before its staff recommends enforcement action, the Office of Enforcement may, at its discretion, give the subject of such recommendation notice of the nature of the subject's potential violations.[413]

The Office of Enforcement may also provide the recipient of the notice with the opportunity to submit written submissions in response. Such written submissions must address legal and policy issues relevant to the investigation and not focus on disputed facts.[414] If however, such submissions do address facts relating to the investigation, such facts can only be asserted under oath by a person who has personal knowledge of such facts.[415]

The early warning process is strictly discretionary and notices need not be issued in cases involving ongoing frauds or where the CFPB's Office of Enforcement is required to act quickly.[416]

In cases where an early warning notice has been issued but the CFPB's Office of Enforcement nonetheless opts to continue with its enforcement recommendation, any written submissions submitted along with the Office of Enforcement's recommendation are to be made available to

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[409] 12 U.S.C. § 5565(c).

[410] The Dodd-Frank Act §1055(c).

[411] Enforcement, Early Warning Notice, CFPB Bulletin 2011-04, November 7, 2011, available at <http://files.consumerfinance.gov/f/2011/11/EarlyWarningNotice.pdf>, last visited on 10th July, 2015. See also, Paul Hastings LLP, Client Alert titled "*CFPB Announces Early Warning Notice Process for Potential Enforcement Targets*" dated December 2011, available at <http://www.paulhastings.com/assets/publications/2058.pdf>, last visited on 10th July, 2015; Morgan, Lewis & Bockius LLP, White Paper on the CFPB titled, "*The Consumer Financial Protection Bureau: What It Is and What to Expect*" dated January 2012, 8, available at <http://www.morganlewis.com/pubs/LIT_WhitePaper_ConsumerFinancialProtectionBureau_Jan2012.pdf>, last visited on 10th July, 2015

[412] *Ibid.*

[413] *Ibid.*

[414] *Ibid.*

[415] *Ibid.*

[416] *Ibid.*

the CFPB's Director or other enforcing staff within the CFPB pursuing the enforcement action.[417]

C. CFPB's Enforcement Record – An Empirical Study

As of July 2014, CFPB's own websites provides the following statistics in respect of its enforcement actions:

- CFPB had ordered monies worth $4.6 Billion in relief to consumers by CFPB enforcement actions.
- 15 million consumers would receive relief because of CFPB enforcement actions.
- CFPB ordered monies worth $150 million to be paid in civil penalties under its enforcement actions.
- CFPB supervisory actions resulted in monetary relief worth $75 million to consumers.
- 775,000 consumers would receive remediation because of CFPB supervisory actions.
- CFPB had received 400,000 complaints.

In December 2014, Latham & Watkins, a white shoe law firm headquartered in New York, conducted an empirical study of the first 62 publicly disclosed enforcement actions conducted by the CFPB over a period of three years since its establishment in 2011.[418] Some of the key findings from the Latham & Watkin's White Paper are summarized below:

- *Choice of forum*: CFPB used both federal civil litigation and administrative enforcement equally. 28 of its cases were filed as civil actions in federal district court and 34 were filed as administrative actions. Of these, almost all cases brought administratively were resolved through consent orders as of December 2014. Of the 28 cases filed in federal court, 13 are pending in the litigation process.[419]

- *Sector-wise distribution of forum choice*: CFPB's choice of forum appeared to be influenced by the defendant's industry, size or sophistication. In the credit card and auto lending sectors where almost all of respondents were large depository institutions (with assets greater than $10 billion), the cases were dealt with in administrative proceedings. By contrast, smaller, non-depository institutions and entities were more frequently brought in federal court.[420]

- *Settlement without admission of guilt*: Largely on account of the consequences attendant to a finding of wrongdoing, a large majority of the resolved cases (41 of 48 or 85.4 percent) were settled. In such cases defendants were not required to admit to CFPB's

[417] *Ibid.*

[418] *See* Latham & Watkins, White Paper No. 1782 titled, "*CFPB Enforcement by the Numbers*" dated December 22, 2014.

[419] *Ibid.*

[420] *Ibid.*

allegations or its findings of fact and conclusions of law.[421] According to the White Paper, the size and sophistication of respondents determined whether cases were settled without admission or denial of guilt. Larger defendants with greater capacity to litigate and engage the CFPB usually settled without admitting or denying guilt. In contrast, two of the smaller entities subject to consent orders explicitly accepted the truth of certain facts and conclusions of law.[422]

	Total CFPB Enforcement Actions	**Federal Court**	**Administrative Proceedings**
Total Actions Not Pending	48	15	33
Resolved Without Admitting or Denying	41	11	30
% of Non-pending Actions	85.4%	73.3%	90.9%

- *Use of civil penalty as a remedy*: Almost all entities (over 80%) subjected to CFPB enforcement proceedings ultimately received some sort of civil monetary penalty.[423]

- *Use of equitable monetary relief (Restitution) as a remedy*: Two-thirds of the cases included some sort of equitable monetary relief.[424] As is usually the case with restitution remedies, the size of monetary relief was usually proportionate to the actual damage to consumers, designed make injured consumers whole. Respondents were usually required to make these restitution payments to the CFPB, which then distributed the funds to consumers.[425]

- *Use of Disgorgement as a remedy*: Defendants have been required to disgorge ill-gotten gains in 17 out of the 48 resolved cases.[426] The data did, however, reveal that the Bureau may be seeking only disgorgement less frequently, instead opting to include other remedies alongside disgorgement.[427]

[421] *Ibid*

[422] *Ibid*

[423] *Ibid*

[424] *Ibid*

[425] *Ibid*

[426] *Ibid*

[427] *Ibid*

- *Interplay between these three remedies*: According to the White Paper, the CFPB appears to favor a remedy that includes both restitution payments and a mandatory minimum penalty that is often secured by disgorgement. The CFPB enforcement orders typically include a clause requiring that in the event the actual restitution amount awarded is less than the minimum penalty amount applicable then such balance must nonetheless be paid to the CFPB or the US Treasury as disgorgement. In effect, defendants are made to pay atleast the minimum penalty applicable to them under statute. Similarly in cases where defendants are unable to accurately identify all affected consumers to make whole through restitution, defendants are nonetheless made to pay the minimum penalty amounts to the CFPB through disgorgement.[428]

A table setting out the sector-wise distribution of the three remedies discussed so far is set out below.

	Mortagage (% of cases not pending)	**Debt Relief (% of cases not pending)**	**Credit Card (% of cases not pending)**	**Total (% of cases not pending)**
Civil Penalty	15 (83.3%)	6 (85.7%)	13 (92.9%)	40 (83.3%)
Restitution / Other Equitable Monetary Relief	6 (33.3.%)	5 (71.4%)	13 (92.9%)	32 (66.7%)
Disgorgement	5 (27.8%)	1 (14.3%)	5 (35.7%)	17 (35.4%)

- *Other remedies*: Apart from its three principal remedies, the CFPB has, not infrequently, tapped into other remedies at its disposal. A table setting out the use of all remedies is set out below.[429]

	Mortgage (% of cases not pending)	**Debt Relief (% of cases not pending)**	**Credit Card (% of cases not pending)**	**Total (% of cases not pending)**
Injunction or Cease & Desist Order	17 (94.4%)	7 (100%)	14 (100%)	47 (97.9%)
Compliance Plan	6 (33.3%)	1 (14.3%)	14 (100%)	27 (56.3%)
Civil Monetary Penalty	15 (83.3%)	6 (85.7%)	13 (92.9%)	40 (83.3%)
Restitution / Equitable Monetary Relief	6 (33.3%)	5 (71.4%)	13 (92.9%)	32 (66.7%)

[428] *Ibid*

[429] *Ibid*

Disgorgement	5 (27.8%)	1 (14.3%)	5 (35.7%)	17 (35.4%)
Monitoring by CFPB	13 (72.2)	5 (71.4%)	13 (92.9%)	37 (77.1%)
Increased Directorial Oversight / Internal Monitoring	5 (27.8%)	1 (14.3%)	14 (100%)	25 (52.1%)
Record Keeping / Document Retention	13 (72.2)	5 (71.4%)	12 (85.7%)	38 (79.2%)
Reporting Requirements	3 (72.2)	5 (71.4%)	14 (100%)	39 (81.3%)

G. AUSTRALIA

In Australia, the ASIC considers enforcement as one of the many regulatory tools at its disposal (the others being engagement with stakeholders, surveillance, guidance, education and policy advice). It uses its enforcement powers to detect and deal with unlawful conduct, recover money in appropriate circumstances and prevent unlawful conduct before it takes place, in order to deter future misconduct.[430] It recognizes that its *credibility as an effective regulator depends, in part, upon how it uses its enforcement powers*.[431]

In deciding whether to take enforcement action, the ASIC considers the following factors: (i) strategic significance – how serious the misconduct and its impact on the market or on the confidence of investors and financial consumers is (ii) the regulatory benefits of pursuing the misconduct, particularly with reference to whether enforcement is cost effective (iii) issues specific to the case – this includes matters such as the harm caused by the misconduct, the time since the misconduct occurred, whether the misconduct was isolated or continuing, and whether the ASIC has admissible evidence. The ASIC does not normally investigate matters that would be better addressed by another agency or by private dispute resolution between the parties concerned.[432]

Even after the ASIC has decided to take enforcement action, it has a range of options available to it (these will be set out below). The following factors are taken into consideration to determine which of these enforcement actions to pursue: (i) *the nature and seriousness of the suspected misconduct* – whether there is evidence that the conduct is dishonest, negligent, reckless or intentional, the amount of benefit secured, the impact on the market, the compliance record of the party (ii) *the conduct of the person or firm after the contravention* – how the breach came to the attention of the ASIC, the level of cooperation, whether remedial steps have been taken (iii) *the strength of the ASIC's case* – the prospects of success and what evidence of the misconduct is available (iv) *the expected level of public benefit* – whether the case is likely to clarify the law, as well as the length and expense of the case (v) *the likelihood that the person or firm's behavior will change* in response to a particular action and the deterrent effect of the action (vi) whether any *mitigating factors* are at play.[433]

[430] Australian Securities and Investments Commission, 'ASIC's approach to enforcement' (Information Sheet 151) (September 2013) 3 ("**ASIC Enforcement Information Sheet**").

[431] ASIC Enforcement Information Sheet, p 3.

[432] ASIC Enforcement Information Sheet, p 3-4.

[433] ASIC Enforcement Information Sheet, p 8-9.

When contemplating enforcement action, the ASIC adopts procedures in order to ensure that the process is both fair and effective. These are: (i) *not* advising a person that they are a potential defendant during investigation (ii) placing the person under a legal obligation to answer questions at a compulsory examination, but allowing them to have legal representation during the process (iii) giving the person the opportunity to explain their conduct prior to laying criminal charges (iv) where a person has been informed about a pending investigation, notifying them if the investigation is terminated (v) when making an administrative decision that directly and materially affects a person (for example, a decision to ban a person from providing financial services), giving them an opportunity to be heard before a decision is made.[434]

1. Whistle-blower protection

The ASIC receives a substantial amount of its information from whistleblowers.[435] The Corporations Act 2001 sets out a number of protections for corporate whistleblowers. Neither the information nor the identity of the whistleblower may be disclosed without specific authority under the law.[436] Whistleblowers are protected from civil and criminal litigation for disclosing information. Further, if their employment is terminated on account of a disclosure, they may seek a reinstatement order from the court.[437] Nevertheless, the Senate Economic References Committee recommended substantive legislative and regulatory changes to improve the corporate whistleblowing framework, including expanding the scope of information covered by whistleblower protection legislation and providing that the ASIC cannot be required to produce a document revealing a whistleblower's identity unless ordered to do so by a court or tribunal.[438]

2. Publicity

The ASIC acknowledges that in general, informing the public of its activities and enforcement action is important because it promotes confidence in the administration of the law, and also encourages compliance with the law according to the standards that the ASIC expects.[439] Nevertheless, the ASIC cannot always inform the public of its activities. The ASIC usually maintains confidentiality and privacy of the information it receives in relation to investigations. However, members of the public can seek access to that information under freedom of information legislation.[440]

The ASIC may make a statement about an investigation when it is in the public interest to do so. It considers whether making a statement promotes confidence in the integrity of the market, or facilitates the interests of consumers and investors in relation to the financial system. It also

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[434] ASIC Enforcement Information Sheet, p 9.

[435] Senate Economic References Committee, 'Performance of the Australian Securities and Investments Commission' (June 2014) 200.("**Senate Economic References Committee**")

[436] Australian Securities and Investments Commission, 'Whistleblowers and whistleblower protection' (Information Sheet 0052).

[437] *Ibid*

[438] Senate Economic References Committee at 224.

[439] Australian Securities and Investments Commission, 'Public comment' (Information Sheet 152) (May 2014) 1.("**ASIC Public Comment**")

[440] ASIC Enforcement Information Sheet, p 9.

carefully weighs the benefits of publicity against its pitfalls, particularly the prejudice that would be caused to the person under investigation. Where publicizing an investigation is likely to cause damage to an individual, the ASIC neither confirms nor denies that it is investigating a particular matter until further facts are analysed.[441] Even when it does confirm the existence of an investigation, ASIC usually makes no further comment until the investigation is concluded.

As regards proceedings in court, in criminal proceedings, the ASIC only comments no earlier than when the accused make their first court appearance. In civil proceedings, comment will only be made when originating documents have been filed and served. In administrative proceedings, the ASIC will only comment when the decision has been made and any relevant requirement to publish the decision has been complied with.[442]

Commenting on ASIC's policies on publicity, the Senate Economic References Committee noted that although the policies in place are adequate, there was evidence that they were not always complied with. Further, it was necessary for ASIC to update past online media releases and statements to reflect recent court developments, such as the outcome of an appeal. As it stood, search engine results often directed people to out of date information on ASIC's website, having serious reputational consequences for the individuals or firms involved.[443]

3. Punitive action

The ASIC has a wide variety of remedies at its disposal for punishing perpetrators of misconduct. It generally considers criminal action for offences involving serious conduct that is dishonest, intentional or highly reckless, *even where there is a civil remedy available for the same breach*.[444] Substantial sentences can be imposed for criminal misconduct. Serious market offences, including market manipulation and insider trading, and punishable with a term of imprisonment for up to ten years. Other serious offences such as insolvent trading or breach of the statutory duty of good faith by a company director or officer carry a sentence of imprisonment of up to five years.

Regulatory offences also attract criminal financial penalties. The offence of dishonest breach of the statutory duty of good faith by a company director or officer is punishable by a fine of up to AUD 340,000. Individuals convicted of serious market offences such as market manipulation or insider trading can be fined up to AUD 765,000 or three times the value of the benefit obtained from the misconduct.[445] In case of civil penalties, the pecuniary penalty that can be imposed is up to AUD 200,000.[446]

Nevertheless, the ASIC has raised concerns about the fact that its range of civil penalties is often insufficient to counteract the benefit secured by the wrongdoer.[447] This means that there

[441] ASIC Public Comment at 2

[442] ASIC Public Comment at 3

[443] Senate Economic References Committee at 289.

[444] ASIC Enforcement Information Sheet, p 5.

[445] ASIC Enforcement Information Sheet, p 5.

[446] For examples of civil penalties imposed by ASIC, see Australian Securities and Investments Commission, 'Report 387: Penalties for Corporate Wrongdoing' (March 2014) 34.

[447] Richard Harris and Alexandra Mason, 'Unravelled: Increasing ASIC's Enforcement Powers' Allens Linklaters (8 July 2014).

is often an *economic incentive* to engage in misconduct.[448] The Financial Systems Inquiry Report also recommended that the ASIC be empowered to impose substantially higher penalties in civil cases. However, it has cautioned against introducing 'extremely high penalties' seen in other jurisdictions, because this 'risks creating inappropriate incentives for government and regulators unless revenue is separated and used for social or public purposes'.[449] Further, some commentators have noted that courts in Australia have effectively treated civil penalties as 'quasi-criminal offences' by granting defendants heightened procedural protections, which makes it harder to impose such penalties.[450]

4. Protective action

The ASIC may also pursue remedies that are directed at protecting investors and financial consumers, rather than punishing the perpetrators of misconduct. These include the following: (i) disqualifying individuals from managing a corporation or banning them from providing financial services or engaging in credit activities (ii) revocation, variation, or suspension, of the conditions of a license (iii) public warning notices.[451] These administrative actions can be taken by the ASIC of its own accord, without judicial intervention.

5. Preservative action, corrective action and compensation action

The ASIC may move a court to secure an injunction in order to protect assets from being dissolved. Here, the court does not determine rights and titles, but makes orders to preserve the status quo.[452]

The ASIC may also take corrective action – for instance, applying to a court for a corrective disclosure order requiring a firm to correct a misleading or deceptive advertisement.

The ASIC has a statutory power to commence a representative action in the courts against wrongdoers in order to recover damages or property for those who have suffered losses. It usually only does so when it is in the wider public interest. ASIC also encourages investors to consider alternative options to recover damages or property from wrongdoers, such as by lodging a dispute with the Financial Ombudsman Service or taking private legal action.[453]

6. Negotiated resolution and enforceable undertakings

Where negotiation can yield an effective regulatory outcome, the ASIC considers negotiated resolutions. The ASIC Commissioner observed that 'negotiated outcomes… can offer a faster, more flexible and effective regulatory outcome than could otherwise be achieved through

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[448] However, the authors argue that no credible evidence of this is available.

[449] 'Financial System Inquiry Final Report' (November 2014) 252.

[450] Vicky Comino, 'Australia's "company law watchdog": the Australian Securities and Investments Commission and the civil penalties regime' (2014) 3 Journal of Business Law 228.

[451] ASIC Enforcement Information Sheet, p 6.

[452] *ASIC v Kercichwost* [2008] NSWSC 855.

[453] ASIC Enforcement Information Sheet, p 6.

administrative or civil action'.[454] It also considers securing an 'enforceable undertaking'[455] from the party that committed the misconduct.[456] Such undertakings require the approval of a senior executive of ASIC.[457] Although these undertakings do not involve a court making a finding against the person, they can produce beneficial regulatory outcomes, such as providing compensation or outlining a process to monitor a person's continuing compliance with the law.[458] They prove to be cost effective for the regulator, and can influence conduct within entities and produce outcomes which may not be possible through litigation.[459] All of the enforceable undertakings accepted by the ASIC are contained in an 'enforceable undertakings register',[460] which is publicly available online.[461]

Enforceable undertakings are not accepted by the ASIC: (i) instead of commencing criminal proceedings against a party (ii) to secure payment of a pecuniary civil liability (iii) after a matter has been referred to a specialist body (iv) in cases of deliberate misconduct, fraud, or conduct involving a high level of recklessness (v) for trivial matters (vi) as an alternative form of relief if conditional relief has not been complied with.[462]

The Senate Economic References Committee has noted widespread perceptions that the ASIC relies on enforceable undertakings in inappropriate cases that should have been prosecuted instead, and tends to be soft on big players.[463] In the Committee's view, the 'public interest would be better served if ASIC was more willing to litigate complex matters involving large entities'.[464] There is little evidence that large corporations fear the threat of litigation brought by ASIC.[465]

The Committee also recommended changes to the manner in which enforceable undertakings were dealt with by the ASIC. These included: (i) requiring stronger terms in the undertaking (ii) requiring a clearer acknowledgement in the undertaking of what the misconduct was (iii) requiring, in all cases, that an independent expert be appointed to supervise the implementation

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[454] Cited in King and Wood Mallesons, 'The Australian Securities & Investments Commission: Recent trends and new directions' (21 November 2014).

[455] These are undertakings given to the ASIC which are enforceable in courts – see Australian Securities and Investments Commission, 'About the enforceable undertakings register' (Information Sheet 28) 1.

[456] Australian Securities and Investments Commission Act, s 93A, s93AA; Consumer Credit Act, s 322.

[457] Australian Securities and Investments Commission, 'Regulatory Guide 100: Enforceable Undertakings' (February 2015) 7.

[458] ASIC Enforcement Information Sheet, p 7.

[459] Senate Economic References Committee at 279.

[460] Australian Securities and Investments Commission, 'About the enforceable undertakings register' (Information Sheet 28) 1.

[461] See <http://asic.gov.au/online-services/search-asics-registers/additional-searches/enforceable-undertakings-register/>.

[462] Australian Securities and Investments Commission, 'Regulatory Guide 100: Enforceable Undertakings' (February 2015) 9.

[463] Senate Economic References Committee at 257-281.

[464] Senate Economic References Committee, 'Performance of the Australian Securities and Investments Commission' (June 2014) 278.

[465] *Ibid.*

of the undertaking (iv) making the process of monitoring compliance with undertakings more transparent.[466]

7. Infringement notices

The ASIC has the administrative power to issue infringement notices, requiring the wrongdoer to pay a stipulated financial penalty depending on the seriousness of the breach. If the penalty is paid by the party, no further regulatory action can be taken. However, if it is not paid, ASIC can bring a civil penalty action against the party concerned in court. The maximum penalty that can be imposed by an infringement notice is AUD 100,000 - a matter that has been subjected to criticism on the basis that it fails to adequately deter misconduct.

8. Involvement in private court proceedings

The ASIC's most regular recourse for enforcement is to take direct regulatory action. However, there are occasions on which it intervenes in private litigation. This can be done in three ways: intervention as a party, intervention as amicus curiae, or commencing civil proceedings on behalf of a party.

To begin with, the ASIC has a right to intervene in matters arising under the Corporations Act 2001 or the National Consumer Credit Protection Act 2009.[467] In deciding whether to intervene, ASIC first considers whether intervention would be of strategic regulatory significance. In determining this, it considers the seriousness of the matter and its market impact.[468] The ASIC also considers whether the benefits of intervention would outweigh the costs of doing so. Issues specific to the case may warrant intervention. For instance, intervention may be valuable if ASIC has evidence that it can submit to the court, which otherwise would not have been submitted by one of the parties.[469] Intervention may also assist ASIC's other regulatory and enforcement action. Finally, ASIC also considers whether other action would be more appropriate than intervention. For example, would it be more appropriate for it to initiate proceedings itself instead of intervening in private court proceedings?

Alternatively, the ASIC may apply to the court for leave to appear as amicus curiae, or the court itself may invite the ASIC to do so. The following are examples of situations in which the courts have given leave to the ASIC to appear as amicus curiae: (i) to draw the court's attention to an aspect of the proceedings that would not otherwise be brought to the court's attention by the parties (ii) to help the court interpret legislation that the ASIC administers (iii) to address issues relevant to an affected class that are not parties to the case (iv) to provide a contradictory view to that of the parties, where no such view would have otherwise been provided.[470]

Finally, the ASIC may commence civil proceedings in the courts on behalf of persons or firms that have suffered losses.[471] Four conditions must be satisfied before the ASIC can commence

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[466] *Ibid.*

[467] Australian Securities and Investments Commission, 'ASIC's approach to involvement in private court proceedings' (Information Sheet 180) (June 2013)

[468] *Ibid.*

[469] *Ibid*

[470] *Ibid*

[471] ASIC Act, s 50; Consumer Credit Act, s 275.

such proceedings: (i) a formal investigation into the suspected misconduct needs to have been commenced (ii) the proceedings should be in the public interest (for instance, the size of the class of persons must be large or the harm caused must be substantial) (iii) the legal alternatives available to the persons on whose behalf proceedings are filed should be considered (iv) if the person on whose behalf proceedings are intended to be filed is not a company, then written consent is required before proceedings are filed.[472]

9. Summary of the ASIC's enforcement powers

The following is a summary of the sanctions set out above and who they may be imposed by - whether the ASIC itself or on an application to a court.

Sanction	**Imposed by**
Publicity	ASIC
Punitive action	Application to court
Protective action	ASIC
Preservative action	Application to court
Corrective action	Application to court
Compensation action	Application to court
Negotiated resolution	ASIC
Enforceable undertakings	ASIC
Infringement notices	ASIC
Involvement in private court proceedings	Application to court

[472] There are also other ways in which the ASIC may take enforcement action in relation to private claims – see Information Sheet 180 (*Ibid*)

H. RECOMMENDATIONS

RBI as the apex regulator of major financial institutions in the country needs to take a closer look at its current enforcement powers and the loopholes to ensure that there is an effective deterrent effect on not only financial institutions, but also the senior individuals responsible for making decisions affecting the entire financial sector. At the same time, such provisions should not be such as to hamper the growth of the financial market or destroy the risk appetite of senior individuals in-charge of the financial institutions. Therefore, a balance needs to be achieved between effective enforcement action and excessive regulation. It is submitted that at present, the penal powers of the RBI seem to be ineffective in certain situations and do not provide for enough nuances in other situations to allow the RBI to tailor the fine or other penalty to the situation for maximum impact. Some of the other financial sector regulators such as the Competition Commission of India and SEBI seem to be better empowered in comparison to the RBI.

Notwithstanding RBI's specific enforcement powers under the BR Act and the RBI Act, our analysis of RBI's powers under Section 35A in Section I of the report indicates the RBI does have the flexibility to make regulations on most of the enforcement related actions discussed in this chapter under its rule-making powers to make the system more effective. Having said that, in order to make RBI's actions under such enforcement rules less susceptible to legal challenges, it is advisable to make some amendments in the relevant acts to empower the RBI more specifically such that it gives RBI all the necessary enforcement tools (including investigation powers and the flexibility to impose higher penalties, as in case of the FCA) while ensuring legal certainty and predictability. Out of the three regimes discussed in this Section, the UK model is more suitable in the Indian context (because of its lesser dependence on courts). The RBI may consider revamping its enforcement powers to specifically provide for the enforcement tools discussed in this Section and implement such powers in accordance with the FCA model. In the context of consumer protection, the RBI may consider empowering the CPED to directly initiate enforcement action in relation to all consumer protection related violations. This would be the most effective way for ensuring compliance. Notwithstanding the approach to be adopted, the RBI should also consider drafting a code/manual on its enforcement powers in line with international best practices.