Financial products consumer protection in conditions of crisis

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Abstract: The application of lax regulations in the financial sector takes place at a time when the financial crisis is already contagious. When the authorities hesitate to compel recognition on the market through stronger regulations, this hesitation can lead to major disruptions in the clients’ trust capital. More importantly, the enforcement of these regulations should be followed up in every state, and, in case of irregularities, clear recovery, correction and penalty measurements should be applied for that particular state.

The faults of the regulations in the financial sector appeared as a consequence of the financial systems globalization, which imposed a more rigorous control from the governmental agencies responsible for enforcing markets’ regulation.

Most countries reached the conclusion that at least a minimum regulatory standard must be implemented in order to counteract the negative effects of the financial services global development.

Generally, economy on the free market can lead to the emergence of some extreme situations which can, in their turn, lead to financial convulsions, that can only be controlled by means of firm regulations. One of the most commonly met situations is the monopoly that restricts the competition inducing a suppression of establishing the demand according to the supply. This usually also leads to a repression of innovation in the financial services sector.

Another reason that justifies the existence of regulations is the fact that on a functional market, all participants (including both service providers and consumers) should dispose of all the information necessary for a correct and judicial evaluation of the market. By this we mean the possibility to completely identify the existing possibilities, with their inherent advantages and disadvantages.

The regulations system should necessarily eliminate, as much as possible, the alternative that one of the suppliers induces a certain false image on its services, which can determine the potential customer to close a deal in conditions that haven’t been previously explained in a clear manner.

A fact worth mentioning is that, as far as information is concerned, the ratio between the financial company and the client is disproportionate, favouring the first entity. If we look at a bank or an insurance company, we realize that both of them hold, before closing a contract or insurance policy, all the information related to the client. This information is obtained through the conditions imposed by the financial entity (information concerning the client's financial situation, accounting documents, guarantees, assessments, feasibility studies, market studies, etc.).

As far as the customers are concerned, they cannot boast of the fact that they know much about the company involved. They don't know in detail the way in which the funds of the depositors are used, the capacity and the intention to honour the obligations incumbent to the financial institution.

This information imbalance between the two partners involved does not allow the client to establish the equality of chances. The imbalance involves an increase in the degree of uncertainty and risk for the client.

Another element that increases this imbalance is represented by the different levels of economic knowledge that each of them holds.

As far as a financial company is concerned, we have in mind the specialised staff it disposes of, with a vast amount of knowledge about the national and international markets, and a rich set of economic knowledge that we can rarely find in the same ratio in a client.

The lack of some rigorous regulations in the field can lead to some contrasting selection situations. This can occur when the financial actors able to produce the most unwanted effects stand the greatest chances to be selected by the client. The adverse selection affects severely the markets' capacity to realize feasible exchanges with no doubts about the quality and the seriousness of the suppliers. In most cases, we see such examples in the creation of bank deposits or life insurance with capital accumulation. Customers are tempted to invest, lured by the advertising of some products or according to the professional training of those in charge of selling and advising clients. But these customers know too little about the solvency of the financial company, since they don't have the opportunity to independently verify it easily. The only support offered to the customer consists in the market regulations.

In fact, most of the times, the customers' response in such cases is simplistic: they compensate for the lack of complete information by accepting more attractive interest rates or more appealing profits. But reality has shown that more often than not, the most profitable offers on the market have finally proved to be fraudulent, the customer ending up by incurring losses in that particular investment.

The effects of such investments are much wider and they have a deeper impact. The customers lose confidence in the entire financial system, which also affects the honest financial entities that have not sought to fascinate the customers through stunning offers, but came on the market with reasonable offers capable to induce advantages for both customers and investors.

This is why imposing clear, precise and unambiguous regulations should be a necessity on the financial markets.

When the authorities hesitate to compel recognition on the market through stronger regulations, this hesitation can lead to major disruptions in the clients' trust capital. Examples of this type can be also taken from the current situation, although at first glance it seems that malfunctions cannot occur in a highly regulated system.

One of the most bizarre examples is the 50^{th} Decree issued by the Romanian government at the end of 2010, which, by means of the ambiguities inserted in its articles, allows certain less honest banking companies to deceive the customers' confidence modifying some charges and interest rates against the clients' best interest. What is worse is that despite the natural reaction of customers involved, the financial institutions managed, by financial or political pressure, to force the central bank and the government institution not to react naturally when to restore legality, which lead in fact to placing national regulatory institutions at the service of private entities.

The effects of such incorrect movements will be visible in a massive decrease in investment banks and the degree of trust in financial and regulatory institutions, which are already losing credibility because of other wrong decisions.

Surprisingly, all this occurs in a member country of the European Union, a multinational entity which is distinguished by proper regulations on the financial markets. It is curious that in the countries holding the EU engines, such situations would not have been allowed even for a moment, but their manifestation in this part of Europe does not stir the interest of those able to sanction such practices.

Applying such lax regulations takes place at a time when the financial crisis is already contagious. In the same geographic area, banking systems have suffered because of the massive withdrawal of capital, although only some of those countries had real problems in the banking system. Banking institutions just turned into simple call-centres to put pressure on existing customers and urge them pay their increased rates, and they stopped fulfilling their functions as banks (those of granting loans). Although the economic recession calls for the banks' active involvement by crediting the markets and reducing the interest rates' pressure to boost the economy and streamline the monetary circuit, other means are applied in Romania. Banks stopped granting credits, the Romanian National Bank does nothing, the state enforces higher and higher interest rates and taxes on the economic agents and the population, while the consumer, economic agent or natural person, is pushed into bankruptcy by the banks and the fiscal institutions of the state. It is not surprising thus that a worldwide statistic placed Romania on the first place in Europe according to the number of taxes and tolls imposed during a year, and, to the disgrace of the Romanian governors, on the second place at global level. However, the state does nothing and agrees with the banks enrichment policies at the expense of a customer increasingly drained of financial powers, and who will ultimately prefer to declare bankruptcy, unable to cope with staggering interest rates and fees. We wonder who will win this battle. The banks which will lose customers and their revenue, the state, left with no producers? It seems that nobody is interested in long-term effects, but only in short term gains. Why is it claimed that financial stability is a "global public good," while such shortfalls are allowed in countries that are, at least at the institutional level, integral parts of strong regional organizations?

Different regulations within the same structure can lead to a competitive disparity. In an increasingly fierce competition between financial entities aiming to grab a market share as relevant and as competitive as possible, a new competition appeared among the institutions issuing these regulations. This led to imposing different standards depending on the issuing state or entity.

Delaware is known to offer more permissive regulations to multinational corporations than the other U.S. states, aiming thus to attract them. Even if this phenomenon was criticized, it was not stopped, but, on the contrary, it grew. This is precisely why most businesses moved to countries with less stringent regulations. If until recently this phenomenon was present in Eastern Europe, especially in the production area (e.g. textile industry), now it is also manifested in the financial sector. Lowering the financial and communications rigor can have negative effects: the first financial companies that will appear on the market will be the least regulated, thereby transmitting their deficiencies and incorrect policy to the whole market. In the case of Romania, the politics of power and financial blackmail lead by some banks are obvious in that they condition the financial support provided to the Romanian state on the foreign markets with the permissiveness of the relevant legislation and its lack of involvement in contractual and financial differences between them and the consumers.

This is the only way we can justify the existence of almost "usurious" margins in credit agreements, included not at the beginning of the contract but by subsequent modifications (the move to a new method for calculating the interest rate by reference to EURIBOR). The reference to EURIBOR is used in other EU member countries but with substantially lower margins (in Romania reaching up to 9%, in addition to other fees and charges, which lead to annual interest rates on loans in Euros of 14 - 15%). Another example is that of the existence, on the Romanian insurance market, of some insurance entities that promote dumping prices, prices that are established only to deceive customers. Such charges lead directly to the inability to sustain damages in case of insured risks. A good example in this respect is the civil liability insurance for car owners (compulsory insurance) which is sold by some insurance companies at very low prices and which is not recognised by any service station. This refusal results from similar situations where the insurance company failed to pay. There are many lawsuits filed by the people and the service stations involved, that are sent by unreliable insurance companies in other parts of the country to discourage them and to determine them to abandon the trial because of the lack of the financial resources necessary to sustain such lawsuits.

Other negative effects on the insurance market are caused by the mandatory minimum insurances introduced by the Romanian state, which are sold mostly by unreliable insurance companies. How else can we interpret housing insurances up to 10,000 or 20,000 Euros for an insurance rate between 10 and 20 Euro a year? Such a product covering only catastrophic risks does nothing but to create the illusion that the customer is the beneficiary of an insurance product, which actually covers a reduced fraction of the possible risks and the amount (s)he can receive as compensation in case of earthquakes does not even cover the cost of a garage, not to mention a house.

What do we lack? Clear standards and detailed implementation rules and also repressive measures to deter the financial firms that violate the rights of the client and only seek to deceive them. This is precisely why we envision the necessity of clear and concise regulations in the financial services sector. Such regulations serve to keep a balance on the market and attract honest investors, protected in their turn against the competition represented by the financial "sharks" or, better said, the financial “hyenas".

The regulations should be supported not only at national, but also at international level, with general applicability. In 2000, Robert Keohane and Joseph Nye called this activity “a set of direct interactions between subunits of different governments that are not controlled or closely guided by the policies of the leaders of those governments”.

It is important that the implementation of these rules should be followed up in every state and, if needed, clear redressing, correction and penalty measures should be enforced. The existence and the implementation of rigorous regulations at global level should be seen not as a favour to consumers, but as an essential condition for carrying out serious, honest and sustainable investments, capable to ensure the proper functioning and development of both private entities, and economies in general and, last but not least, the personal welfare of every consumer.

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