



IFMR CONFERENCE AUG 31, 2012
CONSUMER PROTECTION
A PRACTITIONER'S VIEW



Swadhaar FinServe Pvt. Ltd. (SFPL)

Urban NBFC-MFI headquartered in Mumbai

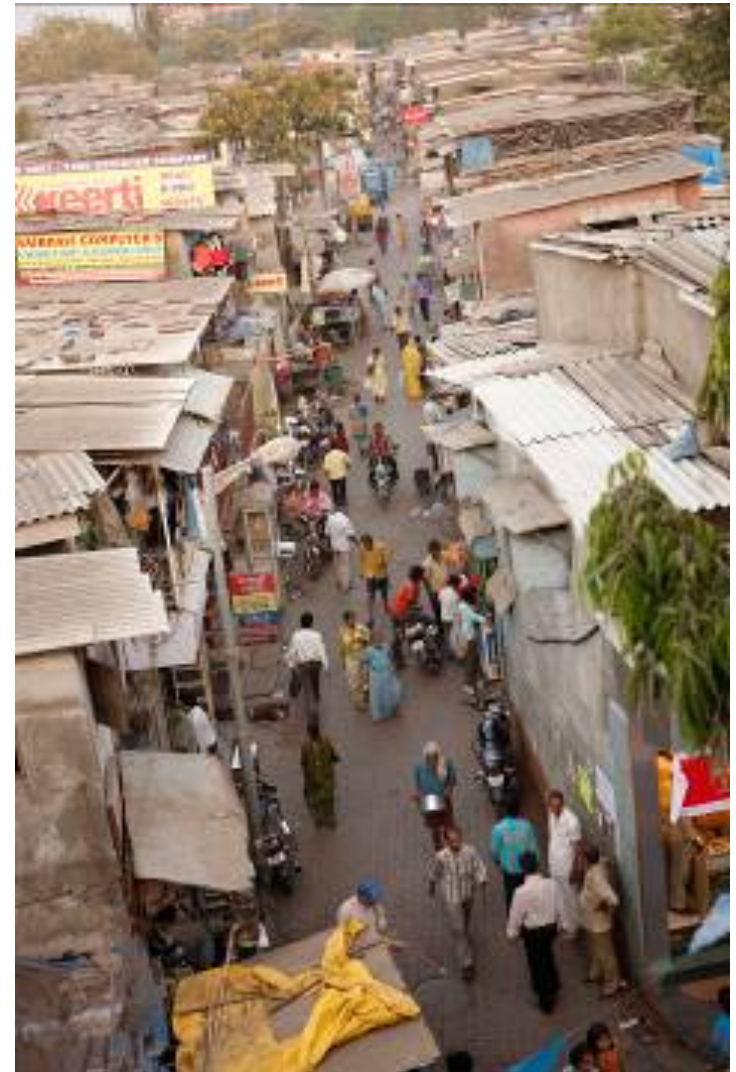
Started operations in 2006 (originally as a non profit)

As on 31st July 2012, 80K+ Active clients and a portfolio of Rs 76.5 crores across 30 branches in 2 states

Individual and Group Loans

Mission Statement

To make available responsible and efficient financial services to **economically vulnerable** and underserved **urban households**, enabling them to **attain financial security and meet their aspirations.**



Consumer Protection – Financial Services



Uniformity across diverse customer segments

- Novice , Educated and Sophisticated Consumer
- Low Income, Middle Income and High Net worth

Uniformity across Entities

- Size, Form, Commercial vs Double Bottom Line

Buyer and Seller

- Informed Choice (Clear Statement of Key Features and Differentiators) vs
- Full Disclosure (Voluminous contracts and fine print)

Typical Customer Profiles



The 'Novice' Financial Services User

- Basic Literacy Levels (largely number literate)
- May be economically active
- Some instinctive understanding of very basic financial concepts
- Low grasp of calculations (e.g. would best understand interest rate as a flat number)
- Low grasp of dense written matter (such as detailed product terms)
- High awe of authority – would follow instructions delivered in person even if contradictory to written details
- Would best understand simple, verbal instructions
- Important information would need to be repeated several times

Typical Customer Profiles



Otherwise ‘Educated’ but unfamiliar Financial Services User

- Reasonable to High Literacy Levels
- Economically active
- Manages household or Short Term Budget
- Low to Reasonable understanding of basic financial concepts
- Unfamiliar with making long term financial decisions
- Good grasp of calculations (e.g. would clearly understand interest rate as a declining rate and APR)
- Averse to legal contracts or dense written matter (e.g. **won't** read detailed product terms rather than **can't** understand)
- Will trust a finance professional – would base decisions on peer group, “expert” recommendations, press rankings etc.

Typical Customer Profiles



The ‘Sophisticated’ Financial Services User

- High Literacy Levels including Financial Concepts
- Economically active and successful
- Familiar with making financial decisions
- Good grasp of dense written matter (e.g. would understand and read detailed product terms and contracts)
- Would question inconsistencies between product details / presentations different from written instructions/terms
- Would prefer official written communication from the Financial services company
- Will research before taking a decision

Components of Customer Disclosures



FINANCIAL EDUCATION

- Life Cycle needs and correlated financial needs
- Principles of Money Management
- Building a simple, personal Cash Flow and net worth statement
- Savings – how small amounts can add up, the effect of compounding
- Different financial instruments; what to use when
- Plan to Build Assets and Meet Goals

PRODUCT DISCLOSURE

All Product Details

All Product Terms and Conditions

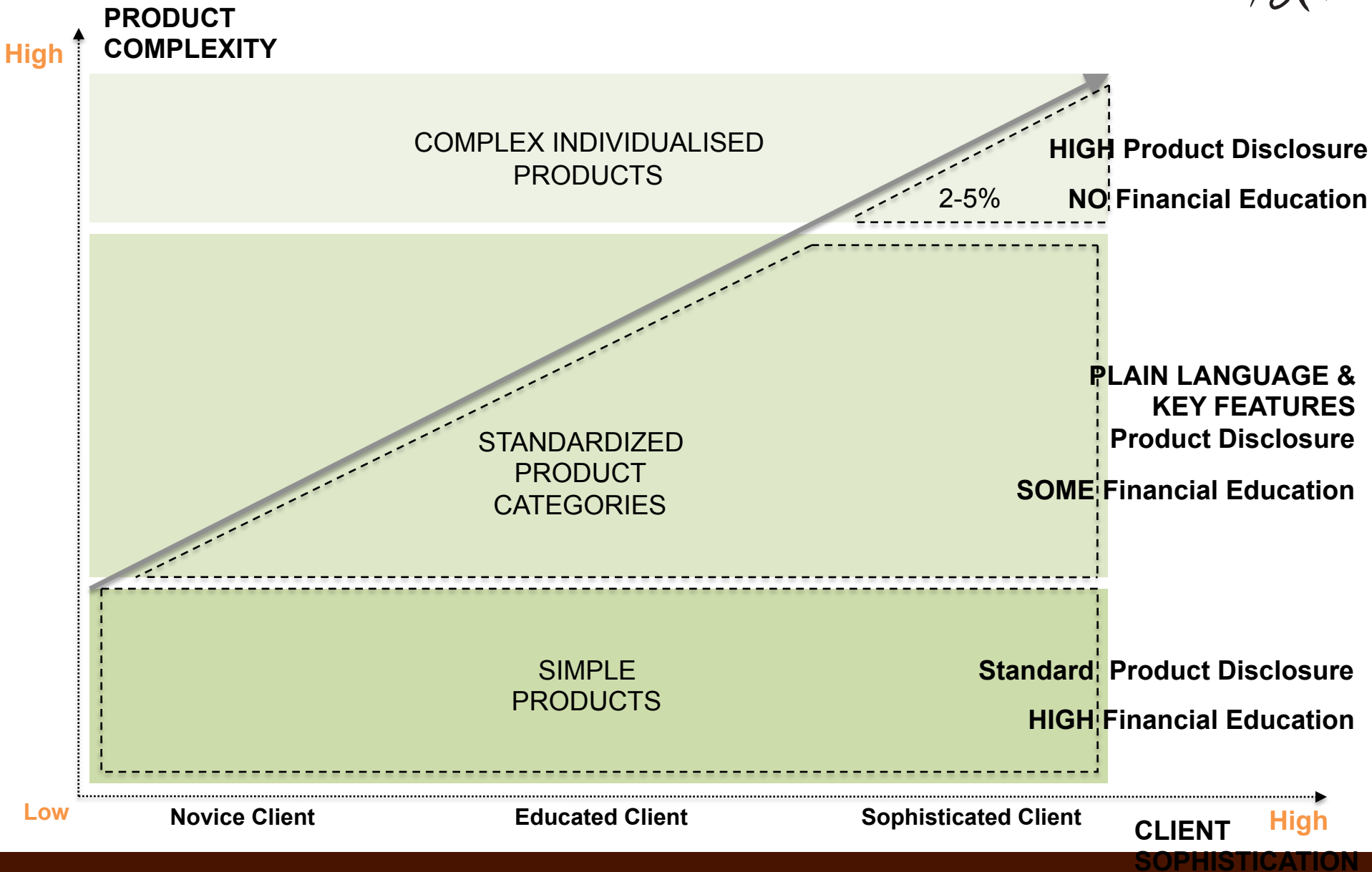
Pricing Information including all charges and fees

Comparison with similar products in the Market

Simulations to show future benefits / risks

Details on Process

Matching Disclosures to Clients





Importance of Consumer Behaviour

- Even “educated” clients face confusion when presented with dense information
- Too many choices deter rather than aid a choice being made
- The context, way it is presented and who presents it – affects decisions:
- Need for
 - Financial education not only for poor clients but a *majority of financial services consumers to provide “context”*
 - Adequate, Understandable and comparable product Information for *a majority of products*

Emphasis on Disclosure vs. needs of MFI Clients



What does the ‘novice’ Microfinance Client understand/ have options for ?

- Simple calculation for Interest Rate; will understand ‘flat rates’ but may not easily understand ‘reducing rates’
- Will use EMI as an important decision factor
- Cash Flow vs. Cost
- Uses Loans as a surrogate for other financial products
- Moving from Micro credit – Micro Finance

Responsibly Meeting the Disclosure needs of MFI Clients



*“More Information does not typically translate into better decisions.”**

- Handouts with detailed information are not enough; information needs to be explained in person
- Use simple and innovative ways to communicate and display information
- Reiterate important messages several times in the process
- Conveying too many details can become confusing for them; hence the most important details should ideally be culled out and explained

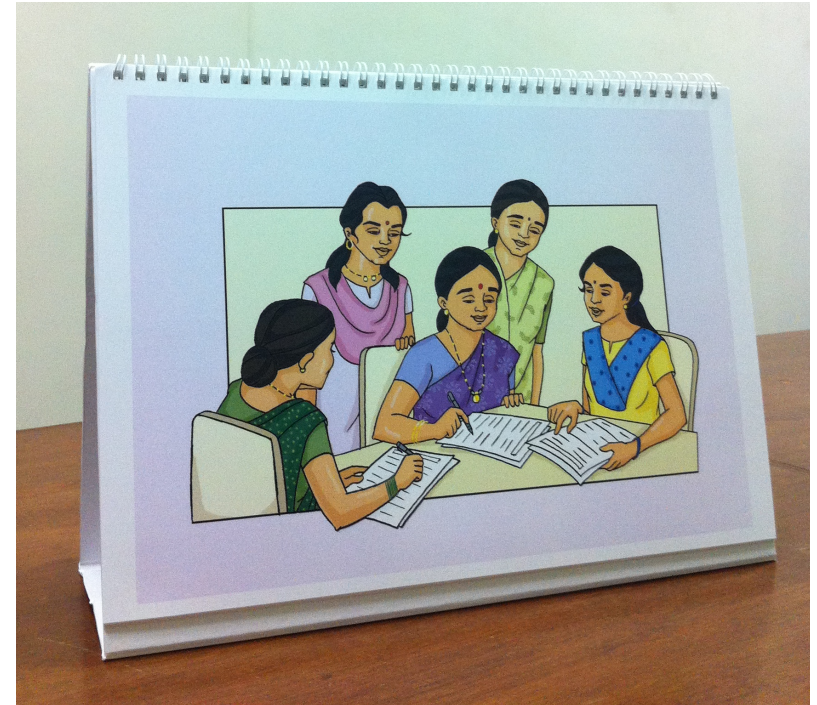
Implementing these measures effectively, can generate high operational costs for the institution



RESPONSIBLE Behaviour - Making Disclosures Effective

FLIPCHARTS

- Using Visual Illustrations to explain products and process details
- Standardize Information given to clients
- Serve as a tool for Administrative Staff and Loan officers for standard client communication



COSTS

One time Cost for designing material: ~Rs 50,000

Production Cost per Flipchart: ~Rs 350

Total Cost for MFI with ~500 Field Staff : **Rs 2,25,000**



Making Disclosures Effective

FINANCIAL EDUCATION MODULES

- 5 module course offered to all clients as a optional service



COSTS

Cost paid by Participants for attending the course: $\text{Rs } 30 \times 25 = 750$

Cost to Organization of running course: $\text{Rs } 1,200$

Making Disclosures Effective



INFORMATION TO CLIENTS

- Tear-off section in application forms to give clients a 'receipt'
- Include product pricing details and customer care number for client's reference
- Serve as a control tool for Administrative Staff

Residence / Business Address Proof : _____ Document No. _____

Ration card _____
 Electricity Bill _____
 Other _____ (specify): _____

4. EMPLOYMENT / BUSINESS DETAILS

Type of Employment : Salaried Business Not Working # of years in Service / Business: _____

4.1. FOR SALARIED

House Maid Cook Security Guard Aaya/Caretaker Peon Others (specify here) : _____

4.2. FOR BUSINESS

Business Ownership : Own Rented Business Structure : Shop / Store Home Based Hawker
Business Type : Self Employed Commission Based Business Sector : Trade Service Manufacturing

Business Activity : Tickli Moti Fruit Selling Papad Making Gen/provision/Kirana Shop Vegetable Selling Milk Selling
Tiffin Services Tailoring Kite Making Imitation Jewellery Fish Selling Other (specify here) _____

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Tear this section and give to the client

Interest rate: 26% p.a. (excluding balance)
(equivalent to 14.65% p.a. flat)
Processing fees: 1% of loan amount
Exclusion of all taxes

Please use this number for all future references
Application number : GL-N- _____

Application Date : _____ Name of Lone Officer : _____
Next Appointment Date : _____ Signature of Loan Officer : _____

COSTS

Additional cost per Application form: Rs 0.20

Average Number of forms used in a year for a MFI doing 150,000 disbursements: 200,000

Total Additional Annual Cost for MFI : ~ **Rs 40,000**



Responsibly Meeting the needs of Disclosure for MFI Clients

Current Regulatory Requirements have an emphasis on Documented Product Disclosure:

- Communication of all Product pricing and terms to clients at every stage of the loan process
- Clients to be given copies of all loan documents
- All Communication to clients in vernacular languages

This needs to be combined with a strong element of Financial education



Mandating Product Features – What is Responsible Lending ?

- Interest / Margin Caps - Institutional viability – Affects supply
- Clients to be treated fairly, and with respect and dignity
- No collection at client location unless client defaults twice
 - Delinquency Risk
- 70% of all loans to be given only for Income generation activities - Customers who need to meet cash flow gaps for needs such as education or house repair are then forced to the moneylender
- Loans to be given only to families with HHI <10,000 per month – many urban customers who may have higher HHI but low disposable incomes due to the high cost of living are unable to access much needed financial services

Starting Somewhere – Emerging Market



Licensed Institution / Delivery Channel

- Foster Responsible Culture
- Industry – SRO?
- **Mandated Disclosures**
- **Control Product Design**
- External assessment/
Grading
- Consumer Recourse?

- **Unregulated Provider**
- Individual with low capital
- Enabled because of -
Lack of Adequate and
Appropriate Supply
- Monopoly Power
- Exploitation
- Consumer options ?
- Consumer Recourse?

And Building to Last



- What to disclose? – All Terms and Contracts , Key Information that impacts the choice
- How to disclose? Standard Contracts – in plain local language training, product literature, third party channels – needs more attention
- Who ? Qualified Institutions, Delivery Channels – Fit and proper – Professionals at what level ?
- Demonstrate Responsible Behavior & Due Care in Product Design, Key Information Design and Consumer selection
- Proactive Regulatory (Self Regulatory) Watch ?
- Fair, Effective Grievance Redressal Mechanism.



- “The truth, of course, is that no consumer “chooses” to accept the tricks and traps buried within the legalese of financial products. Rather, consumers must choose among various products with one feature in common: dozens of pages of incomprehensible fine print.
- The *Consumer Protection Agency* will not limit consumer choice. **Instead, it will focus on putting consumers in a position to make choices for themselves by streamlining regulations, making disclosures smarter, and making financial products easier to understand and compare”**



- Elizabeth Warren, chair of the Congressional Oversight Panel and the Leo Gottlieb Professor of Law at Harvard University.

2009 – after the Crisis on setting up the CPA in the most mature financial market