

University of New South Wales Law Research Series

**Consumer Protection Issues for Digital
Financial Services in Emerging Markets**

LOUISE MALADY

(2016) 31 2 *Banking & Finance Law Review* 389
[2017] *UNSWLRS* 56

UNSW Law
UNSW Sydney NSW 2052 Australia

E: unswlrs@unsw.edu.au

W: <http://www.law.unsw.edu.au/research/faculty-publications>

AustLII: <http://www.austlii.edu.au/au/journals/UNSWLRS/>

SSRN: <http://www.ssrn.com/link/UNSW-LEG.html>

Consumer Protection Issues for Digital Financial Services in Emerging Markets

Louise Malady*

1. INTRODUCTION

Innovative digital financial services (DFS) are held out as a key solution for greater financial inclusion assisting low-income households to overcome poverty using lower cost methods for managing their finances. Financial inclusion refers to consumers having access to, and using, a financial service or a transaction account to meet their financial needs.¹ However, DFS roll-outs are plagued by infrequent end-user usage despite high registration numbers.² Account inactivity rates are estimated at greater than 65 per cent.³ A concerted effort is being placed on building consumer demand for DFS to overcome this inactivity.⁴ Directing regular government payments through DFS channels so consumers become active users of DFS is one key way to build demand ('funding the unfunded' not simply 'banking the unbanked').⁵ However, active usage also requires consumers to value and trust DFS. The newly banked must be confident in storing and accessing what little savings they have in a digital format. Consumer protection frameworks for DFS are critical in building the necessary trust and confidence.⁶

* Senior Research Fellow, UNSW Australia, Sydney, Australia. This research is supported by the Centre for International Finance and Regulation (CIFR) (project no. E226), UNCDF, Standard Chartered Bank, and UNSW Australia, Sydney, Australia. CIFR is a Centre of Excellence for research and education in the financial sector which is funded by the Commonwealth and NSW Governments and supported by other consortium members, www.cifr.edu.au. I would like to thank Ross Buckley for his helpful comments and Nicole Mazurek for research assistance. All responsibility lies with the author.

¹ Committee on Payments and Market Infrastructures, Bank for International Settlements and World Bank Group, *Consultative Report: Payment Aspects of Financial Inclusion* (September 2015), 4 online: <<http://www.bis.org/cpmi/publ/d133.htm>> .

² Mobile money account registrations reached 300 million in 2014 according to GSMA, "The State of the Industry: Mobile Financial Services for the Unbanked" GSMA, 2015, 8.

³ *Ibid.* at 26.

⁴ Ross P. Buckley & Louise Malady, "Building Consumer Demand for Digital Financial Services: The New Regulatory Frontier — Part I" (2014) 131(10) *Banking L.J.* 834 and Ross P. Buckley & Louise Malady "Building Consumer Demand for Digital Financial Services: The New Regulatory Frontier — Part II" (2015) 132(1) *Banking L.J.* 35.

⁵ "Can Governments Ignite Financial Inclusion Programs?" *PYMNTS*, (18 August, 2015), online: PYMNTS <<http://www.pymnts.com/exclusive-series/2015/can-governments-ignite-financial-inclusion-programs-through-mobile-payments/#.Vd5IOkY-poiI>> .

Financial regulators, in designing and developing consumer protection frameworks for DFS, must view the DFS from the consumers' perspective. One straightforward way to do this is to look at the role and characteristics of the participants involved in the typical payments chain of DFS. The particular nature and role of the participants gives rise to specific consumer risks and challenges for DFS. Regulators should consider: the *nature* of the newly banked consumer; the *reliance* on technology and mobile network operators; the use of agents to facilitate use of the service in remote and rural areas; and the nature of the *relationship* between the issuer of the DFS and the end-user. The issuer and end-user are two critical participants in any payments chain; however, the two participants may never even meet face-to-face in the DFS ecosystem.

Using this framework to understand the nature and roles of participants in the DFS payments chain, from the consumers' perspective, and how these roles and characteristics give rise to consumer risks in DFS, regulators can improve the design and development of consumer protection frameworks for DFS in more meaningful ways for the end-user.

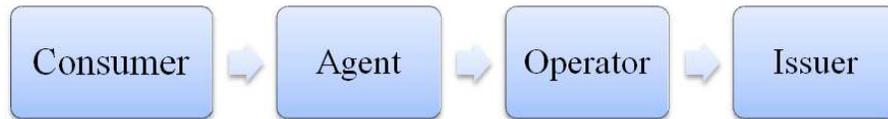
In this paper, we present this framework of analysis and the key principles which consumer protection frameworks should include to mitigate consumer risks, given the particular nature and roles of participants in the DFS payment chain. We also identify responsibilities for regulators in applying these principles, including that regulators address the uncertainty around accountability which arises due to the many and varied participants involved in DFS and the regulatory gaps and/or overlaps which arise as a result. We also recommend regulators make better use of the technological innovations available with digital channels — oversight and supervisory methods would be better for entering the digital age.

2. CONSUMER RISKS IN DFS ANALYSED USING THE PAYMENT CHAIN

Consumer protection frameworks need to guide participants towards behaviour and actions which contribute towards the best outcomes for those being financially included.⁷ In order to do this, the nature and roles of participants in a typical payment chain for DFS must be understood. This section presents a framework for this analysis and, in doing so, identifies consumer risks specific to DFS. The participants include: consumers; agents; mobile network operators; and issuers (or providers).

⁶ Kate McKee & Jamie Zimmerman, "Do Mobile Money Clients Need More Protection?" CGAP, (14 March 2014), online: CGAP <<http://www.cgap.org/blog/do-mobile-money-clients-need-more-protection>> .

⁷ Mobile Financial Services Working Group, "Mobile Financial Services: Consumer Protection in Mobile Financial Services," Alliance for Financial Inclusion, Guideline Note No 13 (March 2014), 2 online: MFSWG <<http://asbaweb.org/E-News/enews-37/incfin/06incfin.pdf>> .

Figure 1: Payment Value Chain by Participants for Typical DFS**The consumers**

Consumers are often previously ‘unbanked’ and unfamiliar with formal financial services, let alone technology-based financial products and services. Consumers may have low levels of literacy, including financial literacy. If, for example, SMS menus on mobile phones are difficult to follow or not in local languages, or sign-up processes are unnecessarily complex, the consumer may find the products and services complex and difficult to understand.⁸

The agents

Agents are the ‘human face’ of the DFS provider for consumers living in remote areas where providers are not physically present. The ultimate success of DFS as the key solution for financial inclusion rests on agent behaviour contributing towards the best outcomes for consumers. *The reliance on non-bank agent networks* in DFS to provide the essential role of cash-in and cash-out for consumers means consumers directly interface with entities which are generally undertaking their activity as an outsourcing arrangement with a bank or a mobile money provider. The provider/principal may well have less control of the agent’s behaviour than bank branch staff, yet this agent’s behaviour will be critical to building consumer trust in the DFS.

The mobile network operators (MNO) and infrastructure used by the MNO

DFS in emerging markets are, by their very nature, *mobile technology dependent* financial services. Reliable mobile telecommunications infrastructure is necessary, as is reliable network coverage. Consumers will not be confident they can conduct transactions safely and efficiently, when needed, if they do not have reliable infrastructure and network coverage.⁹

⁸ World Bank Development Research Group, Better Than Cash Alliance and Bill & Melinda Gates Foundation, “The Opportunities of Digitizing Payments,” International Bank for Reconstruction and Development/The World Bank, (August 2014) 16.

⁹ Antonique Koning & Monique Cohen, “Enabling Customer Empowerments: Choice, Use, and Voice” CGAP, (March 2015), 2-3 online: CGAP < http://www.cgap.org/sites/default/files/Brief-Enabling-Customer-Empowerment-Mar-2015_0.pdf > .

The issuers (or providers)

An issuer (or provider) is the entity acquiring the consumer. It issues its customer with the payment instrument or device used in making transactions. It is the entity with primary responsibility for safeguarding its customer's funds and private data. However, for most DFS products, the issuer will never physically meet its customer. Issuers need to work in different ways when connecting with their customers and providing basic consumer protection. Issuers need to empower customers so customers know what they can do with the DFS and what demands they can make of the issuer.¹⁰ Empowering customers requires *time* and *opportunity*:

- The *relationship* between the issuer and its customer must be seen as *ongoing* and as building over time because this is a new environment for the customer;
- The customer needs the opportunity to use the DFS — be it through receiving regular payments through the DFS channel, or being given digital games to practice using the channel. This assists the customer in remembering their passwords and remembering how to use the product and further appreciating why PINs and mobile phones should be kept safe and secure; and
- The customer needs the *opportunity to use recourse mechanisms* — to ensure the mechanisms work and to provide them with experience in using the mechanisms, increasing familiarity and thereby trust. Without these opportunities, consumers, in general, will not learn to become more capable users of DFS and providers will not learn how to be more supportive of their customers in order to build the relationship.

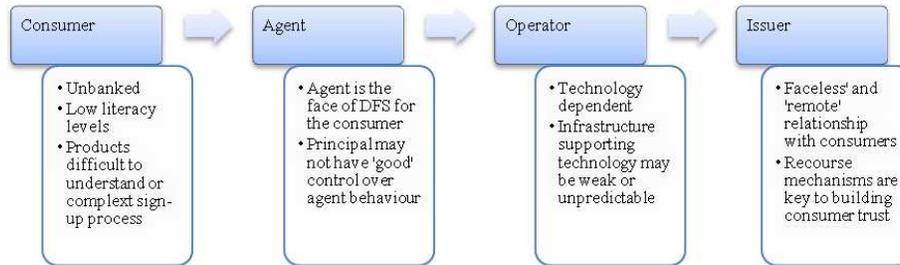
Consumers will not value and trust DFS if there are inadequate recourse mechanisms available to them when using the DFS. The absence of timely and accessible complaint and dispute resolution mechanisms has been found to have a negative effect on consumer trust.¹¹ Consumers will not want to return to using products if they are not satisfied with the experience. Issuers play a crucial role in creating the right consumer experience so their customers become active users. Often this may require issuers to provide a complaint hot-line that is free to call and sufficiently well-staffed to answer calls relatively promptly.

Figure 2 shows the participants in the DFS payments chain and summarises the participants' characteristics and roles which give rise to consumer risks in DFS.

¹⁰ *Ibid.* at 3.

¹¹ Megan Chapman & Rafe Mazer, "Making Recourse Work for Base of Pyramid Financial Consumers," CGAP, Focus Note 90, (December 2013), 1 online: CGAP < <http://www.cgap.org/publications/making-recourse-work-base-pyramid-financial-consumers> > .

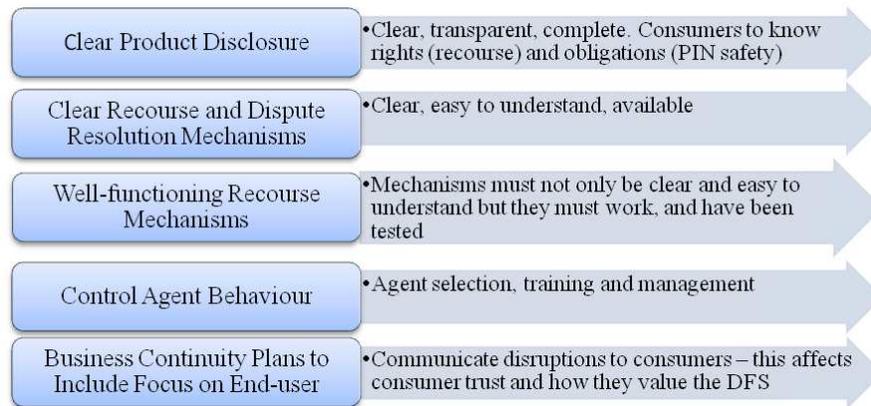
Figure 2: Payment Chain by Participant



3. KEY PRINCIPLES OF DFS CONSUMER PROTECTION FRAMEWORKS AND RESPONSIBILITIES FOR REGULATORS

This section outlines key principles for regulators to use in the design and development of consumer protection frameworks for DFS. Many principles, codes of conduct and standards for financial consumer protection already exist.¹² The principles below draw on these existing principles, codes and standards, but target specifically the risks of DFS in emerging markets as identified with the framework of understanding the nature and role of participants in the typical DFS payment chain. Figure 3 below summarises these key principles.

Figure 3: Key Principles



¹² See for example, OECD, “Report on Consumer Protection in Online and Mobile Payments” OECD, Digital Economy Papers No 204, (August 2012), online: dx.doi.org < <http://dx.doi.org/10.1787/5k9490gwp7f3-en> > and Jamie Zimmerman, “The Emergence of Responsible Digital Finance,” Centre for Financial Inclusion, (21 July 2014), online: cfi-blog.org < <http://cfi-blog.org/2014/07/21/the-emergence-of-responsible-digital-finance/> > .

1. Product Disclosure

Product disclosure must be clear, transparent and complete. Consumers need to understand their rights and obligations when using DFS. In particular, consumers should understand their obligations to keep PINs safe and confidential.

2. Clear Recourse Mechanisms

Dispute resolution mechanisms must be clear, easily understood, available and accessible without increasing call charges.

3. Well-functioning Disclosure and Consumer Recourse Mechanisms

Issuers of DFS must understand their role and responsibility to end-users evidenced by *well-functioning disclosure and consumer recourse mechanisms*. Newly-banked consumers may not be used to lodging formal complaints or using redress mechanisms no matter how clear or well-thought through such processes may be, therefore evidence that these mechanisms are functioning (being used) is needed.

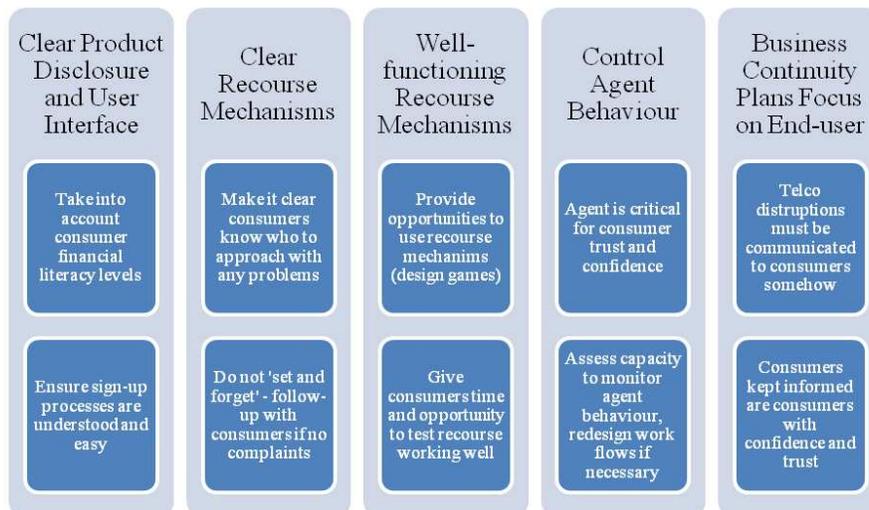
4. Control Agent Behaviour

Issuers must take steps to ensure agents act appropriately when undertaking the agent role.

5. Business Continuity Plans to Factor in End-User Concerns

Issuers must ensure their *responsibilities to consumers are considered in business contingency plans* for dealing with disruptions in consumer transactions due to network coverage problems or disruptions in telecommunication services.

Figure 4: Mapping the Risks to the Key Principles



4. REGULATORY RESPONSIBILITIES

In order to focus specifically on building consumer trust and confidence in DFS, we urge regulators to be active in applying the principles outlined in Section 3 above. In order to be active regulators in this regard, we highlight five responsibilities for regulators to focus on in conducting oversight and supervision of consumer protection issues for DFS:

- a. Demystify accountability for mitigating consumer risk;
- b. Clarify lines of regulatory responsibility and enhance inter-regulatory collaboration when necessary;
- c. Mesh financial literacy and financial education into consumer protection frameworks;
- d. Using behavioural research to inform policies; and
- e. Leverage on the use of digital channels to conduct supervision.

(a) Demystify Accountability for Mitigating Consumer Risk

Gone are the days when the payment chain was simply between the consumer and the bank in traditional bank deposit based transactions. A consumer using DFS now engages with an agent, an MNO and the issuer of the DFS. Furthermore, the agent, the operator and the issuer may all be different types of entities themselves adopting different activities and responsibilities within the payment chain to what was previously envisaged by consumer protection regimes. This multiple engagement on multiple levels can create confusion for the consumer as to who is accountable for product delivery and reliability. Is it the agent, the MNO or the issuer? Even if a consumer is not confused, simply having a broader range of participants involved in the delivery of branchless banking services means the party that is accountable, if there are problems encountered in using the DFS, is *less transparent* to consumers.

Regulators need to ensure the lines of consumer accountability are clear for all participants in the payment chain. Consumers need to know which institution to approach when seeking recourse and redress and regulators have a role to play in ensuring this knowledge for consumers is accessible and easily understood. Regulators can encourage financial institutions to focus on improving consumer awareness on how to have grievances addressed at the institution level — efficiently and effectively. Regulators can also seek to ensure ancillary consumer protection arrangements are in place which acknowledge some consumers may prefer to approach an independent body when making complaints — for example a banking ombudsman.

(b) Clarify Lines of Regulatory Responsibility

There is a range of regulators involved in regulating DFS because of the broad range of participants involved in providing DFS. This has two effects: it can *complicate regulatory accountability* in the minds of the consumer; and it can

give rise to *variability in regulatory and protection* regimes. Regulators have a responsibility to ensure transparency in oversight and supervision and to work with other regulators to reduce variabilities in regulatory requirements with the aim of creating level playing fields. Table 1 maps some of these regulatory overlaps.

Table 1: Regulatory Overlaps

	Payments Oversight (Infrastructure focus)	Banking Supervision (Entity focus)	Consumer Protection (End-user focus)
High Value Payment Systems	X		
Retail Payment Systems	X		X
Banks		X	X
Banks' own (closed loop) payment systems	X?	X	X
Bank Agents		X	X
Payment Instruments	X		X
Non-bank Payment Service Providers	X?	X?	X

Governments and regulators need to identify, and act on, issues concerning *regulatory capacity, mandates or inter-regulatory cooperation*. Regulation which is activity focused and technology neutral will minimise duplication in regulation or regulatory overlaps. With '*entity focused regulation*' different entity types may undertake the same activity and be governed by different regulations. When *regulation is 'provider neutral', or 'activity focused'*, it can facilitate a more consistent supervisory approach across different entities doing the same activities. In other words, it can provide an 'even playing field' for entities offering similar services, and it reduces the likelihood of regulatory arbitrage — as there is no incentive for an institution to change its institutional classification simply to circumvent regulations.

(c) Mesh Financial Literacy and Financial Education into Consumer Protection Frameworks

Consumer education and financial literacy need to be closely inter-linked with consumer protection. When consumers are given access to financial services with the aim of including these consumers in the formal financial system and thereby enhancing their well-being, these efforts will come to nought if consumers are not adequately informed on how to use the products, and their rights and obligation in using the products. Newly-banked consumers need to know how to respond if they encounter a problem in using the DFS. For example, without consumer education there could be little understanding of what redress mechanisms are available to consumers and so they may resist using the DFS in the first instance. Consumer education provides the foundation for building consumer trust in the services, increasing the likelihood the services will be used.

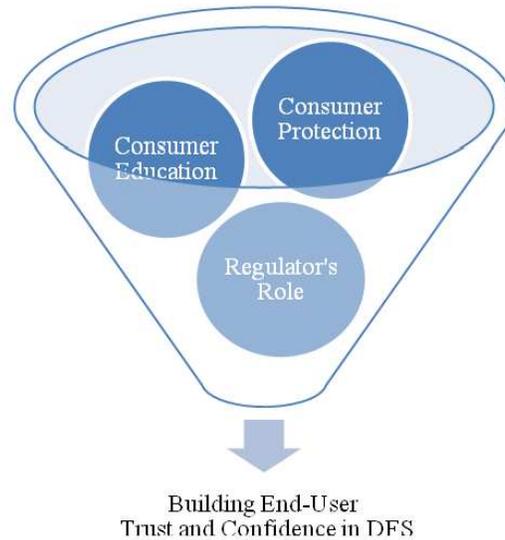
Financial literacy programs should be designed around educating the consumer at the point when they are first using the product or service, as research indicates consumer experience in using new products is more important than pre-education which may be expensive.¹³ In order to build consumer trust and retain it even in case of negative experiences, *education* should focus on the *cost of using the service* and identifying for the consumer the *redress mechanisms* available.¹⁴ More recent research continues to support findings that specific, targeted and simple consumer education is most important.¹⁵ Consumers who know how to respond when problems are encountered are more likely to use and trust the new services.

¹³ Julie Zollman & Daryl Collins, “Financial Capability and the Poor: Are We Missing the Mark?” FSD Kenya, (December 2010), 4 online: FSD Kenya < <http://fsdkenya.org/publication/financial-capability-and-the-poor-are-we-missing-the-mark-fsd-insights-issue-02> > .

¹⁴ *Ibid.* at 4.

¹⁵ Amber Davis, “Improving Everyday Financial Decisions: Brief, Specific and Targeted Education Could Help the Poor Make Better Choices,” NextBillion, (24 October 2014), online: NextBillion < <http://nextbillion.net/blogpost.aspx?blogid=4130> > .

Figure 5: Meshing Financial literacy and Financial Education into Consumer Protection Frameworks



Issuers who provide consumer education alongside the roll-out of new branchless banking products are also more likely to then understand weaknesses in product disclosure and redress mechanisms. Collaborative research undertaken by MicroSave, CGAP and BFA in four countries (Uganda, the Philippines, Bangladesh and Colombia) focusing on how consumers *perceive* risks in DFS found that unclear pricing and recourse were considered “high” risks by consumers.¹⁶

Regulators need to ensure consumer education and financial literacy initiatives are woven into consumer protection frameworks. National financial inclusion strategies are focused on financial education and literacy, however, this needs to be tied in with the simple step of ensuring consumers fully understand consumer protection mechanisms for innovative DFS. For example, regulators should conduct financial education campaigns with the assistance of the issuers (product providers). This could include interactive role-play sessions where consumer protection mechanisms are demonstrated “live”.

¹⁶ MicroSave, CGAP and BFA, “Consumer Protection and Emerging Risks in Digital Financial Services,” presented by MicroSave at the Responsible Finance Forum in Perth, (28 August 2014), 4 online: [responsiblefinanceforum.org <http://responsiblefinanceforum.org/publications/consumer-protection-emerging-risks-digital-financial-services/>](http://responsiblefinanceforum.org/publications/consumer-protection-emerging-risks-digital-financial-services/).

(d) Using Behavioural Research to Inform Policies

Behavioural research sheds light on the financial behaviour and decision making processes of different segments of the population.¹⁷ Policy makers in developing countries can incorporate insights from this research into consumer protection regulation and supervision. Emerging findings from behavioural research, in particular on the role of scarcity in financial decision making for low-income consumers, underscores the importance of policies that better protect consumers from providers.¹⁸ Local context still matters; it is important to apply insights specific to each market and consumer segment within that market as opposed to attempting a “one-size-fits-all approach to behaviourally informed consumer protection policy making”.¹⁹

Behavioural research also highlights that it is important for regulators, for example, to understand how consumers perceive a product’s terms and conditions. Are consumers comprehending the terms and conditions as intended? Are they reading the conditions at all, or just checking the “I accept” box? Oversight and supervision methods can be used to help ensure consumers understand the terms and conditions better.²⁰ Consumer behaviour research has found that some consumers do not perceive digital borrowing in the same way to, or as seriously as, borrowing real money.²¹ This is not so surprising for emerging markets where the culture is steeped not in ‘western’ traditions of borrowing and repayment but in shared community obligations such as debts from marriages or for funerals, for example. In such cultural settings simply rolling out digital products based on traditional ‘western’ borrowing concepts could lead to significant credit problems for consumers, bad debts for providers, and a general mistrust of DFS.

(e) Leverage on the Use of Digital Channels to Conduct Supervision

Regulators must explore, and make better use of, digital capabilities for oversight and supervision as well as expecting industry players to use digital channels to deliver financial services. Digital channels can be used to gain feedback on the sort of job that agents are doing. Where consumers are not necessarily best placed to give feedback on agents, field inspectors can be used, armed with mobile phone technology, to report back on the use of DFS in the field and the behaviour of agents.

¹⁷ Rafe Mazer, Katharine McKee & Alexandra Fiorillo, “Applying Behavioural Insights in Consumer Protection Policy,” CGAP, Focus Note No 95, (June 2014), 1.

¹⁸ *Ibid.* at 2, box 1.

¹⁹ *Ibid.* at 17.

²⁰ Rafe Mazer & Alexandra Fiorillo, “Digital Credit: Consumer Protection for M-Shwari and M-Pawa Users,” CGAP, (April 2015), online: CGAP < <http://www.cgap.org/blog/digital-credit-consumer-protection-m-shwari-and-m-pawa-users> > .

²¹ *Ibid.*

The use of mystery shopping techniques or online surveys can also leverage on the use of digital channels to conduct supervision. Mystery shopping can also provide regulators with a better understanding of how the products work on a number of fronts:

- How terms and conditions are being conveyed to consumers.
- How banks/issuers are educating consumers with respect to keeping PINs safe and confidential.
- How effective are consumer support and dispute resolution mechanisms.
- What the agent behaviour is like in the field.
- How information is conveyed to consumers if there are disruptions in transactions due to technology problems.

On line surveys can be devised for issuers to complete with the objective of developing a better understanding of consumer concerns when using DFS. Regulators can analyse responses to identify areas of concern and developments of trends in market practices. From this analysis regulators can respond, either through regulation or enforcement.²² Surveys could include the following:

- What is the nature of consumer complaints received?
- What is the time taken to resolve the complaints (are the consumer protection policies successful)?
- What are the problems in resolving the complaints (this can give an understanding of gaps in consumer protection policies)?
- Where do consumers lodge complaints (i.e. is it a regulator or provider)?
- Who generally resolves consumer complaints?

The foregoing responsibilities, in summary, suggest the need for regulators to adopt a risk-based, technology-sensitive and collaborative approach in the oversight of consumer protection in DFS. Regulators should be mindful of the distinctive roles and characteristics of the four key players in the payment value chain, and design corresponding initiatives around the proposed key principles. Regulators should stand ready to address gaps in DFS consumer protection where industry actions fall short.²³

5. CONCLUSION

Innovative DFS are held out as a key solution for greater financial inclusion assisting low-income households to overcome poverty using lower cost methods for managing their finances. Initiatives directed at ‘funding the unfunded’ and ‘banking the unbanked’ are, however, not enough. Active usage of DFS also

²² Alliance for Financial Inclusion, “Consumer Protection: Leveling the Playing Field in Financial Inclusion” IFC, (2010), 3 online: ifc.org <<http://www.ifc.org/wps/wcm/connect/fe7cc88049585e949cf2bd19583b6d16/Tool+5.10.+AFI+Report+-+Consumer+Protection+Policy.pdf?MOD=AJPERES>> .

²³ Katharine McKee, Michelle Kaffenberger & Jamie M. Zimmerman, “Doing Digital Finance Right: The Case for Stronger Mitigation of Customer Risks” (Focus Note no 103, CGAP, June 2015), 23 <<http://www.cgap.org/sites/default/files/Focus-Note-Doing-Digital-Finance-Right-Jun-2015.pdf>> .

requires consumers to value and trust the DFS. The newly banked must be confident in storing and accessing what little savings they have in a digital format. Strengthening financial consumer protection frameworks to incorporate the needs and concerns of end-users will enable regulators and market participants to create digital ecosystems which are relevant and used.

Financial regulators, in designing and developing consumer protection frameworks for DFS, must view the DFS from the consumers' perspective. This paper has presented a straightforward way to do this by looking at the role and characteristics of the participants involved in the typical payments chain of DFS, from the consumers' perspective. This acknowledges that the issuer and the end-user are two critical participants in the payments chain, however, these two participants may never even meet face-to-face in the DFS ecosystem. Consumer protection must therefore be handled differently in the case of DFS. This paper also presented key principles for consumer protection frameworks to mitigate consumer risks, given the particular nature and roles of participants in the DFS payment chain. Lastly, this paper identified responsibilities for regulators in applying these principles, including the need to address the uncertainty around accountability which arises due to the many and varied participants involved in DFS and the regulatory gaps and/or overlaps which arise as a result. This paper also recommended that regulators bring oversight and supervisory methods into the digital age by making better use of the technological innovations available with digital channels.