Why customer protection is central to financial inclusion

Imagine the following scenario. Raja and Rani are a low-income householder couple with two children in elementary school. They also take care of Raja's ailing mother. The household's monthly income is ₹20,000. They have some post-office savings, and Rani participates in a group savings-and-loan scheme with some other women in her community.

An insurance agent persuades Raja to buy an endowment policy — an insurance-cum-investment product. Raja must pay a premium every year for a certain number of years. These premiums will be invested in some securities which will earn a certain rate of return. The policy has a maturity date, and on that date, all premiums will have been paid up by Raja, and because they were invested in securities, they will have attained a certain value greater than what Raja had paid up. Raja can "cash out" and receive the value of his investment, but then he will forfeit the life insurance amount that his family would have earned upon his death. Or, he can continue to hold the policy until he dies, and his family will then receive the value of his investment upon his death.

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This sounds wonderful for Raja and Rani, except that they probably cannot afford such a policy for various reasons. The premiums on endowment policies tend to be quite high, especially for a low-income household. Further, it is not as if the "life cover" — the payout to Raja's family in case of his death — is substantially high enough to justify those large premiums. If Raja should miss a premium payment, then he would have to "surrender" the policy and pay a hefty penalty. Simply put, endowment policies are not "suitable" for low-income households.

Raja would be better off buying a term life insurance policy, which would not promise any investment returns but only a single payout to his family in the event of his death. Such a policy would be more affordable as it would not suffer from the drawbacks of the endowment policies described here. However, two interacting factors hinder Raja from buying such a policy. First, because paying the premium will always be difficult for a low-income householder like him, Raja does not appreciate the value of paying for something upfront that does not come back later multiplied in some way (i.e., the missing investment component makes term life insurance less attractive). Second, the insurance agent earns a higher commission from selling an endowment policy even when the term life product is more suitable for Raja.

Thus, customer protection becomes an important issue for retail financial products and services. Retail customers do not understand the intricacies of financial products and services. They are not only unable to figure out the analytical structure of such products but also often can't make any sense of them. Financial products are not like the perishables or the durables that they buy for their homes. These are appreciated for the benefits that they offer, whereas finance is a mysterious thing, only represented by numbers and figures, and financial products are but pieces of paper promising things in a future that to many is fundamentally unknowable. And, many Indian households, rich or poor, have other options for dealing with an uncertain future, namely community, relatives, or religious faith. The promise of money, though, can be a strong distraction from such time-honoured methods of coping with uncertainty.

Unscrupulous suppliers of financial products and services dress up these products and services in the form of interesting stories that have only a fraction of truth in them but resonate with the aspirations of retail customers, especially the poor. As a result, outright mis-selling is all too common, full information about the product is often not disclosed to the customer, post-sale grievance redress is poor, and customers sign over rights to the provider without quite understanding what they have done. With the recent digitisation of financial products and services, these problems have become even more amplified, and issues of data protection and privacy have been added to the list.

Therefore, customers must be protected from the purveyors of financial products and services. The poor are especially vulnerable as they are more desperate and less literate. It is not as if financial products and services are fundamentally bad — as in the case of life insurance, there are good and meaningful products that truly serve the needs of the poor. As India embarks on an ambitious plan to bring finance into the homes of the poor, its true promise should not get tainted by the misbehaviour of a great many unscrupulous actors. Therefore, India needs a robust and comprehensive financial customer protection regime, which it currently lacks.

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