

Financial Well-Being

REPORT OF THE COMMITTEE
ON INVESTOR AWARENESS
AND PROTECTION



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**M E M B E R S L I S T A N D
T E R M S O F R E F E R E N C E**

F.No.5/26/CM/2006
Ministry of Finance
Department of Economics Affairs
(Capital Markets Division)

North Block, New Delhi
17, March, 2009.

OFFICE ORDER

Sub: Committee on Investor Awareness and Protection.

1. High Level Coordination Committee on Financial Markets (HLCCFM) in its meeting held on 22nd December, 2008 among other things, desired to set up a Committee to re-examine the issue of regulating investment advice including the regulations thereof, by various financial sector regulators in the larger context of investor awareness and protection.
2. The Committee will be headed by **Shri D. Swarup, Chairman, PFRDA**. On the basis of nominations received from other regulators it has been decided that the Committee will consist of the following Members:

1.	Shri M.S. Sahoo Whole Time Member, SEBI	Member
2.	Shri G. Prabhakara, Member (Life) IRDA	Member
3.	Shri K. Subrahmanyam, Executive Director (Admn), IRDA	Member
4.	Dr. Sujatha Prasad General Manager, RBI	Member
5.	Dr. K.P. Krishnan, Joint Secretary (Capital Market), Ministry of Finance	Member Secretary
6.	Shri Manoj Kumar Arora, Director, Ministry of Corporate Affairs	Co-opted Member

3. The Terms of Reference of the Committee will be as follows:
- I. Reviewing and strengthening the present arrangements relating to investor awareness and protection.
 - II. Role of regulators in investor awareness and protection.
 - III. Need for a vertically integrated structure/Origination as the nodal agency for promoting financial education through pooling of resources.
 - IV. Importance of the issue in the context of financial crisis with special reference to quality and effectiveness of communication during crisis.
 - V. Recommend measures to enlarge financial literacy and financial awareness.
 - VI. Any other matter the committee may consider relevant.
4. Expenditure as may be required for the activities/meeting etc, of the Committee shall be met by PFRDA out of its funds.
5. The committee shall submit its report to Ministry of Finance by 15th June 2009.

(CKG Nair)
Director
Telefax: 23092685

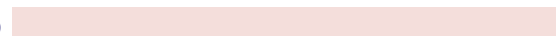
Note: During its deliberations, the following substitutions were made in the constitution of the Committee:

- 1. Shri A. Giridhar, Executive Director (Admn), IRDA (from May 19, 2009) replaced Shri K. Subrahmanyam, Executive Director, IRDA.
- 2. Shri G. Gopalakrishna, Executive Director, RBI (from June 12, 2009) replaced Dr. Sujatha Prasad, General Manager, RBI.
- 3. Shri Manoj Kumar Arora, Director, Ministry of Corporate Affairs, was co-opted as a Member of the Committee from May 9, 2009.

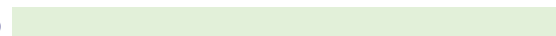
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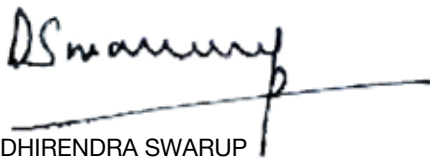
Investor awareness and investor protection, twin areas which subserve the same objective of consumer well-being, have assumed greater significance and urgency in the wake of the recent financial crisis. While financial regulation and governance issues demand a re-look at the efficacy of the current global and national financial architecture, the issue of consumer awareness and protection are areas where renewed and focused efforts are needed. The High-Level Coordination Committee on Financial Markets (HLCCFM), while deliberating on the response to the global financial turmoil, recommended the constitution of an inter-regulatory committee to suggest measures to strengthen the ongoing efforts for imparting financial education and promoting investor protection. The Ministry of Finance, Government of India, accepted the suggestions of the HLCCFM and constituted the Committee on Investor Awareness and Protection.

The Committee adopted an open and transparent methodology of consultation with all stakeholders. The Committee undertook detailed research by surveying over 100 financial sector companies, seeking advice of top professionals in the financial market, regulators and other experts, and also surveying regulatory models in the US, the UK and Australia. The outcome of the research has been documented in the Report. The Committee also prepared a consultation paper, which was put out in the public domain. A public hearing was also organised, where all stakeholders were invited.

The Committee held five meetings. All issues relevant to the terms of reference were examined in great depth. The Report reflects the views of each member of the Committee. The views of the Insurance Regulatory and Development Authority (Irda) have been reproduced in verbatim.

The in-depth analysis and detailed research undertaken by the Committee would not have been possible but for the unstinting and dedicated support received from the research team consisting of Ms. Monika Halan and Mr. Gyan Bhushan. I would also like to thank Mr. Avinash Singh for providing the editorial support for completing the Report.

I hope the researched data and information provided in the Report and the suggestions made by the Committee will be useful in reforming existing practices in the financial sector. The Committee believes the recommendations, when implemented, will meet the objectives of enhancing investor awareness and promoting investor protection, and lead to consumer well-being.



DHIRENDRA SWARUP

Chairman

Committee on Investor Awareness and Protection

1

Executive Summary

1.1 Forty years ago, Delhi had few private cars. The stretch from Old Delhi Railway Station to Qutab Minar had a total of one traffic signal, and opinion is yet divided on whether it was a signal or a policeman at AIIMS. Still, the journey was smooth and uninterrupted. The same journey in Delhi 2009 looks very different. One malfunctioning signal on the stretch causes traffic jams and commuter distress. The signals by themselves are not enough. Drivers need to know the rules. When a new rule is introduced, like the one that made seat belts mandatory in the front seats of a car, users of the grid need to be educated about it. Even if they know the rules, it needs sightings of traffic policemen to deter those wanting to break the rules.

1.2 Financial markets are similar. When the number of investors and products are few, there is little use of a regulatory structure aimed at users and sellers of mass products. There was a time when people could buy only government-guaranteed, zero-risk investment and insurance products. Even the small number who chose to participate in the stock market

knew what they were doing. It was a time when specific rules for sellers of financial products were not needed.

1.3 Today, there are nearly 3 million financial advisors¹ plus banking staff selling non-banking financial products. They serve about 188 million investors² holding financial assets. Of these, 8 million investors participate in debt and equity markets, either directly or indirectly through complex and risk-bearing products like mutual funds and market-linked insurance plans. It drives home the need for order.

1.4 These numbers will only grow. The next 200 million Indian consumers of financial products are waiting to join the traffic. They are at the gate, wanting to see some signs of traffic signals to feel safe enough to navigate the roads. If rules are important, so are efforts to upgrade the skill set of those intersecting with new financial products—from the investor buying a mutual fund or pension product to the village woman taking a lump-sum from a micro-lending

¹ 2.7 million insurance agents, Life Insurance Council, and 55,000 mutual fund agents, Amfi

² Indian Retail Finance Markets, 2007, IIMS Dataworks

organisation. Both sets of people, and all others in the spectrum between, need help in understanding the new financial system so that they can maximise the efficacy of their financial decisions.

1.5 When the government directed that this Committee should focus on the twin areas of investor protection and awareness, the idea was to work on two separate reports: one, on the need for a national strategy on financial education; two, on the need for a minimum common set of rules for the financial advisor population. The work, therefore, began in two different silos.

1.6 But while working on the report, the Committee came to the conclusion that one could not be extricated from the other. **Investor protection and investor education are two sides of the same coin. In isolation, neither will have the desired impact.** A simultaneous and coordinated effort in both investor education and protection will have a pincer effect on the problems of poor financial choices due to a lack of knowledge and mis-selling due to a lack of adequate order in the retail interface of the financial sector.

Order In The Marketplace

1.7 There is a perceived need for more order in the community of financial advisors that reaches out to the financially included in India. Since over 70 per cent of investors buying mutual funds relied on the agent at the time of their most recent investment³ and almost 90 per cent⁴ are buying insurance policies from agents, it is clear that the final retail interface is of critical importance in ensuring a good financial outcome from the transaction.

1.8 Ensuring that the retail sales interface does not mislead becomes imperative. To believe that agents

will look after the interests of their consumer, rather than their own income, is naive. In the words of a US regulator⁵: “The agent will go where the money is.”

1.9 Historical events in India and abroad show that advisors or product manufacturers will need not just a nudge, but effective rules that will induce them to do the right thing. This Committee believes that the Micro Financial Sector (Development and Regulation) Bill, to be tabled in Parliament, will take care of the sales side issues of credit relating to micro-finance institutions.

1.10 This leaves the 3 million-plus insurance and mutual fund sellers and advisors and bank officers (selling non-banking investment and credit products), who are reaching 188 million customers, to be regulated today. This 3 million will increase as the sales network for emerging products like the New Pension System begins to fall into place and the next 200 million consumers⁶ become active in the financial markets.

1.11 Financial products are invisible—they cannot be tasted, smelt, sat in, worn or perceived by the senses in any other way. A car can be driven before it is bought. The performance of a music system can be easily verified before you buy it. A garment can be tried on to see if it fits. But because a financial product is invisible, it needs to be described by the person selling it. And because the moment of truth of a financial product is 1-20 years away from the point of sale, its actual face will only be seen sometime in the future.

1.12 These two attributes of a financial product (invisibility and distant moment of truth) make the point of sale an extremely important link to the entire product chain. Unless the sales person is able to correctly describe the product and its role in the portfolio of an investor, the product is likely to ‘explode’⁷.

³ Influential factors at the time of most recent investment in mutual funds: 72.2 per cent agent, 51.6 per cent TV/radio promotion, 31.4 per cent banks. IIMS Dataworks, 2007

⁴ 89.9 per cent buy insurance from agents, 6.1 per cent from independent advisor and 1.8 per cent from banks, IIMS Dataworks, 2007

⁵ Non-formal interviews with US regulatory staff

⁶ IIMS Dataworks 2007

⁷ The US saw ‘exploding’ financial products during the sub-prime crisis, when mortgage products were sold that were inherently unsafe. For example, a product that allows a partial interest repayment in the first few years and capitalises the unpaid interest into the principal will explode in any average portfolio. It is a term made famous by academician Elizabeth Warren <http://bit.ly/31DbpW>

1.13 This importance can prove to be potentially harmful for customers, who rely on the verbal communication of the sales person to describe the product, its costs, risks, returns and flexibility to them. The written communication, as it exists today, is lengthy and leans towards 'checklist compliance'. Offer documents and communication with customers lie within the letter of the law, but gives them very little idea of what it is that they have bought. There are notable exceptions in the industry that do try to bridge the gap, but this is not the industry standard.

1.14 Consumers lose faith if they have a bad financial outcome due to an ill-fitting financial product. This can happen in two ways. One, a badly constructed product being sold in the market. Two, a product that does not fit the risk-return profile of the consumer, and has the potential to 'explode'.

1.15 India has good product manufacturer regulations in place and the instances of products that are designed to mislead are few. However, the manner of their sales has perceived scope for improvement. Consider a zero-risk appetite individual, who wants a tiny part of her portfolio invested in equity. She is sold an equity unit-linked insurance plan that soaks up all her investible surplus or a sector mutual fund that sits at the upper end of the risk-return curve. Who has misled the consumer in this case: the insurance company or mutual fund, or the seller who sold it?

1.16 This Committee recommends tighter norms for financial advisors in India. There are two arguments that previous committees⁸ have flagged to prefer status quo instead of more order in the marketplace. One, the insurance and mutual fund agent is already a regulated entity and the Reserve Bank of India (RBI) regulates banks who sell financial products. Two, while the agent is regulated, it is the advisor who is not under regulation, and may hence need action at a future date.

1.17 But examining the IOSCO (the International Organization of Securities Commissions, which is the global meeting place for securities markets regulators⁹) guidelines, and the code of conduct of insurance associations and regulators¹⁰, shows a regulated entity is one that faces:

- A set of compliance exams
- A system of continuing education
- A process of registration
- A process of regulatory filings
- An ongoing system of monitoring
- A system of compliance that the advisor will follow
- Well-defined enforcement procedures
- Punitive action

1.18 Clearly, the current sellers of financial products cannot be called 'regulated' by any global standard. Agents are, at best, passing a threshold exam. Two, the distinction between an advisor and an agent is fictitious when the agent is selling a load-bearing product. **A load-bearing product has advice embedded in it¹¹.**

1.19 The US is grappling with the creeping transformation of broker-dealers to advisors, as they sell load-bearing products. The UK will do away with this conflict of interest by making all products no-load from 2012. Australia favours the fee-for model over the commission-based model. **The key question here is: whose agent are they—the consumer's, the producer's or their own?** And if they are the agent of the consumer, surely the consumer should directly compensate them to ensure quality service.

The Insurance Experience

1.20 It is apparent from the ground reality in India that the lack of fear of punitive action or responsibility nudges the bulk of the sales force

⁸ Report of the Committee on Regulation of Investment Advisors in Non-Securities Markets, 2008

⁹ Objectives and Principles of Securities Regulation, IOSCO, 2003

¹⁰ 1. Advocis, the Financial Advisors Association of Canada, <http://www.advocis.ca/index.html>

2. The Singapore Insurance Act 2002, <http://tinyurl.com/lgppdp>

3. The Financial Services Authority, UK, <http://tinyurl.com/ngwgoe>

¹¹ The Role of Brokers and Financial Advisors Behind Investments Into Load Funds, Xinge Zhao, China Europe International Business School (CEIBS)

to use incentives on financial products as the driving force to sell products. If this were not so, the lapsation rates of insurance policies would not be so high. Data for 2007-08 shows that lapsation rates range between 4 per cent and 80 per cent. The lapsation rate for half of the 16 companies was more than 20 per cent. Only three insurers had a rate of less than 10 per cent¹². However, LIC, with 64 per cent of total premium underwritten in 2007-08, had a lapsation rate of 6 per cent.

1.21 While no single factor can be isolated for such a situation, the distributor has a huge role to play in this regard¹³. There is agreement in the insurance regulatory system that high lapsations that occur during the first few years of the policy are caused “**by mis-selling—intentional or otherwise, and selling under duress. For instance, in consideration of a loan sanctioned by a bank or any other nature of ‘favour’ done by the insurance salesman to the policyholder, or under ‘obligation’ to a relative or a friend¹⁴.**”

1.22 The chief cause of mis-selling is the incentive structure that induces agents to look after their own interests rather than that of the customer. With an average industry commission-expense ratio (commission expenses as a percentage of total premium) of 16.25 per cent and total commissions paid at Rs 14,704 crore in 2007-08¹⁵, the reason for sharp selling practices is obvious.

1.23 The life insurance incentive structure is currently under change, with the difference between gross yield and net yield capped at 300 basis points. Still, the underlying issue of front-loading—pushing the cost applicable over the life of a product to the entry point of the product, or to recover upfront the cost across many years—the product with commissions that are due over the lifetime of a product makes harmful sales that much more easy.

1.24 The high front-loading of commissions is allowed by the Insurance Act, 1938. The commission for the first year can be as high as 40 per cent of the premium¹⁶. In years two and three, the cap is 7.5 per cent, and 5 per cent thereafter.

1.25 Any Act or regulation needs to keep pace with changing markets, as its aim is to ensure a fair deal for all parts of the market. When the high front-load was envisaged in the Insurance Act originally, the premise was that the agent would service the policy owner over the policy life of 10, 15 or more years. The customer then would be indifferent towards paying the cost upfront or distributed evenly over the life of the product.

1.26 It must be remembered that the logic of such an incentive structure worked in 1938, when a single-player industry was envisaged and consumers had few other options for long-term investments. The year 2009 is a different time and place in terms of number of players, products, consumers and their needs. Arguably, the Insurance Act needs to keep pace and take notice of a changed world.

1.27 Now, with multiple players, each time an agent switches companies, or a new agent approaches a policyholder of some other company, they can potentially get those customers to churn—sell their old policy and buy a new one. **Churning a product that has a cost structure where the customer has paid in advance the service fee for the next 10 to 50 years in the first three years is a harmful trade practice. With no system in place to refund the commission paid for the years foregone, the consumer ends up losing not just money, but also faith in the financial system.**

1.28 The reactions from the insurance industry have been mainly in terms of the interests of agents and companies. The representations that the Committee has got from the industry and the agency network all

¹² Statement 53, Irda Annual Report 2007-08

¹³ J Hari Narayan, Chairman, Irda, Irda Journal, Lapsation in Life Insurance, August 2008

¹⁴ Lapsation of life insurance policies, Irda Annual Report 2007-08

¹⁵ Annual report 2007-08, Irda

¹⁶ This is 35 per cent of the first year's premium for an insurer who has completed 10 years of his business

talk about the business side of the equation—about how difficult it is to sell and service consumers—but **there is no discussion of the business from the point of view of the consumer.**

1.29 There is no discussion about consumers who buy insurance policies based on verbal promises, or of consumers who are not serviced by agents after the first two premiums, or of consumers who are made to stop policies after the first three years to buy another front-loaded policy. There is little discussion on, or attention given to, the interests of the consumer. The report has been written keeping in view the difficulties faced by consumers, with some specific consumer stories being appended in Annexure 1.

The Mutual Fund Experience

1.30 The mutual fund experience shows that it is indeed the incentive structure that tilts sales towards particular funds. The change in incentives from 2006 till 2009 is a story of the regulator gradually tightening the regulation to contain motivated product manufacture and sale.

1.31 In 2004 and 2005, as the stock market was rising, it came to the notice of the regulator that some banks and large distributors were churning mutual fund investors from one new fund offer (NFO) to another. At stake was the 6 per cent cost that each NFO was allowed to charge investors, plus the upfront load of 2.25 per cent.

1.32 Under Sebi (Mutual Fund) Regulations 1996, initial issue expenses of up to 6 per cent of the amount raised by the scheme was permitted to be amortised over a period of five years. This meant that 6 per cent of whatever an NFO collected during the NFO period could be charged to the scheme, apportioned over five years. So, an NFO gathering Rs 1,000 crore could charge the scheme's investors Rs 60 crore from their assets, or Rs 12 crore a year.

1.33 Meant to take care of the advertising and marketing costs, most of this money was routed to distributors as commission, in the form of cash and as a percentage of the amount raised. The use of

the initial issue expenses to compensate distributors became so widespread that no new fund could enter the market without promising the large distribution chains 7-8 per cent commissions.

1.34 The practice became so widespread that it came under the regulatory radar. In April 2006, amortisation charges were banned in open-ended funds. Fund houses, right away, began launching closed-end schemes that were like an open-ended scheme, with a regular redemption window. In 2007, 42 closed-end schemes were launched, compared to nil in the few years preceding that. In January 2008, this window was shut as well, with closed-end funds not being allowed to charge the 6 per cent amortisation cost.

1.35 However, questions over the 2.25 per cent entry load being used to push new funds continued. To do away with this problem, **Sebi has recently taken a significant step forward by making advisors the agents of customers, rather than that of the company whose products they sell. Mutual funds have gone no-load from August 1, 2009.**

1.36 This follows the New Pension System (NPS) example, where there are no entry or exit loads from inception. It is up to customers to compensate the agent and advisor according to the service they receive. It is early days yet after the changeover to a no-load world in mutual funds. While no system can deal with an errant jaywalker dashing across a busy road or a speeding driver jumping a red light and hurting someone, on the whole, there is a greater obvious display of order. The inherent contradiction in the system has been addressed.

The New Pension System Experience

1.37 With mutual funds going no-load, one piece of the market is largely in place. The emerging pensions piece is already structured to give the consumer a fair deal. The New Pension System (NPS) has been conceived as a no-load product. It also has other investor-friendly features like full portability at no cost, which allows investors to switch fund managers.

1.38 With no inducement to push one fund over another, the point of sale will either allow the customer

to make the product choice, or the customer will be put in a default option. Default options are used to make the decision for the customer who would rather not choose. The NPS uses a well-regarded, lifecycle-based investing formula that reduces the equity allocation of a person as they age.

1.39 Globally, there is a rethink on loads in products, and the blurring of lines between a broker-dealer and an advisor. **India could set global standards by following a no-load plus fee model for the entire financial sector, and then using outcome-based regulation to ensure a fair deal for all market participants, namely the producer, the advisor and the consumer.** Given the size of a market like India and the ability of the seller to move with the money, a low-cost, high-impact method to taking away the incentive to mis-sell is proposed.

The Way Forward

1.40 The Committee proposes the use of financial incentives in a manner that nudge participants into doing the right thing. The commission and reward system today makes advisors the agents of the financial products manufacturer, even though their compensation comes from the customer. This gives rise to an inherent conflict in this relationship.

1.41 A (agent) is the agent of B (manufacturer), but is paid by C (customer). So, A will sell to C a product that B manufactures that gives A the greatest remuneration. There is no other way for A to behave in a market economy—A is programmed to maximise its own utility rather than that of either B or C. **Now, if instead of B, C, the customer, was to compensate A, the whole equation changes. It is now in A's interest to keep C happy.** Not just this one time, but over a lifetime of financial product buying, maintaining and selling.

Educating Consumers

1.42 There is a global buzz around an emerging area that goes by many titles: financial literacy, financial competence, financial education or financial ability. The names are many, but the goal is the same: a population that has the knowledge, understanding, skill and competence to deal with everyday financial matters and make informed choices in selecting products that meet their needs.

1.43 There is a sharp increase in the number and complexity of financial products. Risk is being transferred to the household. A large population in newly developed or developing countries is being exposed to formal banking and financial products, as well as smart sales practices, for the first time. All these make a base level of understanding of money, its management and use a basic life skill.

1.44 The lack of this skill has the potential to fritter away economic gains made at an aggregate level by nations, resulting in wealth transfer from the financially illiterate to a small sliver of the financially literate. OECD research¹⁷ shows that a financially literate population promotes economic growth and well-being by expanding the quality of available financial services, and by enhancing the ability of individuals to more effectively use the services in their best interests.

1.45 Work on the topic by financial literacy scholar Annamaria Lusardi¹⁸, Professor of Economics at Dartmouth College and a Research Associate at the National Bureau of Economic Research (NBER), shows that individuals with low levels of financial literacy tend not to plan for retirement and borrow at high rates of interest. No wonder, there is a rush to get citizens financially literate, sparking off an article in *The Economist*¹⁹ calling it the “global crusade”.

¹⁷ Improving Financial Literacy: Analysis of Issues and Policies. OECD 2005

¹⁸ Lusardi, Annamaria and Olivia S. Mitchell (2007b): Financial Literacy and Retirement Preparedness: Evidence and Implications for Financial Education. Business Economics, January 2007

¹⁹ Getting it Right on the Money, 3 April, 2008, The Economist

1.46 With a household savings rate of over 30 per cent²⁰, India understands the merits of saving over current consumption. Unlike much of the west, where getting people to save is an issue, the need for India is the efficient conversion of this saving into investment. A large part of this money is in low-yielding assets like bank deposits and traditional insurance²¹, but there is a clear trend²² of individuals preferring security-based investments as they go up the income ladder.

1.47 One part of the population, due to advantages of birth, location and education, has benefited from the growth spurt in the Indian economy. It has moved into the population bracket with cash incomes that are large enough to allow a surplus after taking care of all expenses. Estimated at 321 million²³, this population segment is usually the first to begin buying financial products other than bank deposits and real assets like gold and property.

1.48 The share of mutual funds in the household savings wallet more than doubling, from 3.7 per cent in 2005-06 to 7.8 per cent in 2007-08²⁴, points to the emerging better-off population looking for avenues other than those traditionally available to target a better return. The growth in the number of market-linked insurance plans and home loans, too, points in the direction of the newly emerged middle-class experimenting with financial products and credit.

1.49 While heavy advertising and a powerful sales push has generated awareness of a new set of products in the market, few are able to understand what these products will help them achieve in their financial journey. As many as 98.3 per cent of traditional insurance policyholders did not buy unit-linked insurance plans (Ulips)—the market-linked, investment-bearing life insurance plan—since they did not understand it. A large 90.2 per cent of working

Indians with cash incomes were unaware of a mutual fund as a vehicle of investment and less than 5 per cent could give an accurate description of the mutual fund concept²⁵.

1.50 Clearly, advertising and the agent network have worked positively to create awareness, but not build knowledge. A coordinated approach is now needed to convert this awareness into knowledge. Interviews with the industry confirm the need for such an effort that is beyond what an individual company, association, regulator or non-profit can do. While spontaneous efforts have been initiated by government departments, regulators and associations, each looks at the world with a limited view of the part of the market they serve. For instance, the Reserve Bank of India (RBI) has taken a lead in the financial literacy space. The Ministry of Corporate Affairs also has programmes on the ground including the establishment of Investor Education and Protection Fund (IEPF), but these deal mainly with investments in the companies made through various instruments.

1.51 However, for the consumer, the piecemeal approach does not work. Individuals are not looking to learn markets, banking and insurance as separate modules that they will later put together and connect the dots. Rather, while buying a product, they feel the need to get a quick shot of information that will help them choose. They want a big-picture view of their money life and then specific information for the part of the market they choose to go to for product transactions.

1.52 If this is the story of the largely urban investor, the rural consumer possibly needs the literacy effort even more urgently, though at a different scale and content level. While more than 80 per cent of the agricultural wage labour is still unbanked²⁶, due

²⁰ Handbook of Statistics October 2008, RBI

²¹ Of the 105 million insurance customers, 90.9 million have a traditional endowment plan, IIMS Dataworks

²² Indian Retail Finance Markets, 2007, IIMS Dataworks

²³ Indian Retail Finance Markets, 2007, IIMS Dataworks

²⁴ Handbook of Statistics, 2008, RBI

²⁵ IIMS Dataworks, 2007

²⁶ A 100 Small Steps, 2008, Planning Commission, Government of India

to reasons of location, society, caste, religion and poverty, micro-finance institutions have been able to reach 86 million²⁷ of the poorest Indians (80 per cent of them women) with tiny loans.

1.53 Handling a lump sum for the first time, this population needs a basic course in money management, cash-flow rhythms and budgeting, agree the micro-finance companies. In addition, this will be the first generation of financial savers from the ranks of the poor who will save in terms of money, instead of land or gold. A base level of understanding of risk, return, financial products and their use is mandatory so that the millions of choices become informed ones.

1.54 A global review of efforts in financial literacy initiatives shows that state-led, national-level financial education programmes are already in place in many parts of the world, especially in the mature markets and the emerging ones. The US, the UK, Australia, New Zealand and OECD countries have well-defined financial education programmes led by the state. Some are funded by the government (like the US) and some by the financial sector (the UK).

1.55 When asked if India needs a national-level effort to build financial literacy, respondents from the financial sector, regulators, NGOs, micro-finance professionals, consumers and global regulators were unanimous in their verdict: yes. The need for common definitions, benchmarks, a core content set, a depository of knowledge, clearing-house of already created content, non-duplication of effort were reasons given for the need for such a national-level agency. The need for a strategy-based, cohesive approach that uses innovative means to deal with one of the most difficult lessons to impart—how to manage money—is strongly felt.

1.56 As India embarks on the road to financial literacy, we must not ignore the red flags raised by the experiences of countries already on this path. Apart from the fear of financial literacy becoming the reason for looser financial regulation at the product

manufacturing and advisor level, the big global concern is around measuring efficacy of financial education. Unless outcomes are built into the system, there is a real fear of this effort of time and money going waste.

Order + Education = Well-Being

1.57 Educating individuals in money matters is one of the toughest challenges faced by the national efforts in financial education across the world. To get an adult in a class, and that too in a money class, is not the easiest thing to do. Even if one gets them in a class, retention and efficacy are issues to worry about.

1.58 One of the best ‘teachable moments’ identified is when the person has a need, and is looking for information and knowledge before making a financial decision. The seller of the financial product becomes the default source of this information—in the hope of making a sale, the advisor will spend time and effort to communicate with the consumer. If this communication is motivated, and hung on the weight of commissions and other benefits the advisor earns from the sale of the product from the manufacturer, the consumer is unlikely to get the right advice.

1.59 One way to take care of this problem is to take the load, or the motivation to mis-sell, away from the advisor. The second way is to back this step up with a system that fixes responsibility of the product sold on the advisor to stop them from harmful sales practices.

1.60 Education of the consumer and more order in the market emerge as two sides of the same coin. The UK regulator, Financial Services Authority (FSA), has financial capability as part of its mandate. The Australian regulator, Australian Securities and Investments Commission (ASIC), too is responsible for educating the end-user of financial products. **This Committee comes to the conclusion that instead of setting up two institutions with overlapping mandates, it would**

²⁷ Sa-Dhan, the Bharat Microfinance Report-Quick Data 2008

be efficient to club the education and order pieces into one organisation, which will be responsible for the financial well-being of the Indian consumer of financial products.

1.61 This report is divided into three parts. Part A builds a case for a common minimum standard of regulation for retail financial advisors that cuts across regulators, products and markets. Part B builds a case for a state-led, national-level effort in financial education. Part C connects the dots and sees education and order as two sides of the same coin.

1.62 It suggests the setting up of the **Financial Well-Being Board of India (FINWEB)**, which will have order and literacy as its twin mandates. It is an outcome-based organisation, as is apparent from its name. The Committee believes that development of the profession of investment advice and financial education should be seen as social infrastructure. India needs to develop common standards within this framework.

Recommendations

Recommendation 1. The objectives of greater financial literacy for Indians and establishing a system of common minimum standards for financial advisors should be met by a single organisation. **Financial Well-Being Board of India (FINWEB)**, the proposed organisation, will have the twin objectives of building a financially literate population and bringing order to the advisor market to facilitate good financial outcomes from financial decisions. With an outcome written into its very name, FINWEB is envisaged to be truly working in the interests of consumers of financial products and services.

Recommendation 2. FINWEB should consist of two operational arms. **The Self-Regulatory Organisation (SRO)** will work on bringing financial advisors under one common standard. The **Financial Literacy Cell** will work on making Indians financially literate.

Recommendation 3. The organisational structure of FINWEB should be geared towards a cost-efficient model, with minimal staffing, using outsourcing of functions to experts as an organisation structure device.

Recommendation 4. FINWEB should be a participative organisation, with representatives from government ministries and departments, regulators, industry associations and financial organisations active in the field of financial literacy and investor protection.

Recommendation 5. Its board of directors should be drawn from the existing regulators, Ministry of Finance, financial sector, industry associations, independent entities, experts and academics.

Recommendation 6. FINWEB should be funded by the government through a capital grant, drawing upon the monies available in the investor protection funds, if necessary.

FINWEB: The SRO Cell

Recommendation 7. There should be a common minimum standard for all sellers and advisors on mutual funds, insurance products (life and general), pension products and those products of commodities markets which are purely financial in nature. Pro-bono advice will not be under the purview of FINWEB.

Recommendation 8. **An SRO-driven regulatory system should be adopted for financial advisors²⁸.**

Recommendation 9. All retail financial products should go no-load by April 2011. The pension product in the NPS is already no-load. Mutual funds have become no-load with effect from August 1, 2009. Sellers of insurance policies need to remove the bias towards selling the policy with the highest commission. Because there are almost three million small agents who will have to adjust to a new way of earning an income, **it is suggested**

²⁸ FPSB India has presented a workable SRO model to the Committee. Also, RBI has commented that given the current level of heterogeneity in the market, initial handholding of the SRO is needed from regulators. The Business Correspondent model developed by the RBI can serve as a starting point of reference.

that the upfront commission embedded in the premium paid should be cut in a gradual manner to become zero by April 1, 2011. The interim period should be used by insurance companies to help their agents make the transition to a fee-based model of selling and advising.

Following a public hearing on September 9, 2009, the Committee adds the following:

Recommendation 9.1. Consumers should be given the choice to pay the fee (agreed upon as outside of the investment amount) through a cheque or debit to the product manufacturer. The manufacturer will, in turn, remit the fee to the seller. This is purely for operational ease of collecting the fee by the seller. The choice to pay separately through a cheque will, of course, exist.

Recommendation 9.2. In order to take care of consumers who might not know how to evaluate the services of financial advisors, FINWEB will set the fees in a price band linked to the service provided. Similar products will be clubbed into comparable price bands. This will be based on research in the Indian market and global best practices.

Recommendation 9.3. Commissions on the term-insurance product (pure life cover, with zero investment or money-back/return of premium component) will be reduced in a gradual manner till they reach 5 per cent of premium by April 1, 2011. This 5 per cent commission will continue till pure life insurance (without an investment component) penetration reaches targets set by the government.

Recommendation 10. The overarching **outcome of the SRO arm of FINWEB should be financial health**. The outcome of financial health can be broken down into the **outcomes of safety, fairness and trust**, which will have **goals around education, conduct, disclosures, reporting, punitive action and dispute redress**. The existing mechanisms

for dispute redress must be strengthened.

Recommendation 11. There should be a common minimum entry barrier for all financial advisors. The entry barrier should comprise a minimum knowledge-linked training programme, which specifies a set of knowledge outcomes rather than number of hours of study.

Recommendation 12. A person must clear a common examination, with several modules, before beginning selling financial products to retail consumers. The existing examinations in mutual funds, insurance and others will continue as different modules within the outcome-specific goals of FINWEB. In addition, the SRO will give a threshold certification to any seller or advisor of a financial product that results in the consumer paying a transaction cost (including commission and fee).

Recommendation 13. A new benchmark qualification should be introduced that will license an advisor to operate in the market. There should be a graded qualification matrix that will link more complicated products to a higher level of education and testing. The nature of the license will determine what products or what level of service an advisor can provide.

Recommendation 14. There should be a system of continuing education. The license should be renewed every five years by clearing the refresher exam. This will be available for each level of the qualification matrix.

Recommendation 15. There should be a system of educating not just individual advisors, but also employees working for a financial entity that intermediates. Anybody facing the customer must be a licensed entity. A corporate license is not enough—the entire sales team will need to acquire the qualification²⁹.

Recommendation 16. All advisors should be registered with FINWEB and should be governed by a code of ethics that is standard across products and organisations. While formulating the code of ethics, note will be taken of the structure put in place by the RBI for its business correspondents standards. The

²⁹ The RBI had reservations about this recommendation

code of conduct should have principles of integrity, privacy and honesty as key goals.

Recommendation 17. FINWEB should develop a disclosure template that has consumer understanding as an outcome.

Recommendation 17.1. The disclosures should reveal the income—direct or indirect—that an advisor earns from the sale and maintenance of a product, both from consumers and from product manufacturers.

Recommendation 17.2. A one-page note, with the most important terms and conditions, should be part of the disclosures to ensure the customer understands the product and its impact fully.

Recommendation 18. The sales process should be documented. A customer-profiling process should be put in place, as should a documentation of the process that led to product selection.

Recommendation 19. There should be a well-defined process to affix responsibility for loss attributable to wrong and misleading advice.

Recommendation 20. Consumers should have a common interface to complain about financial products, service and outcomes. A time-bound redress system should be put in place.

FINWEB: The Financial Literacy Cell

Recommendation 21. **FINWEB should be at the centre of all financial literacy initiatives in the country.** It is from the knowledge and expertise of FINWEB that willing agencies active in the field of financial literacy should draw material, conceptual knowledge, expert trainer and testing.

Recommendation 22. FINWEB will engage key professionals and experts in various steering groups to drive specific financial education programmes in identified areas of intervention.

Recommendation 23. **FINWEB will not prevent any financial literacy initiative from carrying on its work in its chosen area of interest and work.** Its aim is to be a knowledge and resource partner; not a regulator of financial literacy, but a standards setting body.

The aim of FINWEB is not to educate people to choose between mutual fund A and mutual fund B. That is the work of the financial advisor. The aim is not to substitute financial education for effective advisor and product regulation. The goal of FINWEB would be to enable individuals, at their level of need, to understand the role of money in their lives, the need and use of savings, the various options available in the market they can access to convert their savings into investments, and a realistic recognition of the attributes of these options. **FINWEB would consider its work well done if the financially literate person knows enough to be able to ask the right questions of the person selling financial products.**

Recommendation 24. This report recommends an alternative approach to financial education in India. **The content plan should focus on utility- and concept-based learning.** The key question to be asked before developing any material or conducting any training will be: how will this connect with the desired audience and of what use is it in a person's financial life in a practical way? While definitions and descriptions are important, they come as an aside.

Recommendation 25. **FINWEB will identify, after consultation with various parts of the market, a set of concepts that are basic to financial products. These will then be innovatively worked on by a small group of finance experts.**

Recommendation 26. Financial literacy modules and training should be embedded in existing pipelines namely:

- 26.1 Advisors**
- 26.2 Government programmes**
- 26.3 School curriculum**
- 26.4 Post-class XII**
- 26.5 HR departments**
- 26.6 Life transition points**
- 26.7 Social organisations**
- 26.8 NGOs**
- 26.9 Micro-finance companies**
- 26.10 Existing efforts**

Recommendation 27. FINWEB will have an outcome-specific role. Any intervention by FINWEB will result in a basic skill set getting created.

Recommendation 28. The content and training modules will have efficacy parameters as part of the programme.

Recommendation 29. FINWEB will develop a website that will become the clearing-house for all financial education efforts. **The material developed by FINWEB will be put on the website for downloading by anybody who wants to use it.** It may encourage smaller organisations to use it by moulding it to their own needs.

Recommendation 30. FINWEB will operate in three distinct ways. One, it will begin engaging with those who are already doing work. Two, it will reach out to large arteries who could carry this. Three, it will be available as a resource house for any organisation that may want customisation for its specific purpose.

Recommendation 31. To measure the change in behaviour, FINWEB will carry out a nationwide survey to fix benchmarks of current behaviour. Only then will subsequent surveys determine efficacy.

1.63 As the population transits from a portfolio heavy on bank deposits and real estate to a portfolio that makes a greater allocation to financial assets, we need to address two questions. One, do we need regulation for sellers and advisors at all at this stage of our markets? Two, if yes, then which of the two regulatory standards prevalent in the world should we choose: a rule-based system, which uses a full disclosure-plus-literacy model to move responsibility of the outcome to the consumer; or, a principle-based system, where a good outcome is the responsibility of the product vendor and advisor? The report will answer these two questions.

1.64 Chapter Three builds the case for a common minimum set of regulations for sellers and advisors across all retail financial products. It looks at the financial world from the point of view of the customer, not the product manufacturer or the regulator. The objective is not to have the consumer run from one product regulator to another, but to present one integrated regulatory face to the consumer, with the existing regulators cooperating behind the scenes.

1.65 Chapter Four documents the findings of a series of interviews with key people in the financial sector. It also analyses the results of a survey of mutual funds, insurance companies, brokers, advisors and other entities in the financial markets on the need, form and direction of a common minimum regulatory standard for financial sellers and advisors.

1.66 Chapter Five looks at regulatory structures in 23 countries to see what fits best for India. The US and

the UK are taken as representative examples of the two approaches to regulation in use for sellers and advisors. The US believes in rule-based regulation and the UK in principle-based regulation. A survey conducted by the Financial Planning Standards Board (FPSB) gives insights into the regulatory experience of 23 countries in dealing with this issue.

1.67 The report's target is the retail financial sector that serves the financially included population. This would mean citizens with bank accounts and with already active financial lives in organised market products. The regulation of the unbanked through informal chains, the micro-finance industry, and other traditional channels of credit and asset creation, are outside the scope of this report.

1.68 IRDA has certain reservations about some of the recommendations given and data used in the report as detailed at Annexure V. IRDA feels that the Committee has treated the varying product classes, industry objectives and customer profile of various financial instruments on the same footing. In particular, intermediation has a very important role in driving insurance penetration. Insurance contracts are generally long term and agents are responsible for providing data for basic underwriting and for servicing sold insurance policies. A change in the product pricing structure will have an impact on the existing in-force policies leading to higher lapsation. Following a no-load approach will cause the shifting of the expenses from agents to the insurance company resulting in disturbing the business structure of life insurance business which may not be an efficient way of doing life insurance business. IRDA feels that the theme of the report seems to be to bring down the presumed commission structure of the insurance products to drive the sales of mutual funds and equity products.

1.69 IRDA further views that common minimum standards for financial intermediaries may lead to regulatory gaps, because the objectives of various branches of the financial sector distinctly vary. A common examination as suggested by the Committee is likely to lead to escalation of regulatory costs among the regulated entities. In view of the above, the standard norms laid down by FINWEB shall be on advisory lines. Some of the data presented in the report regarding the insurance sector is picked up out of context and presented in a biased manner.



PART A: Investor Protection

2

Introduction

2.1 Forty years ago, Delhi had few private vehicles. The stretch from Old Delhi Railway Station to Qutab Minar had a total of one traffic signal, and opinion is still divided on whether it was an automated signal or a policeman at AIIMS. Regardless, the journey was smooth. The same journey in 2009 looks very different. Even one malfunctioning signal on the stretch causes traffic jams and commuter distress.

The Need For Regulation

2.2 Financial markets are similar. **When the number of investors and products were few, there wasn't a pressing need for a regulatory structure.** Most people bought government-guaranteed, zero-risk investment and insurance products; even the small number of investors who did participate in the stock market knew what they were doing.

2.3 But the appearance of over 100 million investors¹ in risk-bearing products like mutual funds and market-linked insurance plans, with features and implications that need understanding, brings home the need for order. With another 200 million middle-class Indians waiting to invest in these products, the need for traffic signals and rules to make them feel safe enough to cross over becomes imperative.

2.4 Just as traffic rules need to be upgraded with time, investor protection is a continuum, not a one-time quick fix. In 1991, when India began the process of opening up its economy and financial sector, the biggest risk facing the individual financial consumer was the risk of fraud. Continuous government action in the securities market² has reduced this risk significantly. A structured approach towards cleaner

¹ While the number of investors in equity or equity-linked plans is smaller, even traditional policies in insurance and debt funds are market-linked and can be called 'risk-bearing'.

² The Sebi Act, 1992; NSE incorporated, 1992; Screen-based trading begins with NSE commencing operations, 1994; The Securities Laws (Amendment) Ordinance, 1995; Depositories Act, 1996; The Securities Contracts Regulation Act (SCRA) amended, 1999; Sebi (Amendments) Act, 2001

markets worked in terms of greater participation in the capital market, lower costs and greater efficiency.

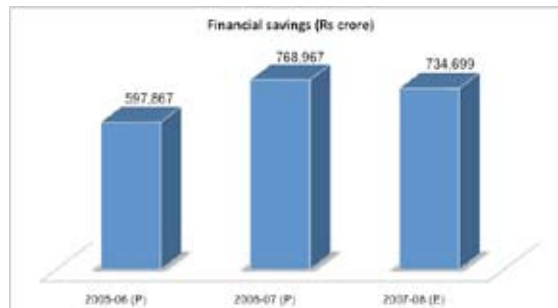
2.5 Wanting to protect the small investor, the government first put in place regulations, and then opened up the mutual fund³ and insurance⁴ sectors to competition and the private sector. Today, in 2009, the risk of fraud is small; even a Satyam is an exception, not the rule. The risk that a fly-by-night operator will disappear with pooled investments such as mutual funds and insurance is quite low. In the case of mutual funds, it is the sponsor-trustee-asset management company (AMC) structure that prevents the sponsor (the person or firm setting up the business) or the AMC (the fee-for-service fund-manager) from owning the funds. In insurance, it is the capital requirement of Rs 100 crore that gives the stability of intent to product manufacturers.

2.6 While the market risk is, and should be, with retail customers, the risk of wilful fraud is now not a deterrent to retail participation in the capital market. **However, participation of retail investors in non-traditional, market-linked financial products is still limited, with less than 10 per cent of household savings flowing in to the capital market (Graphic 1: Financial Savings Of Households).** One reason for this preference for fixed-return, guaranteed options is the high risk-free return that investors can earn on government small savings and provident fund schemes, and the comfort of the bank deposit as a perceived safe way to save⁵.

2.7 Indian retail investors have had a love-hate relationship with market-linked products. In a down market, investors prefer to stay at the lowest end of the risk-return spectrum—zero risk, low real return deposits. When the market starts to rise, they tend to jump in. More often than not, they enter the market when it is about to peak, that too

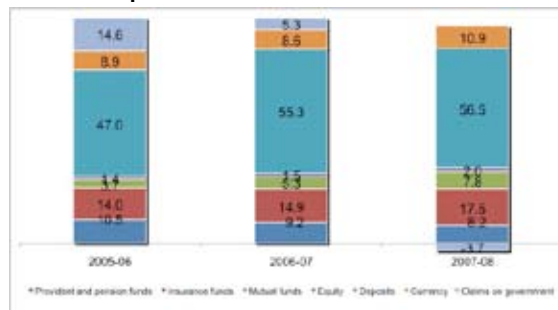
Graphic 1: Financial Savings Of Households

The Big Numbers



P: Provisional; E: Preliminary estimates

The Breakup



Figures in per cent

Source: RBI Data, 2008, and FPSB

by adopting the riskiest investing strategies. When the market slumps again, retail investors, stung by the experience, retreat into their zero-risk shell, swearing never to return.

The Emerging Investor

2.8 This sort of irrational swing between fear and avarice saw a tiny change in the last stock market boom-bust cycle that culminated in 2008. In the early-2000s, a new species of retail investor was born. It believed in taking the lower risk route of a mutual fund to the capital market. Along with these investors came a tiny group of financial planners who looked to sign up clients—and retain them—over a lifetime, rather than practice the

³ Sebi (Mutual Funds) Regulations, 1996

⁴ Irda Act, 1999

⁵ Bank deposits make up 56.5% of the household savings pie (RBI Data, 2008).

typical 'hit-and-run' sales strategy of agents. A more literate investor operating with a more literate advisor resulted in a surprising statistic.

2.9 During that boom-bust cycle, October 2008 was the worst month for equities. Equity funds, however, registered a pullout of just Rs 706 crore—a statistically insignificant 0.72 per cent of the equity assets under management (AUM) that month⁶. Financial planners servicing this market recount the close and careful handholding they had to do during this market crisis to encourage customers to not just stay on, but to keep investing.

2.10 Clients are appreciating this advice in hindsight, as the market has recovered, making their systematic investment plan (SIP)-based portfolios look good. The continuation of equity-linked SIPs, with no large retail redemptions in equity funds⁷, shows an investor category that has understood equity as a long-term vehicle of wealth creation. It understands systematic

investing and cost averaging, and is willing to stay invested through swings in the market.

2.11 It took a good investment vehicle and financial planners to bring about this change. **When offered a viable and fair product, with a structure that can be easily understood and trusted, the retail investor does make optimal choices, aided by an advisor who clearly has the investor's interest in mind.**

2.12 In the right environment, the traditional risk-averse Indian investor does show an appetite for a riskier product that can deliver potentially higher returns. As the zero-risk products guaranteed by the government slowly lose their tax-friendly status and as the concept of taking structured risk becomes clear and acceptable to more and more people, India will see an increase in the number of people moving to financial markets.



⁶ Association of Mutual Funds in India data, Monthly Report October 2008

⁷ Information gathered from mutual funds through interviews

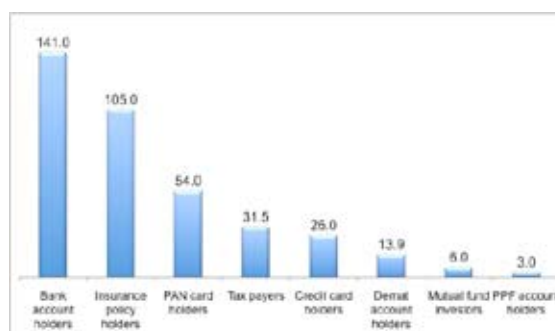
3

The Need For Common Minimum Standards

3.1 About 56 per cent of Indian household savings are parked in low-yielding bank deposits and another 11 per cent sit idle in cash, losing purchasing power to inflation. The number of bank account holders in 2007 was 141 million, almost 24 times the 6 million mutual fund investors (See *Graphic 2*). Insurance funds have over 17 per cent of the household financial savings pie, but the average sum assured is small.

3.2 The product basket of wealthier countries (See *Graphics 3 and 4*) shows a larger proportion of household savings in financial assets as compared to that in developing countries. As an economy matures, there is a shift in the share of the household asset pie from bank deposits to market-linked products. During 1990-2008, the US, for example, saw contributions to mutual funds through Individual Retirement Accounts (IRAs) jump 10-fold to \$1,598

Graphic 2: Financial Ownership In India



Figures in million, for 2007
Source: FPSB India

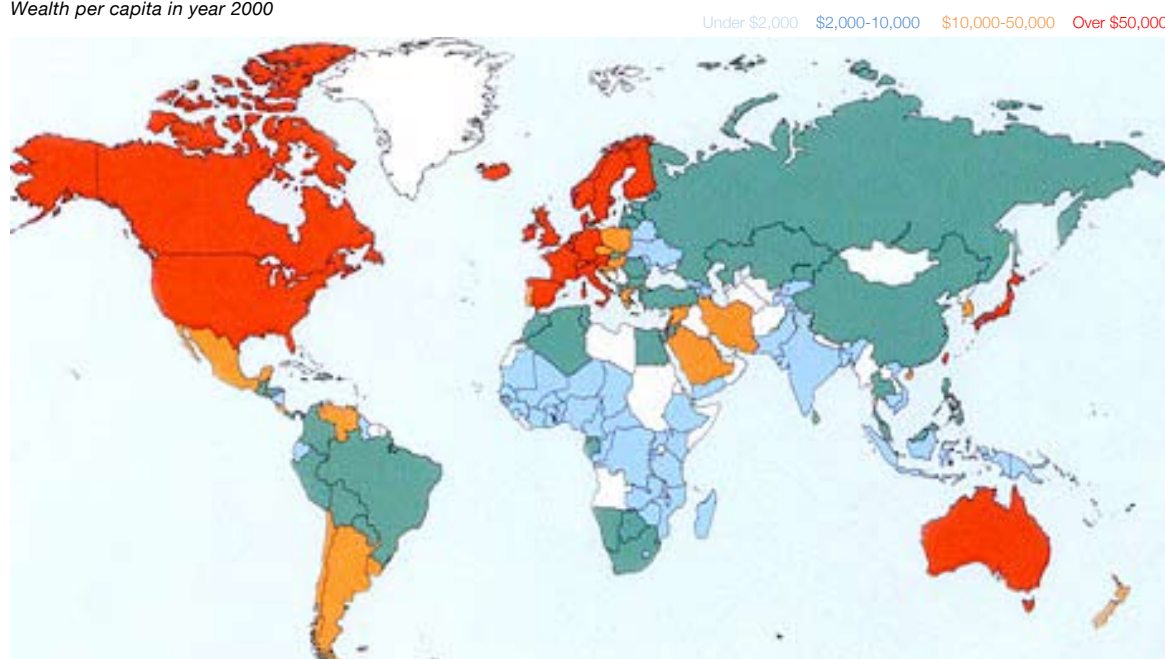
billion; by comparison, growth in bank deposits during that period was about 50 per cent, to \$391 billion¹. Similarly, in India, the share of mutual funds in the household savings pie increased from 3.7 per cent in 2005-06 to 7.8 per cent in 2007-08².

¹ Sources: Investment Company Institute, Federal Reserve Board, American Council of Life Insurers, and Internal Revenue Service Statistics of Income Division

² Indian Retail Finance Markets, 2007, IIMS Dataworks

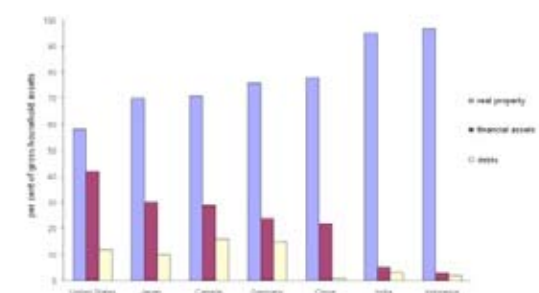
Graphic 3: World Wealth Levels

Wealth per capita in year 2000



Source: UNU-WIDER

Graphic 4: Asset Composition in Select Countries



Source: *The World Distribution of Household Wealth*, James B Davies, Susanna Sandström, Anthony Shorrocks, and Edward N Wolff, World Institute for Development Economics Research, February 2008

3.3 There is no reason to believe that India will be an outlier, and not experience a transition from real assets and bank deposits to financial assets. The financial market is brimming with products for sale and 188 million consumers are already holding some kind of financial assets in their household savings pie. Another potential 200 million are getting ready to join them.

Need For Regulation

3.4 A significant factor that can derail the metamorphosis of the investor from a risk-free deposit holder to a consumer of insurance, investment and credit products that are linked to the market is the experience of the early consumers. **Consumers usually lose faith in markets for two reasons. One, if products are harmful.** Products are harmful if they are designed to ‘explode’³ in retail portfolios—that

³ The US saw ‘exploding’ financial products during the sub-prime crisis when mortgage products that were inherently unsafe were sold. For example, a product that allows a partial interest repayment in the first few years and capitalises the unpaid interest into the principal will explode in any average portfolio. <http://bit.ly/31DbpW>

is, they are structured to dupe and are bound to cause a bad outcome in an average portfolio. **Two, if products are sold in a manner that they cause a bad outcome due to inappropriate matching of a product to a customer's needs by the seller.**

3.5 In the Indian context, the first is less of a risk than the second. India's product manufacturers are fairly well-regulated⁴. In the current regulatory mindset, it is unlikely that regulators will clear products that, by themselves, have the potential to 'explode'⁵. But the second needs closer examination. Are financial products being sold in a way that takes care of the interests of the customer? In order to understand the importance of the point of sale in a financial product, it is important to understand its nature.

3.6 Financial products are invisible—they cannot be tasted, smelt, felt, or perceived by the senses in any other way. A car can be driven before it is bought. A music system can be heard to see what it does. A garment can be tried on to see if it fits. But since a financial product is invisible, it needs to be described by the person selling it. And since the moment of truth of a financial product is several years away from its point of sale, its utility to the customer can be accurately measured only sometime in the future.

3.7 These two attributes of a financial product—its invisible nature and distant moment of truth—makes the point of sale an extremely important link in the entire product chain. Unless the sales person is able to correctly describe the product and its role in the portfolio of an investor, the product is likely to 'explode'. This can prove to be potentially harmful for the customer, who relies on verbal communication from the sales person to understand the product, its costs, its return potential and its flexibility.

3.8 The written communication, as it exists today, is lengthy and leans towards 'checklist' compliance. So, the offer document and communication with

customers is done to the letter of the law, but gives them little idea of what they have bought. There are notable exceptions in the industry that try to bridge the gap, but it's not the industry standard.

Incentives And The Industry

3.9 In order to understand the role and importance of the product seller, we take the help of an analogy. Say, there is a *mithaiwala*, which makes sweets and supplies them to other retail shops. The law of the land prevents it from making unhygienic sweets or using harmful substances. Now, for the *mithaiwala*, sugar is not a harmful substance, and it uses it to prepare, say, a batch of *sandesh*. This is bought in bulk by a retail chain. A diabetic visits one of these outlets and asks for sugar-free *sandesh*. The retailer has run out of stock of sugar-free *sandesh*, but wanting to make a sale, he sells the sugared *sandesh* as sugar-free *sandesh*. The diabetic finds out in the worst possible way and incurs health problems. Whose fault is it: the product manufacturer, the regulator of the product manufacturer, the retailer or the customer?

3.10 Transpose this argument to the financial products industry. The results are identical. Here, the product manufacturers are insurance companies, mutual funds, banks (selling credit cards, debit cards, home loans, personal loans) and, now, pensions. Each has its own regulator that looks closely at their products and clears them before they can start selling them. While there is plenty of scope to improve outcomes in terms of benchmarks, disclosures, service standards and costs, there is no product that is inherently unsafe.

3.11 But safety is also a function of the customer's situation. A product can legitimately exist in the market (sugared *sandesh*), but it does not belong in the portfolio of a person (the diabetic) who does not seek the risk, reward and cost implications of the product. Say, a risk-averse individual, wanting

⁴ Insurance products are approved by Irda and mutual fund products by Sebi.

⁵ Unsafe At Any Rate, Elizabeth Warren, Democracy, A Journal of Idea, Summer 2007

a small equity exposure in her portfolio, goes to a seller of financial products. The seller advises and sells her an equity unit-linked insurance plan that soaks up all her investible surplus or a high risk, high return sector mutual fund. Who is responsible for misleading her: the insurance company or mutual fund, the seller, or is she herself responsible?

3.12 The above argument will change if it is proven that the *mithaiwala* paid the retailer a higher margin to sell the sugared *sandesh* and wilfully turned a blind eye on the mis-selling in the market. In that case, it is a failure of the product manufacturer, who could not put in place enough safety norms to prevent this predatory sales practice.

3.13 Sebi has been working on the sales incentive structure to curb predatory sales practices that originate from the manufacturer. To remove the incentive for agents to sell mutual funds that offer them a higher commission, Sebi, in April 2006, stopped mutual funds from charging the 6 per cent amortisation cost⁶, as it encouraged portfolio churn⁷. **From August 1, 2009, mutual funds have become no-load⁸. The pension product, New Pension System (NPS), was constructed without any entry or exit loads.**

3.14 Irda, too, is working in the same direction. As a first small step, the difference between the gross yield and the net yield on a 10-year unit-linked policy has been capped at 300 basis points⁹. **There is yet a long road ahead for the insurance regulator to rationalise market incentives to protect consumers. Given that the average commission-to-premium ratio is 16.25 per cent¹⁰, there is much to be done to bring about parity in products that target an investment role.**

3.15 So, we are in a situation where investors are showing an increasing appetite for market-linked insurance, credit and investment products. The products are out there. Global experience shows that, sooner or later, the transition from real assets and zero-risk products to market-linked products will be made. The presence of a trustworthy, regulated retail intermediation industry, with common minimum standards, becomes the crucial link between investors and products. It is important that the first brush of investors with new products should not result in bad outcomes.

The Problem Of Mis-selling

3.16 There is yet debate in India on the need for a separate set of regulations for financial sellers and advisors. For example, a recent report was convinced that there was no need for such regulation. This report was of the Committee on Regulation of Investment Advisors in Non-Securities Markets, in 2008. It concluded that status quo be maintained since there was no evidence of need for a separate set of regulations for financial sellers and advisors.

"The Committee therefore accordingly concluded that the development of a new regulatory framework for overall financial advisory, particularly in the face of serious administrative and regulatory problems and significant constraints in their oversight, is clearly avoidable at the current stage of development. Considering the balance of advantage and ground realities, the Committee therefore decided that it would be appropriate to desist from recommending formulation of

⁶ Open-ended mutual funds were allowed to charge 6 per cent of the amount mobilised by a new fund offer and get its unitholders to pay for it over a period of five years. This resulted in product churning and a rush to launch new funds that were no different from those already in the market from the same AMC.

⁷ Churn is the practice that encourages an investor to change a cost-bearing financial product frequently because the agent is paid every time there is a change in the investor's portfolio.

⁸ Sebi has removed the 2.25 per cent commission that was paid by the AMC to the distributor out of investors' funds, with effect from August 1, 2009. Any compensation, as a transaction fee or for service, will now be paid directly by the investor to the agent. This model already works successfully in direct equity investing.

⁹ Irda circular titled 'Unit-Linked Products—Cap On Charges', July 22, 2009. <http://tinyurl.com/l2vsdu>

¹⁰ Annual report 2007-08, Irda

any new arrangement for creation of a new architecture of financial sector advisors or their regulation till a future date¹¹.”

3.17 This report will document actual consumer experiences and some typical sales calls to show the nature and gravity of problems that retail investors face when transacting in the market for financial products. Annexure 1 documents actual experiences of customers who agreed to share their stories with this Committee. Below are some typical sales calls narrated during the process of data collection for this report:

- “I am calling from your bank and I see that you have Rs 5 lakh in your savings account. There is a good pension plan we can offer. When can I send a person to tell you more about it? You need to pay for only 3 years.”
- “Your old endowment policy is not good anymore. Let me show you a new product that will give you Rs 25 lakh in 10 years. You can encash your old endowment policy now.”
- “India is not going anywhere. I have a mutual fund that invests abroad that will make your money grow safely.”
- “Why are you buying a term-insurance plan? You get no money back, it is useless. I have a plan that will give you a good return and an insurance cover comes free with it.”
- “Your unit-linked plan has lost money. You made a mistake buying from company A. I’m from company B. You stop that product and buy from me. We have given 30 per cent return.” (This was when the market had risen 50 per cent.)
- “Why are you buying that fund? It costs Rs 56 per unit. I have one that is just Rs 10 per unit. Why pay more when you can get something cheaper?”
- “There is a new fund in the market, you must

have seen the ad. This one will double your money in three years.”

3.18 It would be easy and naïve to dismiss the above examples as exceptions. Although there is no survey that quantifies the extent of mis-selling of retail financial products, we have stories of mis-selling told across the length and breadth of the financial sector. We also have the words of a market veteran, who told this Committee: “When there is a fever raging, it does not take a thermometer to tell you that a person is sick. A mere touching of the forehead will do. If the thermometer were to show otherwise, I would call it faulty. You cannot ignore obvious symptoms.”

3.19 The other concern this Committee wants to flag is the sale of financial products by bank staff. **When a bank relationship manager sells a mutual fund or an insurance product, who is the regulator looking at the process to prevent sharp sales practices, excessive churning of portfolios and products being sold to portfolios where they will explode?** On the ground, this part of the market falls into a regulatory crack. This is serious because mis-selling by bank staff has the potential to erode the high confidence that Indians have in their banks¹². Another area of concern is the use of the negative option for sale of products. Oral consent, or saying ‘yes’ on the phone, needs to be followed up by written documentation. Although mandated, it is not done, but substituted by the free-look period in the case of insurance products. Negative option and free-look period are causing trouble to consumers and have become a nursery for ghost insurance policies. These policies are issued without the customer’s application and knowledge, and huge premium charged/paid.

3.20 It would only take a small mystery-shopping exercise to prove the above situation. This Committee believes that sharp sales practices are widespread. A simple check will reveal that most banks are selling mainly life insurance products after mutual funds went no-load from August 1, 2009.

¹¹ Report of the Committee on Regulation of Investment Advisors in Non-Securities Markets, 2008

¹² Complaints of bank customers in cases of insurance mis-selling in Annexure 1

Who Is A 'Regulated' Entity?

3.21 The argument given is this: mutual fund and insurance agents are already regulated entities; further, since they don't offer any advice, regulation, if any, must be restricted to financial planners and advisors. But are agents truly regulated entities? Let us consider the current regulations and see if they match global definitions of a regulated entity.

3.22 Mutual fund agents are licensed entities. Sebi mandates an entry threshold for mutual fund agents through Amfi certification. All employees of a mutual fund have to clear the Amfi Mutual Fund (Basic) Module. All agents or the sales team need to clear the Amfi Mutual Fund (Advisors) Module. Every three years, agents need to clear the exam again to retain their license to sell.

3.23 Insurance agents and brokers, too, are licensed entities. Irda mandates an entry threshold and code of conduct for insurance agents and brokers. They need minimum education hours and have to clear an exam to get a certification. The education requirement is minimum 50 hours of training for first-time agents and 25 hours of training for license renewal. This comes under Irda (Licensing of Insurance Agents) Regulations 2000 and Irda (Licensing of Corporate Agents) Regulations 2002. Irda (Insurance Brokers) Regulations 2002 lay down the rules for licensing of insurance brokers.

3.24 But is this good enough? One way to assess this would be to see if the regulation in place in India for mutual fund and insurance agents (even for bank employees selling non-banking financial products) fits the internationally accepted definition of a 'regulated' entity. Guidelines of the International Organization of Securities Commissions (IOSCO), which is the global meeting place for securities markets regulators,¹³ say:

"Supervision of market intermediaries should achieve investor protection by setting minimum standards for market participants. Investors should be treated in a just and equitable manner by market intermediaries according to standards, which should be set out in rules of business conduct. There should be a comprehensive system of inspection, surveillance and compliance programmes. Investors in securities markets are particularly vulnerable to misconduct by intermediaries and others, but the capacity of individual investors to take action may be limited.

Further, the complex character of securities transactions and of fraudulent schemes requires strong enforcement of securities laws. Where a breach of law does occur, investors should be protected through strong enforcement of the law. Investors should have access to a neutral mechanism (such as courts or other mechanisms of dispute resolution) or means of redress and compensation for improper behaviour. Effective supervision and enforcement depend upon close cooperation between regulators at the domestic and international levels.

3.25 Next, a survey of codes of conduct of insurance associations and regulators¹⁴ shows a basic distinction between an advisor and a broker, with the latter earning only transaction charges and the former getting a fee for the advisory role.

3.26 Best practices for the regulation of the agent or broker-dealer in both the insurance and securities markets reveal similar basic requirements of:

- A set of compliance exams
- A system of continuing education
- A process of registration

¹³ Objectives and Principles of Securities Regulation, IOSCO, 2003

¹⁴ Advocis, the Financial Advisors Association of Canada, <http://www.advocis.ca/index.html>; the Singapore Insurance Act 2002, <http://tinyurl.com/lgppdp>; the Financial Services Authority, UK. <http://tinyurl.com/ngwgoe>

- A process of regulatory filings
- An ongoing system of monitoring
- A system of compliance for the agent or broker-dealer to follow
- Well-defined enforcement procedures
- Punitive action

3.27 Clearly, the agent selling financial products in India cannot be called a ‘regulated’ entity by globally accepted standards. There are entry thresholds, but they do little to contain the malpractice of selling customers inappropriate products using false verbal promises. There is no system of regulatory filings. There is no system of monitoring. There is no visible system of enforcement.

‘Agent’ Is Also An ‘Advisor’

3.28 The second argument of the Committee on Regulation of Investment Advisors in Non-Securities Markets in 2008, which dismissed the need for financial intermediary regulation, has to do with the definitions of ‘advisor’ and ‘agent’. It said:

“It was noted at this stage that it would be appropriate to distinguish regulation of advisors in the non-securities market from the existing regulatory framework applicable to intermediaries such as sales agents functioning as distributors. The agents, who are regulated, not only promote the products of the company they represent, but they also help investors in servicing the policies/claims over the entire term of the contract. Their relationship with the customer was therefore different from that of the advisors¹⁵.”

3.29 The world over, the retail market for financial products is divided into two parts. One, agents or broker-dealers, who are vendors of a product. They have no view on the product and act like a chemist selling prescribed medicines over the counter.

Two, advisors or planners, or financial doctors. They evaluate a person’s needs and accordingly recommend particular products.

3.30 Globally, there are growing concerns over the creeping move of broker-dealers turning advisors, by selling products that carry loads. US regulators, in particular, flag the difficulty in monitoring such broker-dealers. They point to the conflict of interest: are broker-dealers meeting the needs of their clients or their own? Xinge Zhao¹⁶, an economist with the China Europe International Business School, says a load product carries advice.

“Brokers and financial advisors ultimately serve as the true decision-makers behind investments in load funds. In terms of the current SEC investigation as to whether they have abused their influence on investors, when there exists a conflict of interest, brokers and financial advisors apparently serve their own interests by guiding investors into funds with higher loads.”

3.31 A sales load will have advice embedded into it, irrespective of whether the seller is called an agent, advisor or a planner. To address this conflict of interest, the UK will make all products no-load from 2012¹⁷. Australia too is exploring whether to ban commissions and move to a fee-for model, which is seen as reducing potential conflicts of interest that exist for commission-based advisors. It would not be untrue to conclude that sellers, when they sell load products, tend to increase their own welfare, rather than that of their client.

3.32 To extricate the advisor from a pure seller is like dividing up the *sandesh* vendor into two people. One would inform the customer about the various options and which one to buy. This product information is available only with the product advisor, not with the customer. The other would only collect the payment without speaking a word. This is clearly not the way financial products are sold in India.

¹⁵ Report of the Committee on Regulation of Investment Advisors in Non-Securities Markets, 2008

¹⁶ The Role of Brokers and Financial Advisors Behind Investments Into Load Funds, CEIBS, China

¹⁷ Distribution of retail investments: Delivering the RDR, FSA June 2009

Box 1: A New Approach to Financial Inclusion And Intermediation

Although India's unbanked population is not the target set of this report, it yet has relevance for them. An increasing number of people in rural areas are being sold equity-linked products, products they have not understood or can't even afford to buy (Annexure 1). While some companies are using urban products to net rural consumers to meet their 'financial inclusion' targets, others are trying out micro-insurance, micro-SIP plans to genuinely understand rural needs.

Once companies step through this door, they realise the financially excluded lead "incredibly complex economic lives...as they juggle many balls like volatile incomes, health uncertainties, rainfall failures and old favours to be returned to neighbours, even as they struggle to feed their families daily and keep their children in school"¹⁸.

A project by Chennai-based IFMR Trust goes deep into those dilemmas. The business looks at finance as "noise-reducing headphones", which will remove wrinkles that cause small events to push a poor rural family into poverty.

It translates into branches of Kshetriya Gramin Financial Services (KGFS), which leverages the relationship with the micro-finance customer to offer a variety of investment and insurance products tailored to the needs of the people in that region. In its fully developed form, the KGFS network will offer a full suite of financial services, including credit, investments and insurance, for those outside the banking sector. It will cover their property, including their crops and animals.

A software is being tested that will match individual profiles to a set of financial products. These products are tailored to local needs, rather than mass-produced for some other geographical and economic market without

knowledge or empathy for the problems of the poor. So, for example, the monthly repayment option in a loan works well for urban consumers. But a poor person, with a different periodicity of income flows, seeks a "weekly or daily or even hourly repayment option. And when combined with rainfall insurance, the loan can provide a 'payment skip' when the rains fail".

The key to a simple personal accident policy, designed to meet the needs of the people of a particular area, is to link it to the financial lifecycle of a village daily wage, and see the rest of her life's financial chart move from red to blue, from despair to hope. On the one hand, the project uses technology embedded in biometric cards, and VSAT and broadband links to connect the off-map population. On the other, it leans heavily on knowledge of high finance. It combines the two to design and source specialised products for this market. The project is already running in three states, namely Tamil Nadu, Orissa and Uttarakhand.

Run by employees, rather than commission-seeking agents, KGFS is unique as it takes the responsibility of a good outcome on itself. It argues that just as a doctor is liable for wrong medical advice, the seller of financial products should also be held liable for selling a product that results in a bad outcome.

In order to demonstrate this ownership of outcome, Bindu Ananth, President of IFMR Trust, likes to tell this story. A daily wage, who was the sole earning member of a family of five, pawned her gold jewellery to take a loan. Subsequently, she died. KGFS is yet to begin offering a life cover, but as a full-service wealth manager, it ruled it was at fault for not having a life cover in place for the woman. KGFS returned the gold to her family, not out of a sense of pity, but out of a sense of responsibility.

¹⁸ Finance as Noise-Cancelling Headphones, June 24, 2009, WSJ. <http://bit.ly/g1Abq>

3.33 This Committee clubs all agents, advisors and planners into one category and will treat all load products as carrying advice. This Committee feels the seller of financial products is an entity that is not different from an advisor; hence, regulation, if any, should not be confined to advisors. It calls for a common minimum set of regulations for the sale and advice of all retail financial products. Any seller or advisor serving retail customers must be regulated.

3.34 This Committee is not of the view that India does not need agents and distributors of financial products. The retail interface is a key element of financial markets and the agent network is very important. Agents have been servicing customers and will continue to do so. The only change that the Committee sees as necessary is in turning a trade into a profession. This will necessitate some changes, which this report will document.



4

Need For Regulation: The Industry View

4.1 Regulating a population of about three million financial sellers and advisors is a subject that generates much interest, opinion and emotion. While the population affected by this regulation—investors—can say little since they are a disaggregated lot, they vote with their share of the asset pie, and continue to keep their money in defensive options. The other three parties in this discussion are regulators, product manufacturers, and advisors and sellers.

4.2 It is important to get the views of these three parts of the market before formulating a set of common minimum standards, as it will affect their jurisdictions, product structures and selling practices, respectively. A full survey of the financial sector would have taken several months to execute. This Committee used the dipstick-survey technique to tap key market participants—regulators, product manufacturers, sellers and advisors—for their views. **This survey should be seen as a first information report of an area that has remained uncharted by formal surveys.**

Survey Of Market Participants

4.3 Chapter 3 built a theoretical argument to set up a common minimum regulatory framework for sellers and advisors of financial products. But what may work in a laboratory may not work in the marketplace. And when the marketplace is as vast and varied as India is, and has about three million livelihoods earning commissions that will potentially get affected, the need to avoid blindly replicating mature market structures in India is even more essential. That was the thought behind conducting strategic interviews with key people in the financial sector—regulators, market veterans, heads of insurance companies, mutual funds and brokerage houses, among others. Annexure 2 has the list of the people interviewed.

4.4 The Committee also conducted an e-mail survey of mutual funds, insurance companies, banks, brokerage houses and financial planners to get information on specific sales-side practices and self-regulatory mechanisms in place. It also asked them for their views, opinions and suggestions on regulating sellers and advisors.

4.5 Surveys can be quantitative or qualitative. The aim of this survey was not to get numbers, but to get voices from the industry who have a view and are willing to share it. The survey was emailed to about 100 organisations, of which, 25 responded. The Committee got a confirmation of receipt of the survey from most of the organisations that didn't respond, but nothing further.

4.6 The aim of the survey was three-fold, namely to get:

- A sketch of the product sales lifecycle, from the point of view of manufacturers, sellers and advisors.
- Best practices on disclosures to the customer at the point of sale.
- Opinions on the need for a common set of regulations for sellers and advisors, and suggestions on what they should like.

Annexure 3 has the full list of respondents and their answer scripts.

4.7 The survey responses showed a consensus building among financial sector participants on three broad points:

- **The time is right to put in place common minimum standards of regulation for sellers and advisors.**
- **There is a need for a unified approach that gives consumers a single regulatory interface rather than across multiple regulators.**
- **Best practices should include a threshold entry-level examination common across product sellers, a system of continuing education, professional standards, code of conduct, disclosure norms, product matching with personal profile, and punitive action against mis-selling.**

What Does The Market Look Like?

4.8 The intermediary market consists of independent product sellers and advisors, and staff of organised entities that sell mutual funds, insurance and pension products. These entities include banks (public sector, private sector and foreign), broker-dealers (organisations that are registered stock brokers), distribution houses and financial services companies. The market has a small presence of independent financial advisors (IFAs) who carry the globally accepted CFP¹ license.

4.9 While the market is mostly sales-push, it turns demand-pull for certain products and at certain times of the year. Home-loan schemes, compulsory motor insurance and health cover are clear demand-pull products. During the tax-saving season (January to March), products that qualify for the Section 80C tax benefit become demand-pull. Insurance companies see an interesting trend of health and investment products becoming demand-pull as age and/or wealth increases. For younger and less well-off consumers, the market is still sales-push.

4.10 In this largely sales-push market, it takes 2 to 30 days and 2 to 5 visits to get a customer to sign a cheque. This is the cost incurred by a seller or advisor, in terms of time taken, to get a new client. The sale of equity products takes longer than fixed-income products, as consumers need more convincing to put their money at risk. Most distributors confirm that once a relationship starts, be it because of any product, subsequent product sales take less time.

4.11 Among emerging product-specific trends, the general insurance industry describes a new market, 'instant policies', which are policies that can be bought over the Internet and need little advice. One of the respondents spoke of the ease of selling the New Pension System (NPS), as the sale is largely demand-pull and it takes just two days to invest the customer's money.

¹ Certified Financial Planner

Are There Ground Rules?

4.12 While the Committee mostly found instances of ‘checklist compliance’, some product manufacturers are trying to reach out to consumers and financial planners seem to have a structured practice in place.

4.13 Disclosure norms are not standardised across different products. For instance, KYC is essential for mutual funds, but not for insurance products. Mutual funds have to disclose all material facts in a Key Information Memorandum (KIM), but the disclosure of costs is not mandatory in insurance. Most insurance companies rely on brochures and policy documents for disclosures and product features. Some insurers disclosed the reduction in yield due to costs at the point of sale, even before the Irda notice.

4.14 A dichotomy was seen between practices of brokerage houses and financial planners. The planners begin with a detailed client-profiling and data gathering to determine the personal financial situation of the client. This initial exercise formed the basis of future interactions and services rendered. Brokers mostly pass on brochures and other sales material of manufacturers, and their experience of disclosures and customer-profiling is not uniform.

Do We Need Common Minimum Rules For Sellers And Advisors?

4.15 Most respondents wanted common minimum standards of regulation for sellers and advisors that were delinked from the products sold by them. A life insurance company suggested that, given the developments in the life insurance, pension and mutual fund industries, this might be the right time to set up a Professional Standards Committee in India. This could be set up as a Board under the aegis of the High-Level Coordination Committee (HLCC) of the RBI, Irda, Sebi and PFRDA to consider professional requirements for sellers and advisors in all segments of the financial markets.

4.16 A mutual fund house had a similar suggestion. The fund house said that though industry bodies like

Amfi have a code of conduct for agents, the regulator has not set any specific regulations. Therefore, there is a need for specific regulations across the financial sector, including mutual funds, insurance, banks, primary and secondary markets, and others. There should be similar regulations for financial advisors selling mutual funds, pensions and insurance.

4.17 Another fund house felt that regulating distributors across all financial products sold to retail customers is the need of the hour, as it will ensure accountability. The AMC suggested that such a regulation could lay down minimum distribution standards to be followed by a seller or advisor when selling to retail customers an investment-oriented product like mutual funds, bonds and debentures, equities, portfolio management schemes, structured products and company fixed deposits, as well as for investment-oriented insurance products like Ulips.

4.18 One suggestion coming from the insurance industry is to allow companies to take agents on their rolls. Less than 20 per cent of the agency is full-time in the insurance business and serious players will be happy to see this happen, they say.

4.19 Respondents generally agreed that there must be a set of regulations to ensure customers were not misled by financial advisors or misinterpreted the advice given in product brochures. Today, different regulators govern different segments of financial services providers. A unified body that covers financial services providers and distributors across product lines will simplify the customer interaction process and lead to better service levels.

What Should The Rules Contain?

4.20 The survey respondents gave several suggestions on what all common minimum standards of regulation for financial sellers and advisors should contain.

4.21 Education and examination as an entry threshold. Many respondents said the starting point of such a regulatory system should be

minimum outcome-based training, culminating in an examination process. A certification course for intermediaries that went beyond the Amfi and Irda exams, and covered the entire financial planning process was suggested.

4.22 A fund house suggested that there should be minimum educational qualification requirements, and sellers and advisors should be required to pass industry exams. There should also be a regular requirement of appearing for refresher exams. Another fund house suggested a tiered system of qualifications for advisors in a way that required those advising on more complex products to have higher levels of qualification. This must be followed by a continuing education requirement.

4.23 Professional standards. The need for a common minimum level of professional standards was expressed by many companies.

4.24 A fund house believes it is reasonable for consumers to expect their financial advisor to have a practising certificate, just as a lawyer or an accountant does. It suggested that all individuals and organisations involved in selling financial products register themselves with a common regulatory body. All members should be governed by a code of ethics that must be followed irrespective of the individual/organisation being a distributor or an advisor.

4.25 Profiling and product match. The fact that products are being sold without first ascertaining a customer fit worried some in the financial sector. There were suggestions given on how a system that ensures customer profiling (understanding her needs/goals, risk appetite, age, dependants), and product sales based on such profiling, can be implemented.

4.26 A financial planning firm suggested a four-step process that every advisor and seller must follow for a client. One, assessment of the client's needs. Two, mapping of products to the client's needs. Three, presenting different choices of manufacturers, along with pros and cons of each product, and disclosure of fees. Four, an after-sales compliance check to

ensure the sale was carried out in a correct manner.

4.27 A fund house felt that regulations should define and make customer-profiling mandatory before providing financial advice or options to the client. Another fund house had a similar suggestion: it wanted a regulatory requirement for advisors to know their customers, and understand their risk-profile and appetite. It should also be made mandatory for the advisor to make customers aware that their capital could be at risk.

4.28 Disclosures. Respondents were also in favour of disclosure of costs and risks. A financial services provider suggested that financial advisors must declare the financial advice they have provided at the sale of every financial product. The declaration should be countersigned by the customer, acknowledging the declaration made by the advisor.

4.29 A fund house suggested that disclosures need to be embedded in the sales and advice processes, and intermediaries must be required to follow a 'disclosure template'. That will ensure the disclosure is driving the process instead of being relegated to the status of administration at the end of the sales and advice process. Two life insurance companies were also in favour of proper disclosures in a standardised form.

4.30 Penalties. A fund house suggested a strict penalty clause for default and compulsory license renewal at fixed periodicity. A life insurer suggested that sellers and advisors should be made to renew their license periodically, and should run the risk of suspension or loss of license if consumer complaints are recorded against them.

4.31 SRO. A fund house suggested the setting up of a new self-regulatory organisation (SRO) called National Association of Financial Advisors (NAFA), under the regulatory umbrella of Sebi. All financial advisors should become a part of NAFA, including stockbrokers, sub-brokers, mutual fund agents, insurance agents, company FD sellers, commodity-market brokers, those selling international financial products to Indian investors, sellers of PMS products, sellers of venture capital funds, and so on.

4.32 Equalisation of commissions. A fund house believes there is scope for change in the insurance industry. It says that Sebi has brought in regulations that ban mutual funds from paying upfront commission to distributors. Although this will remove the bias that a distributor might have had for a fund house that paid higher commissions, unless similar regulations are introduced in insurance too, the inter-industry bias will remain for the distributor.

4.33 Ratings for advisors and sellers. A life insurance company suggested ratings and/or certifications (in addition to licensing) for advisors and sellers. Also, their track-record and complaints trail should be made publicly available to consumers.

4.34 Simpler products. A fund house suggested an open architecture for distribution, with the customer

being the focus. India needs simpler products, especially in insurance. Complicated products could be offered, but only to qualified investors and for larger amounts.

4.35 'Advisor', not 'agent'. A general insurance company suggested the nomenclature of 'agent' should be replaced by 'advisor'. The term agent generally tends to get obscured and misunderstood as commission agent.

4.36 No need for change. General insurance companies largely asked for less regulation rather than more. A transaction processing firm too felt that the current regulations of Amfi are enough, though they need to be implemented both in letter and in spirit.



5

The Global Experience In Intermediary Regulation

5.1 Regulators say investors don't complain in a rising market, but a market fall gets them protesting on several counts. **While regulators in mature markets ignore complaints that deal with market risk in equity-linked products, they take other kinds of complaints seriously. They see these complaints as entry points into market practices they were unaware of.** For instance, after the sub-prime crisis exposed cracks in their regulatory oversight, the UK and the US are taking specific steps to give their retail customers a better deal.

5.2 This report analyses the experience of 23 countries on various parameters, as documented by the Financial Planning Standards Board (FPSB), US, in a survey of its member-countries. The questions asked:

- How many financial regulators does the country have?
- Does it have uniform regulations for different financial intermediaries?
- Are payments of commissions to financial advisors banned?

- Is the market predominantly fee-based or commission-based?
- Are regulatory disclosures mandatory for advisors?

Single Or Multiple Regulators?

5.3 One of the debates, across the world, is on the efficacy of single or multiple regulators. There are merits and demerits in both models. While the world is neater with a single regulator, a regulatory oversight in this model can be more damaging than a situation where multiple regulators are watching over different parts of the market. At the same time, regulatory overlap or blind spots in regimes of multiple regulators lead to growing malpractice, which can degenerate into 'scams'.

5.4 In the 23 countries it polled, the FPSB survey found no clear case for one model over the other. Ten of the 23 countries had a single regulator, prominent among them being France, Singapore, South Africa and the UK. Four countries had either two

or three regulators. Seven countries had four or more regulators. Two, Germany and South Korea, had none.

How many regulators oversee financial services?

Multiple regulators are the norm.



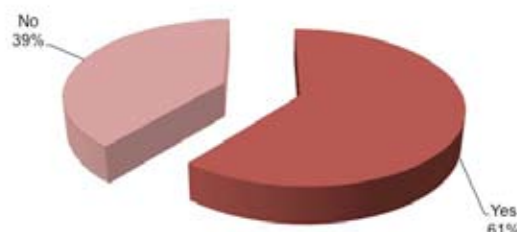
5.5 In markets with multiple regulators, the key separation is between the securities market and the banking sector. Australia and Indonesia, for instance, have one regulator for the securities market, and another one for banking, insurance and pensions. Countries with four or more regulators, like Brazil, China, India, Thailand and the US, divide the market according to segments of the financial sector—banking, securities, insurance and pensions. The US, notably, has an unwieldy structure, with 50 state-level securities and insurance regulators. The US is tightening these rules after it found that insurance multinational AIG was running a global business operation, but was answering to a state regulator in Idaho.

Uniform Regulation For Financial Intermediaries?

5.6 The regulation of financial intermediaries is a key transformational event for the large-scale participation of household monies in insurance, credit and securities-linked investment products. Intermediary regulation transforms a trade into a profession, giving a better deal not just to consumers, but also to intermediaries. The survey showed that all 23 countries have some form of regulation aimed at financial intermediaries. However, regulations in some countries, notably India, may not clear the IOSCO definition of a 'regulated' entity.

Are there uniform regulations covering financial services?

Three out of five countries have uniform regulations across financial services.



5.7 Of the 23 countries, 15 had uniform regulations for intermediaries across products and services in the financial sector. Australia has recently moved to the one intermediary regulator model. Further, credit is currently being included in federal regulation. After this, only property and real estate will be state regulated in Australia, the rest will all be federal. Brazil, France, Ireland, Japan, Malaysia, Singapore, South Africa and the UK have uniform intermediary regulation. Canada, China, India, Indonesia, Thailand and the US do not have uniform regulations. The US is setting up a federal agency to regulate the sale of financial products across banking, credit, insurance and investment products.

Are Commissions Banned?

5.8 The key question facing regulators of the banking and financial sector is: do commission-earning agents or broker-dealers look after their own interests or that of their clients? Although no country completely bans commissions on all financial products, there are stirrings of regulatory change.

Are commissions for advice banned?

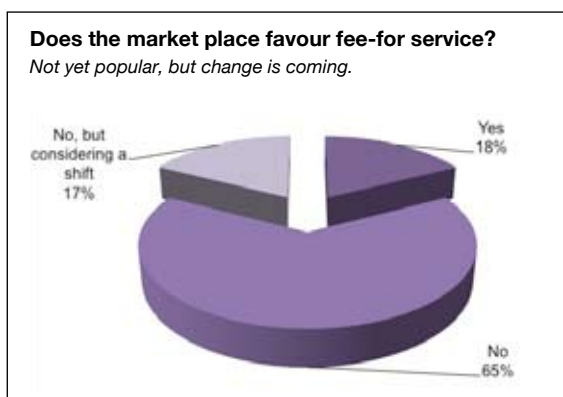
It's commission-driven, but there are rumblings of change.



5.9 In Australia, the Financial Planning Association has recommended to its members to move away from a commission-based model. The UK has initiated a process to phase out product commissions by 2012. India is the only country to have two pieces of the market already no-load. The New Pension System, launched in 2009, does not charge any entry or exit loads. And Sebi, the capital market regulator, has made mutual funds a zero-commission product with effect from August 1, 2009. For these two parts of the market, agents and broker-dealers will now become service providers to customers, rather than to producers.

Fee-For Or Commission-Based?

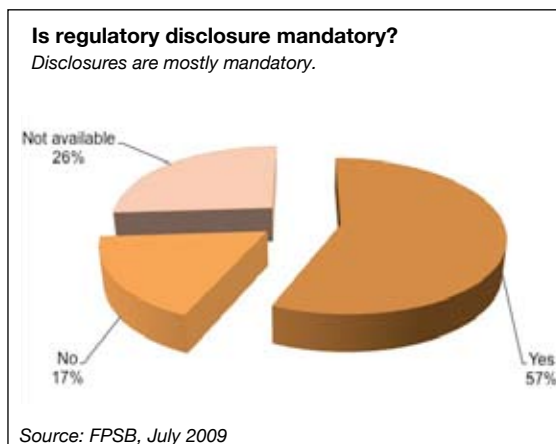
5.10 A fee-for model is possibly fairer to consumers as they can directly evaluate the service an intermediary gives them and compensate them accordingly. However, the global market is skewed towards a commission-based sales structure. Just four countries favour a fee-for model as opposed to a commission-based model, namely Australia, Japan, Netherlands and Singapore. South Africa, Switzerland and the UK are rethinking regulation to facilitate a market move to a fee-for model.



Are Disclosures Mandatory?

5.11 In the absence of the ability of consumers to ‘kick the wheels’ of a financial product to evaluate it, disclosures by advisors and sellers become a key determinant to a fair sale. In 13 of the 23 countries, notably Australia, China, New Zealand and the UK,

a regulatory disclosure is mandatory for advisors of financial products. In Austria, Germany, Singapore and South Africa, the disclosure is documented in writing. Some of the countries that don’t mandate a written disclosure are Canada, India, Malaysia and the US.



5.12 The survey shows a world in transition—from a regulatory structure that aimed to stop market failure by keeping firms from going under to one whose focus is the financial well-being of retail customers. The thought that the retail consumer is as much to be protected is a new one for some regulators. But the thought has taken root and the world should expect regulatory changes in the next decade that will democratise the financial sector.

5.13 The report next examines the changes in the UK and the US to understand the form of their existing financial intermediary regulation and the direction of the changes they are proposing in the wake of the 2008 financial crisis.

The UK Experience

Existing Regulations

5.14 The sales side is divided into pure product vendors (sellers) and advisors. The latter influence product choices as they have a view on the products a customer should buy, based on a process to establish the need and fit of that product for the customer. Clear guidelines separate the two.

5.15 The Financial Services Authority (FSA) is the

Box 2: An Outcome-Based Approach

The FSA is using the Treating Consumers Fairly (TCF) approach to move to an outcome-oriented regulatory system for the retail customer. Apart from 'good' and 'bad' management practices described, the TCF defines six consumer outcomes that it aims to achieve:

Outcome 1: Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture.

Outcome 2: Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.

Outcome 3: Consumers are provided clear information

and are kept appropriately informed before, during and after the point of sale.

Outcome 4: Where consumers receive advice, the advice is suitable and takes into account their circumstances.

Outcome 5: Consumers are provided with products that perform as firms have led them to expect, and the associated service is of an acceptable standard and as they have been led to expect.

Outcome 6: Consumers do not face unreasonable post-sale barriers imposed by firms to change a product, switch providers, submit a claim or make a complaint.

sole financial markets regulator in the UK. The FSA currently uses principle-based regulation and is now sharpening its focus even more towards good outcomes. Hector Sants, Chief Executive Officer, FSA, wrote in its 2008 annual report: "I believe it is more instructive to focus on the need to judge individuals on the consequences of their actions. This has led us to revise the description of our philosophy to 'outcomes-focused regulation'¹."

5.16 Towards this end, the Treating Customers Fairly² (TCF) initiative aims at placing the responsibility of a good consumer outcome on product manufacturers and advisors. Along with transferring responsibility to the manufacturing, advisory and sales side, the FSA has shown increasing aggression in using its punitive powers over the last one year.

5.17 It imposed financial penalties of £27.3 million in 2008-09, compared to £4.4 million in 2007-08. It banned 58 individuals (a record for the UK) from the industry on charges of unacceptable conduct like market abuse, mortgage fraud and failure to adhere to TCF guidelines. It secured

two convictions and a custodial sentence in its first criminal prosecution for insider trading³.

Proposed Changes

5.18 Initiated in 2006, the Retail Distribution Review (RDR)⁴ conducted by the FSA was focused on positive consumer outcomes, building confidence and trust, and on the quality of advice consumers of financial products in the UK receive. The FSA, in a consultation paper titled 'Distribution of Retail Investments: Delivering the RDR'⁵, proposed:

- Improving the clarity with which firms describe their services to consumers. The change aims to enable consumers to differentiate between 'restricted' advice and 'independent' advice.
- Addressing the potential of advisor remuneration to distort consumer outcomes. The proposals bring to an end the current commission-based system of advisor remuneration. The FSA proposes to ban product providers from offering commissions to secure sales from advisor firms and, in turn, to ban advisor firms from recommending products that automatically pay commission.

¹ FSA Annual Report, 2008-09, page 10

² <http://www.fsa.gov.uk/pages/Doing/Regulated/tcf/index.shtml>

³ FSA Annual Report, 2008-09

⁴ <http://www.fsa.gov.uk/Pages/About/What/rdr/index.shtml>

⁵ http://www.fsa.gov.uk/pubs/cp/cp09_18.pdf

Box 3: The Good And The Bad in Treating Customers Fairly

The FSA indicates what is 'good' and what is 'bad' practice to help smaller advisory firms comply better with the TCF initiative⁶.

Good Practice

1. Comprehensive fact finds enabled the advisor to identify:

- Areas of need/priority
- The customer's financial priorities
- The customer's objectives and their expectation from their product/investment portfolio
- Existing provision for premature death, disability, income in retirement

2. Advisors took customers through disclosure documents, rather than leave it to them to read and digest it on their own.

3. Advice on high-risk products restricted to a small number of specialist advisors.

4. Risk-based approach taken to after-sales contact. Customers who were recommended more complex products are contacted more regularly.

5. Suitability letter included a short summary of existing investments to illustrate that the advice provided had taken these factors into account.

Poor Practice

1. Inaccurate information given to customers about the firm's remuneration.

2. Failing to bring to the customer's attention the importance of disclosure documents.

3. Inadequate and outdated know-your-customer (KYC) information for customers who have an ongoing relationship with the firm.

4. Attitude to risk not explored with customers and no record made of the decision reached.

This, in effect, means that financial products will go no-load from 2012 in the UK, with consumers paying transaction costs for non-advisory purchases, and deciding what they will pay for advice and service.

- Improving the professional standards of advisors. The FSA plans to raise the minimum level of qualification for investment advisors, and to institute an overarching Code of Ethics and enhanced standards for continuing professional development. There are proposals that deal with visible maintenance and enforcement of these standards through the establishment of a Professional Standards Board.

5.19 This consultation paper was open for comments till October 30, 2009. Clearly, the RDR

found that it was not enough to define 'advisor' and 'vendor' as two separate categories with varying levels of consumer care responsibilities. The presence of load products turns a pure seller into an advisor as well. Hence, the recommendation to remove all product loads beginning 2012.

The US Experience

Existing Regulations

5.20 The US financial services regulatory structure has been put together largely over the last 75 years. Much of this framework was put in place in a different time and in response to circumstances that may no longer exist, as products and markets have moved faster than regulation.

5.21 There are currently five federal depository

⁶ http://www.fsa.gov.uk/smallfirms/pdf/tcf_culture.pdf

institution regulators, one federal securities regulator, one federal futures regulator and a state-based insurance regulatory system. There is an additional state-based supervision of depositories and securities firms, as well as SROs with broad regulatory powers. This structure has evolved in order to meet the growing demands of the US financial services industry.

5.22 However, it has largely resulted in adding layers of regulation without an overall evaluation of the optimal way to regulate the financial services industry. The Securities and Exchange Commission (SEC) regulates broker-dealers (who sell securities) and investment advisors (who provide investment advice). The Financial Industry Regulatory Authority (Finra) too regulates broker-dealers selling securities. The state securities administrators (50 of them) also oversee broker-dealers and investment advisors. The state insurance administrators (50 of them) oversee insurance brokers.

5.23 The US market differentiates between a broker-dealer and a financial advisor, though regulators admit the line gets blurred when dealing with a load product. This distinction is based on an earlier understanding of the roles of the two, but in reality, broker-dealers do give advice and regulating them is a challenge⁷.

Proposed Changes

5.24 US President Barack Obama has led a series of changes in the way financial markets are regulated⁸. The aim is to protect consumers and investors from financial abuse and to rebuild trust in markets. The US is now talking about “strong and consistent regulation and supervision of consumer financial services and investment markets”⁹.

5.25 The new regulations will be based on how people make financial decisions, with the clear aim of promoting transparency, simplicity, fairness, accountability and access. “Consumer protection is a critical foundation of our financial system. It gives the public confidence that financial markets are fair,

and enables policymakers and regulators to maintain stability in regulation. Stable regulation, in turn, promotes growth, efficiency and innovation over the long term,” says the Financial Regulatory Reform document. The specific proposals are:

- A new Consumer Financial Protection Agency (CFPA) will be set up to protect consumers across the financial sector from unfair, deceptive and abusive practices.
- Stronger regulations to improve transparency, fairness, and appropriateness of consumer and investor products and services.
- A level-playing field and higher standards for providers of consumer financial products and services, whether they are part of a bank or not.

Consumer Financial Protection Agency (CFPA)

5.26 The single, primary, federal consumer protection supervisor will protect consumers of credit, savings, payment, and other consumer financial products and services. It will regulate providers of these products and services. It will be an independent authority with ‘stable and robust’ funding. It will have rule-making, supervisory, enforcement and jurisdiction authority over all products and services that come under its ambit. The CFPA will work towards four goals:

5.27 Transparency. With disclosure as its key tool, the CFPA will ensure that communication with consumers is reasonable, balanced in its presentation of benefits, and clear and conspicuous in its identification of costs, penalties and risks. It frowns upon 40-page disclosure documents that need a law degree to understand.

5.28 Simplicity. CFPA will design standards for ‘plain-vanilla’ products that are simpler and have straightforward pricing. All providers and intermediaries will have to mandatorily offer these products prominently, alongside whatever other lawful products they choose to offer.

⁷ Informal discussion with US regulators

⁸ Financial Regulatory Reform. A New Foundation: Rebuilding Financial Supervision and Regulation, US Treasury, 2009

⁹ Financial Regulatory Reform. A New Foundation: Rebuilding Financial Supervision and Regulation, US Treasury, 2009, page 3

5.29 Fairness. If the above two fail to prevent unfair treatment and abuse, and if the costs outweigh benefits, the CFPA will be authorised to place specific restrictions on product terms and provider practices. Duties of care will now be imposed on financial intermediaries.

5.30 Access. CFPA will ensure that underserved consumers of financial products have access to prudent financial services, lending and investment.

Box 4: Modernising The Swiss Retros

In Switzerland, clients entrust their money to an independent asset manager (IAM), who usually works for the bank where they deposit their money. The management fee is generally about 1 per cent of assets under management (AUM) per year. Besides the management fee, most IAMs receive 'retrocessions' (commissions) and other kickbacks on trading commissions, brokerage, custodian administration fees and structured product commissions. Moreover, the IAM often receives a finder's fee (of 0.2-1 per cent) from the bank for bringing in new money.

Prior to the landmark Swiss Supreme Court ruling in 2006, most IAMs did not disclose these payments to their clients in any way. IAMs often denied the very existence of retrocessions. IAMs are self-regulated in Switzerland and come under the purview of the Swiss Financial Markets Authority (FINMA). There are 11 recognised Self-Regulatory Organisations (SROs), and each IAM is required to join one.

In 2007, FINMA asked the 11 SROs and banks to develop a set of minimum standards for independent asset management. The SROs and banks were, however, unable to agree; they submitted a range of different and inconsistent standards, with the proposal that each SRO have its rules approved separately. FINMA finally gave up on the SROs, and in October 2008, it released a set of guidelines, Cornerstones of Asset Management.

This document contained the first concrete, recommended minimum standards for disclosures, transparency, reporting, fees, content of the asset management contract, and yes, detailed requirements for the treatment and disclosure of retrocessions. Unfortunately, the standards are only recommendations and are in no way enforceable. Thus, it's still business as usual.

The problem with retros is not that they exist; rather, the problem is that they are not disclosed and are not transparent. Improving disclosures and transparency will probably make retros go away of their own accord over time. FINMA's point of view also seems to be that with the full disclosure of retros, clients will eventually migrate to other providers or demand better deals. Indeed, some IAMs are switching over to 'retro-free' models, admittedly at a glacial pace.

Following the global trend, the Swiss market is slowly moving toward increased transparency. Over the long term, retros should vanish or be transformed into other forms of disclosed compensation, without the need for heavy-handed regulation, which often creates bizarre incentives, distorts market signals and leads to unexpected results.

An opportunity exists for some IAMs to distinguish themselves through better service, for which, clients are demonstrably willing to pay. FINMA appears to be taking the approach of requiring increased disclosure to enable both client and IAM to act in their self-interest. This approach will either consign retros to the dustbin of history or make them a legitimate, disclosed, service-linked component of compensation.

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PART B: Investor Awareness

6

Introduction

6.1 Financial literacy has assumed great importance in the last few years. The attention to it has gathered momentum in the aftermath of the sub-prime crisis, which exposed cracks, both in regulatory structures and in consumer understanding of financial products and their use. India has about 188 million consumers of financial products, with another 200 million ready to come into the market. This is the financially included part of the population. On the excluded side, about 70 million unbanked women have received credit through the micro-finance route.

6.2 There are concerns that the lack of financial knowledge among this group of people can be extremely harmful. Individual organisations are making efforts to bridge this gap in select areas. Apart from targeted programmes for the excluded, India has seen spontaneous work by regulators, financial sector firms and NGOs to fill the financial knowledge gaps of the general population.

6.3 Even as individual efforts are on, India does not yet have an integrated, coordinated, national-level approach to make the population financially

literate. The question this Committee asked was: should individual agencies continue to work in isolation and through their own initiative, or does India need a national-level effort that works on financial education in a systematic manner?

6.4 Interviews with key people in the financial sector, Indian and global regulators, NGO workers, micro-finance professionals and consumers showed a clear consensus for a national agency. The need for common definitions, benchmarks, a core content set, a repository of knowledge, clearing house of already created content and non-duplication of effort were reasons given for the need for such a national agency.

6.5 The need for a strategic and cohesive approach that uses innovative means to deal with one of the most difficult lessons to impart—how to manage money—was clearly articulated. The discussions also threw up plenty of red flags, like substituting financial literacy for effective intermediary and product regulation.

6.6 Given the need for a national-level initiative that makes the population more financially aware and the experience of other countries that have done work in this direction, **this report makes a case for a national-level financial education organisation that aims to make the average Indian more financially literate.**

6.7 Chapter Seven is a building block for the rest of the report. It deals with the question of why India needs financial education and a financially literate population. It defines, and highlights the differences between, financial education and financial literacy. The former is the road, the latter is the goal.

6.8 It documents the efforts of government departments, regulators, financial sector institutions, NGOs and others in increasing financial education in India. It also describes the financial literacy efforts in countries like the US, the UK, Australia, New Zealand, and draws on OECD reports that document the experience of about 20 countries in their quest for a more financially literate citizen. This chapter establishes the need for an Indian national-level nodal agency to promote financial literacy.

6.9 Chapter Eight examines the model and outcomes of two national-level agencies that are working on financial education and the emerging area of edutainment. The chapter critically examines the US and UK national programmes that aim to build

a more financially capable citizen. By looking at the path already travelled, India can take pointers on what not to do, and what can possibly provide a direction to the unique path that a country the size of India will need to take. The chapter also looks at the emerging field of edutainment to promote financial literacy. Poland, for example, has experimented boldly with the entertainment media, including TV serials, radio serials and national-level game shows, to push financial literacy. Other individual corporate efforts are also mentioned.

6.10 Chapter Nine will flag issues that are contentious and need close attention before India sets up a national-level agency. Apart from the fear of financial literacy becoming the reason for looser financial regulation at the product and intermediary levels, other concerns include measuring the efficacy of financial education, and the proposed agency becoming an allocator of resources rather than a nodal clearing-house and a repository of knowledge.

6.11 Part C contains the final recommendations relating to the structure of the national agency, its mandate and ideas for making a cogent plan of financial education operative in terms of content, reach and efficacy. The direction of content and the nature of the outreach channels is described. The report stops short of fleshing out these ideas as it is beyond its mandate.



7

Status Report

What Is Financial Literacy?

7.1 Before we can begin to examine the area that is interchangeably called financial literacy, financial competence, financial education and financial ability, we need to work with a tighter definition. There are different definitions at work in various parts of the world.

7.2 A report by the US-based Institute for Socio-Financial Studies defines it as follows: “A financially literate person understands her relationship with money (for example, the need for financial security, tolerance for risk) and can read about, discuss and communicate regarding personal finance issues. She has knowledge of banking and credit, practices money management, understands the need for protection against unforeseen emergencies, plans for major life events, and saves and invests for the future. A financially literate person is a lifelong learner who applies that learning to new financial situations. She knows how and where to find information to make effective personal financial choices. The distinguishing characteristic of such a person is self-

efficacy—the sense that ‘I can do this’ and that ‘I want to do this’—in pursuit of what she believes are attainable goals.

7.3 The UK apex regulator, the Financial Services Authority (FSA), defines financial capability as: “Being able to manage your money, keeping track of your finances, planning ahead, choosing financial products, and staying informed about financial matters.”

7.4 The Australian market regulator, Australian Securities & Investments Commission (ASIC), uses a definition that places emphasis on the skills and areas of knowledge that are likely to be necessary to make informed judgments: “Ability to make informed judgments and take effective decisions regarding the use and management of money.”

7.5 Another definition comes from Sewa Bank, which terms financial literacy as: “Spreading the knowledge of good money management practices. It encompasses all monetary transactions that a person enters into such as earning, spending, saving, borrowing and investing.”

7.6 The OECD uses the definition from its April 2007 report: **“The ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial well-being.”**

7.7 Given that markets, financial products, selling practices and the impact of money on livelihoods is largely similar across the world, the definition of financial literacy in India can draw on the work already done. We can use the OECD definition since it is the widely accepted industry standard. In short, we can say that a financially literate person is able to make informed choices about her money life.

The Road To Financial Literacy

7.8 If we see financial literacy as a goal that needs to be worked towards, we next look for ways to reach that destination, or the process that will make a person financially literate.

7.9 The National Strategy for Financial Literacy, enunciated by the OECD in 2007, uses the following definitions of ‘financial literacy’ and ‘financial education’. It succinctly makes the distinction between financial literacy as a personal attribute and financial education as a process that enables that attribute: “Financial literacy is the ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial well-being. Financial education is the process by which people improve their understanding of financial products, services and concepts, so that they are empowered to make informed choices, avoid pitfalls, know where to go for help, and take other actions to improve their present and long-term financial well-being.”

7.10 Once we recognise the difference, we can look for further exploration of the term financial education. The OECD believes that financial education goes beyond the provision of financial information and advice, which should be regulated, in particular for the protection of financial clients. It defines financial education as: “The process by which financial consumers/investors improve their understanding of financial products, concepts and risks and, through information, instruction and/or objective advice,

develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being.”

7.11 Closer home, the RBI has defined financial education as: “Financial education can broadly be defined as the capacity to have familiarity with and understanding of financial market products, especially rewards and risks, in order to make informed choices. Viewed from this standpoint, financial education primarily relates to personal financial education to enable individuals to take effective actions to improve their overall well-being and avoid distress in matters that are financial.”

7.12 Looking at the above definitions, it is clear that **if financial literacy is a goal, then financial education is the vehicle to reach that goal.** When defined in this manner, financial education will include all systematic efforts to build financial knowledge and decision-making skills in individuals. This would include printed material, education, workshops and awareness campaigns. And it would be done through the mass media, schools, communities, work places and at points of purchase of financial products, among other places. It must be remembered that promotion of financial education is not a substitute for financial regulation, which is essential to protect consumers (for instance, against fraud) and which financial education is expected to complement.

Why Is Financial Literacy Important?

7.13 But is financial literacy important at all, or is it something that only rich countries have the luxury to invest in? Does India, with its long list of projects that demand attention and funding, need to even look in this direction today? The question we want to answer is this: is financial education a necessity or a luxury for India?

7.14 To answer this question, we need to look at the current state of the consumer of Indian financial products, and at the rapid changes taking place in the Indian

society and economy. India has seen an accelerating rate of urbanisation. Riding pillion on this rural-urban transformation is the demise of the Indian community-living/joint-family system and the social cushion it provides. The growing nuclearisation of the family means that the extended family or the extended community no longer takes care of medical, other emergency and old-age financial needs of an individual.

7.15 Pre-1991, an economically active Indian relied mostly on public sector financial product and service providers like the State Bank of India (SBI), the Life Insurance Corporation (LIC) and the Unit Trust of India (UTI). The government/RBI mostly fixed interest rates, public issue prices and rates of return. Pensions, where available, were under a defined-benefit plan. This meant that **risk was something that the individual did not take, understand or even worry about. But as the financial sector began to open up after 1991, risk began to get transferred to the individual.**

7.16 This happened in two ways. One, multiple players in the market, other than the gilt-edged government agencies, meant that individuals had to choose the perceived higher risk that came with the private sector. Hitherto unasked questions on the solvency of large companies began to crop up in the minds of financial consumers. Two, as competition increased, the financial product and service basket began to expand, offering new concepts, products and options to the financial consumer.

7.17 Greater choice is good only if the consumer is equipped to evaluate the products on offer or if the sales process ensures a clear cost-benefit understanding of product choice. The gradual dismantling of the guaranteed-return regime and the arrival of market-linked products meant a transfer of risk to the individual, in return for a chance to earn a higher return. The zero-risk options of government small savings schemes and Public Provident Fund (PPF) still continue for the risk-averse individual, who prefers the certainty of return over taking on risk to attempt to get a higher return.

7.18 On the positive side, the transfer of risk has happened in a graded fashion in India. Almost two decades after the financial sector was opened up and at least a part of

the population was exposed to market risk and private players, an important step in the risk-transfer journey came in pensions. The central government and 23 state governments moved from a defined-benefit pension plan to a defined-contribution pension plan for employees who joined government service after January 1, 2004. These employees can now target a higher return by choosing an investing vehicle with an equity component, or prefer the safety of low-risk options that are also available. With the rollout of the New Pension System (NPS) for all citizens of India, retirement saving is now fully market-linked—risk bearing, higher return is a choice they can exercise.

7.19 Along with this freedom of choice has come a basket full of financial services providers, and products and services. **In May 2009, there were 590 mutual fund schemes from 37 fund houses. There were 21 life insurance and 21 general insurance companies, offering a range of covers. More than 170 banks and housing finance companies vie for the consumer's wallet and credit needs. There are about 50 million-plus credit cards in use, offering an easy way to spend tomorrow's income today.**

7.20 Given the systemic nature of the transfer of risk to the individual, and the number and complexity of financial products on offer, it becomes increasingly important that the individual is able to take the most efficient decision according to her personal financial and family situation. Since a financial product is invisible, unlike a consumer product that can be tried and experienced before purchase, the proof of the financial product will become obvious only at the end of the tenure of the product.

7.21 It is usually very costly to rectify sub-optimal choices. Whereas a faulty toaster can be repaired, a faulty financial product can destroy the economic well-being of a family. During the sub-prime crisis that affected the world, pension funds invested in alternative financial products whose outcomes were not clear. Which brings us to the geo-political changes in the world that make Mumbai and Manhattan, Bangalore and Boston, Hyderabad and The Hague all part of one global financial system. The Indian financial products consumer is no longer fully isolated from global events and risks.

7.22 If we have defined financial literacy as the ability of individuals to make informed choices about their money life, we need to ensure that financial education—the road to this goal of literacy—becomes a crucial element in navigating the post-1991 India. Research shows that without this ability, efficient choices will be difficult to make, causing the gains of a rising GDP to be frittered away, instead of building long-term wealth for the Indian household.

7.23 This makes financial literacy an important life-skill that will allow every Indian to stretch the efficiency of every rupee they earn, save and invest. When personal financial resources have competing uses—first, between current and future consumption; second, between asset classes; and finally, between products within an asset class—a base-level knowledge of financial concepts is essential to facilitate efficient choices. The absence of this skill has the potential to jeopardise the financial well-being of an individual and her family.

7.24 Developing countries like Indonesia have made financial literacy a key area of work. The Indonesian government declared 2008 as the year of financial education, with a clear goal to improve access to financial services by increasing financial literacy.

7.25 Financial development is seen as an important determinant to economic growth. And financial literacy has been well-documented as increasing financial development and individual wealth. More importantly, **increasing the level of individual literacy will not be a zero-sum game. Individuals gain through greater empowerment and wealth. Financial firms gain due to larger markets. The nation gains due to more savings, investments and growth.**

7.26 While there is an individual good in a more financially literate population, there is a greater good as well. According to OECD: “Financially educated consumers can also benefit the economy. By demanding products more responsive to their needs, they also encourage providers to develop new products and services, thus increasing competition in financial markets, innovation and improvement in quality.

7.27 Financially educated consumers are also more likely to save, and save more, than their less literate counterparts. The increase in savings associated with greater financial literacy should have a positive effect on both investment levels and economic growth. By providing information and training to consumers on the operation of markets and on the roles of market participants, emerging economies can make the most of their developing markets. In addition, financially educated consumers are in a better position to protect themselves on their own and to report possible misconduct by financial intermediaries to the authorities. Thus, they would facilitate supervisory activity and might in-principle allow for lower levels of regulatory intervention. As a result, there would be a reduced regulatory burden on firms.

Financial Education Initiatives In India

7.28 If we were to look down from the sky over India and just the financial education efforts were visible, most of the landscape would seem dark. There would, however, be tiny dots of light. Zooming in to these bright, buzzing spots, we see that the activity begins to split up according to the work and the organisation doing it. Even closer, we see the good intentions of a number of participants, all of whom recognise the role of financial education as a key element to India’s growth.

7.29 But the darkness is overwhelming. Even among the existing efforts, there are large gaps in coverage and content, even overlap of material and coverage. Content, the most important and expensive resource, is being duplicated in some instances. The finer points of content generation, application and delivery are dealt with later in the report.

7.30 The focus of this section is to give a status report on the financial education initiatives undertaken by existing participants, namely the government, regulators, stock exchanges, product manufacturers, educational and training institutes, NGOs and others.

7.31 Given the urgency of the Committee’s mandate, it did not commission a full national survey. Instead,

it used a three-pronged approach to map the significant participants in financial education aiming at increasing financial literacy in India:

- Interviews with key stakeholders in the financial sector, including regulators, NGOs, education and training companies, manufacturers of financial products, providers of financial services, and individuals.
- Shortlisting of financial education work according to origin.
- Collection of material from original sources, namely regulators, government reports, financial education material available, material sent by companies, information on websites and conference reports.

These, then, are the participants and the initiatives undertaken by them:

Government of India

7.32 Although there is no coordinated, focused effort on financial education operational on the ground that has been initiated by the government, there are traces of action by individual ministries or departments.

7.33 The Ministry of Corporate Affairs has established the Investor Education and Protection Fund (IEPF) under the provisions of Section 205C of the Companies Act, 1956, with the objectives of promoting investor awareness and protecting their interests. Under this initiative, the Ministry, while promoting the concept of prudent and informed investment decision-making, also provides services related to making available informational and educational content for investors, investor grievance redress and technical/financial assistance to organisations engaged in investor education activities. The activities undertaken through the aegis of IEPF include the following:

- Providing (simple, user-friendly) educational and awareness content to all investors through the website www.iepf.gov.in.
- Providing the registry of economic offenders through the website www.watchoutinvestors.com.

com, which covers all entities that have been found to be guilty under different economic laws of the country.

- Providing online investor grievance redressal through the website www.investorhelpline.in.
- Undertaking investor awareness programmes in partnership with Institute of Chartered Accountants of India, Institute of Company Secretaries of India, Institute of Cost and Works Accountants of India, specifically targeting investors in tier-II and tier-III cities.
- Providing technical/financial assistance to voluntary organisations for undertaking investor awareness related activities.
- Undertaking multi-lingual media campaigns to reach out to investors across the country.

National Bank for Agricultural and Rural Development (Nabard)

7.34 The financial inclusion department of Nabard has a funding role, rather than an execution role. It looks at financial inclusion and the use of technology in this area. Nabard works towards this goal through two funds: Financial Inclusion Fund (FIF) and Financial Inclusion Technology Fund (FITF). Each has a corpus of Rs 500 crore.

Regulators

7.35 Globally, regulators have been at the forefront of initiating, coordinating and implementing financial literacy programmes. The Indian case is no different. There is a broad understanding among regulators that financial education goes beyond the basic regulatory duties of policing and protection, and that financial education should not be substituted for financial regulation, but should be seen to complement it. We examine the financial education efforts of the four financial sector regulators in India.

Reserve Bank Of India (RBI)

7.36 The banking regulator has taken the lead in initiating financial education in India. It began a financial literacy drive in 2007. The aim of this drive is an empowered banking consumer, who is capable

of taking optimal financial decisions after a base level of education. The RBI's view is that while India is creating incomes for the individual, this individual may not have adequate financial knowledge to retain that income and convert it into wealth. Towards this end, the RBI is adopting a two-pronged approach:

- Basic level: empower the individual who is currently out of the banking system with basic banking concepts.
- Higher level: empower the individual who is a part of the banking system with material on the regulatory role of the RBI and its importance.

7.37 Since the issue is made complex by divisions based on income, social status, geography, language, community and gender, the RBI has decided to work, in the initial stage, with children and young adults. These are further divided into two age groups—8-12 years and 12-16 years. The RBI financial education initiatives, continuous and one-off, are:

- Website: it has put up a website for financial education to take its Project Financial Literacy forward.
- Films: it has developed films on the basics of money.
- Games: for example, puzzles that ask a child to reconstruct currency notes online.
- Comics: it is using comic books to demystify complex concepts and convey them in a non-threatening and boring manner. The Raju and Gopi Chacha characters address basic questions related to money and banking. Money Kumar and Old Man Monetary are characters that talk about regulations, monetary policy and the journey of a child through the monetary system. So far, six comic books have been printed.
- Stalls at state-level exhibitions: the RBI's 26 centres are encouraged to participate in state-level exhibitions. The RBI stall has posters, banners, pamphlets and comic books to spread the financial literacy message. A coin vending-machine is a big crowd puller, as is

the live demonstration by an RBI employee on the safety features of currency notes.

- The regulator had sponsored a corner on the Azad Express (a special exhibition train that commemorated 150 years of the first war of Indian independence) with the financial literacy message.
- It has begun a summer training programme for students. As part of this, 50 students make two visits to the RBI to see its operations, including a visit to the clearing-house.
- Its Young Scholars Award is in its second batch in 2009. About 150 students are chosen after a written exam to work in the RBI and become its ambassadors after that. Most scholars are given financial education project work during their stint with the regulator.
- Essay competition for school children on the theme of financial education.
- It has tied up with the Ministry of Consumer Affairs to release print advertisements on financial education to empower bank customers.
- It is encouraging banks and the Indian Banks' Association to undertake financial education initiatives.
- It is working with NGOs and self-help groups (SHGs) to disseminate financial education modules across the country.
- RBI's book on money management for first-time employees was released in July 2009.
- As part of its 75th year celebrations, earlier this year, the RBI tied up with the state of Karnataka to make financial education a part of school curriculum.
- As part of the Platinum Jubilee celebrations, regional offices are conducting outreach programmes at schools, villages and other places to reach the common man. This includes familiarising participants about the role and importance of the RBI, facilities under various government schemes like Kisan Credit Card and Artisan Credit Card, and dissemination

of the message of financial inclusion through distribution of pamphlets on various aspects of banking and currency.

Securities and Exchange Board Of India (Sebi)

7.38 The main thrust of the capital market regulator has been to activate ground-level organisations into taking the lead in financial education efforts. Investors' associations, non-government and non-profit organisations active in the area of investor welfare have been chosen by Sebi to be its conduit to facilitate grievance redress and to disseminate financial education.

7.39 Working through 25 registered investor associations, Sebi wants to decentralise financial education activities. It has been active in conducting an investor education campaign, setting up a website and creating financial education curriculum.

7.40 The regulator initiated an investor education campaign in 2003. More than 3,000 investor education workshops, some in local languages, were conducted on a pro bono basis. Women investors, defence personnel and other special needs groups also found space in these workshops. In order to conduct these workshops, Sebi partnered with stock exchanges, intermediaries, investors' associations, industry associations like Amfi, and undergraduate and management colleges. It made use of the mass media like television, radio and newspapers. The educational material developed for this campaign can be distributed at any investor workshop or meet.

7.41 It has designed a dedicated investor website, for its Securities Market Awareness Campaign. Sebi has also been instrumental in setting up the National Institute of Securities Markets (NISM). NISM's School for Investor Education and Financial Literacy aims at achieving both financial literacy and education of investors in the securities markets. Through the NISM, Sebi is now targeting 200 public schools to impart financial education in their SUPW slots. NISM is planning to introduce a dedicated website for investor education, from November 2009.

The Insurance Regulatory and Development Authority (Irda)

7.42 As a relatively younger regulator compared to the RBI and Sebi, Irda has been busy with setting the stage for opening up of the insurance market in a gradual manner. Its efforts in financial literacy are:

- To develop the insurance market, Irda launched an insurance awareness programme in 11 regional languages, on television and radio, in the form of advertisements (jingles) and monthly phone-in programmes of 30 minutes duration on selective topics. Officials of Irda and industry representatives answer queries of the public in these programmes.
- Irda, in association with the Andhra Pradesh government, has constituted a standalone academic institution of international standards. The institution offers PG diplomas in insurance and risk management.
- Irda conducts workshops on grievance redress, with participation from industry representatives and consumer activists.
- It has posted frequently asked questions (FAQs) on unit-linked insurance plans on its website.

The Pension Fund Regulatory and Development Authority (PFRDA)

7.43 India's youngest regulator has been the window to the world in the space of financial literacy and education. PFRDA hosted the PFRDA-OECD conference on Financial Education in Delhi on September 21, 2006. The regulator has been the Indian voice in the OECD financial literacy movement till now and is the vice-chair of the International Network of Financial Education.

Stock Exchanges

7.44 The market place is the first interface of the individual with financial products. This makes stock exchanges key players in any effort that has the retail investor as its target. In the two main stock exchanges of India—National Stock Exchange (NSE) and Bombay Stock Exchange (BSE)—we see capital market-focused activity in the form of workshops,

and education-linked initiatives to develop the skill set of the financial sector and the consumer.

National Stock Exchange (NSE)

7.45 NSE has been carrying out investor awareness and education seminars on a regular basis across the country. At these seminars, information brochures and booklets are distributed free of cost, and speakers from NSE make presentations.

7.46 NSE launched a financial literacy campaign for students of higher secondary schools and colleges in Kerala in October 2006. A one-and-a-half hour presentation is followed by a question and answer session. This is now also operational in Tamil Nadu, Andhra Pradesh, Gujarat and Karnataka.

7.47 In partnership with CNBC Awaaz and National Securities Depository Limited (NSDL), it launched a television programme called 'Pehla Kadam'. Broadcast on CNBC, the programme answers market-related questions of first-time investors in the stock market.

7.48 NSE has also launched an initiative called Money Yatra, in partnership with CNBC Awaaz, India Post and NSDL. These are investor education seminars, where leading financial experts teach investors the importance of saving and investing, and guide them to take well-informed investment decisions. A number of such seminars have been held, mainly in non-metro cities.

7.49 NSE, along with the Central Board of Secondary Education (CBSE), has introduced a joint certification in financial markets for students of class XI and XII. CBSE introduced a vocational course titled 'Financial Markets Management' from the academic year 2007-08. A two-year course, it comprises subjects such as English language, Economics, Business Studies and Accounting for Business.

7.50 Two financial market-related subjects—Introduction to Financial Markets-I and Introduction to Financial Markets-II—are taught in class XI and XII, respectively. Students are required to take NSE's online certification exams in Financial Markets: A Beginners Module in class XI, and both Capital Markets (Dealers) Module and Derivatives Markets (Dealers) Module in

class XII. Training programmes have been conducted by NSE to upgrade the skills of teachers who would be teaching these subjects to students. Around 2,000 students are currently participating in this course in various schools across India.

7.51 NSE has also developed a comic to aid understanding of the stock market. Titled 'Understanding the Stock Market Index', this comic is authored by Quantum Information Services, which owns www.equitymaster.com and www.personalfn.com.

Bombay Stock Exchange (BSE)

7.52 BSE has focused on the intermediary rather than the retail customer. Its website (www.bseindia.com) has study material for various modules for BSE's Certification in Financial Markets (BCFM):

- Derivatives Exchange (English & Gujarati): This module equips candidates with knowledge and skills required for dealers in derivative market operations.
- Stock Markets: This module has been prepared for those who are keen to acquire some basic knowledge on the stock market and its operations.
- Central Depository: This module equips candidates with the working of depository participants.
- Securities Market module (Gujarati).

Product Manufacturers

7.53 This category includes banks, mutual funds, insurance companies, home loan and credit card companies. **Their financial education programmes mostly revolve around the products offered by the company.** Further, their initiatives largely take the shape of sponsoring financial education-linked content in the mass media or developing an advertisement with an educational message. The following is a list of activities by individual companies. It is not exhaustive, but it does cover the large initiatives, some of which have gone beyond the usual product-push advertising.

Citibank

7.54 The bank, working through its Citi Foundation, has funded initiatives with the NGO sector. A US\$3.5 million grant from the Citi Foundation helped set up the Indian School of Microfinance for Women (ISMW) in 2004, in partnership with Sewa Bank, Friends of Women's World Banking and Coady International Canada.

7.55 The bank has been instrumental in setting up the Citi Center for Financial Literacy in 2005, which is a unit of ISMW. It aims to spread and manage financial literacy-linked activities in the micro-finance sector. The missing link for those newly introduced to capital through micro-finance is the ability to make informed decisions. The aim of the programme is to instil a base level of financial literacy, which will enable women to carry out basic finance-linked tasks like setting financial goals, constructing a financial plan, managing cash flows, minimising debt and planning for the future.

ICICI Bank

7.56 ICICI Bank, through its ICICI Foundation, has committed about 1 per cent of its annual profits towards the ICICI Foundation for Inclusive Growth, an institution that aims to increase incomes of low-income households in a sustainable manner. One part of the work relates to facilitating universal access to finance by making markets more responsive to the needs of the poor and to link with low-income households, both as producers and consumers. This is done by developing appropriate channels, business models and back-ends for financial services access. It also supports research and model building for expanding financial services access.

7.57 Disha Financial Counselling, set up by ICICI Bank, provides counselling on debt management and financial problems. It works in the area of spreading education on budgeting and saving, credit and debit card use, secure online shopping and protecting consumer identity.

Mutual Funds

7.58 Most asset management companies (AMCs) work on financial literacy through product training for their sales force and by giving advertising support to financial education-led content in the mass media. A few fund houses have put out some more material for the retail investor:

- Fidelity AMC has guides on a number of subjects related to the mutual fund industry and its own products. It has also published a booklet called 'Top Ten Tips for Successful Investing' and specific product guides. In 2008, to reassure investors, Fidelity launched a tool that provides a longer-term perspective to market movement.
- UTI Mutual Fund is advertising financial literacy content in the mass media.
- JP Morgan AMC has a six-module CD set that introduces customers to basic financial concepts, makes them play a game and understand the relevance of equity as a long-term wealth creation avenue, before making a sales pitch.
- Most AMCs, including SBI, ICICI Prudential and Birla Sun life, regularly sponsor financial education content in the mass media.

Insurance Companies

7.59 The scope of work of most insurers covers sponsoring financial education content in the mass media and product-based training of the sales force. HDFC Standard Life, for instance, sponsors booklets in magazines that explain the basics of life insurance and specific product categories to readers. Its knowledge centre aims to explain various concepts to retail customers.

NGOs

7.60 The not-for-profit sector has been the most active in last-mile financial education work. This is partly by default, riding on the micro-finance initiative that the NGO sector has taken up like a mission. About 88 million Indians have been touched

by micro-finance. At least a fraction of this population has had at least one face-to-face session to discuss basics relating to money and its management.

7.61 Having said that, one interaction is not enough to help borrowers understand how to use their money most effectively. Financial education and literacy is an ongoing process. A sustained financial education programme is needed to teach the basics of cash management, household budgeting, and the nature of financial products like insurance.

7.62 Given the fact that micro-finance channels have existing links, this system emerges as the most powerful way to reach out to the poor. The entity that delivers micro-finance must counsel borrowers before handing them money. For example, in an SHG, at the time of group formation, one of the key areas of delivery needs to be financial literacy. As the group matures, it gets used to the idea of financial products. By the time an SHG member gets her loan, she is more financially literate and equipped to use the loan.

7.63 Excellent work has been initiated by several NGOs. Here, we review some of the big projects that work largely with the rural poor. The selective nature of this list is not intended to reduce the importance of the work being done in hundreds of locations, in multiple languages, to educate the poor on the basics of money and its management.

National Alliance for Financial Literacy (NAFiL)

7.64 The Indian School of Microfinance for Women (ISMW), through the Citi Center for Financial Literacy (CCFL), launched the National Financial Literacy Drive (NFLD) on October 14, 2008, in Mumbai. Its objective: to provide basic financial literacy to one million poor women across India in 2009, through different micro-finance organisations in different states.

7.65 Ten micro-finance organisations, with a cross-country presence, have partnered with NAFiL. These are Sewa Bank, Ahmedabad; Friends of Women's World Banking, (India), Ahmedabad; Centre for Youth and Social Development (CYSD), Orissa; Village Welfare Society (VWS), Kolkata;

Self-Help Promotion For Health and Rural Development (SHEPHERD), Tamil Nadu; Mahila Shram Sewa Nyas (MSSN), Indore; Bullock Cart Workers Development Association (BWDA), Tamil Nadu; Chaitanya, Rajgurunagar, Maharashtra; Sarba Shanti Ayog SSA/Sasha, Kolkata, West Bengal; and Rural Development Organisation (RDO), Lamsang Bazar, Manipur.

Institute for Financial Management and Research (IFMR) Trust

7.66 The IFMR Trust, being mentored by ICICI Foundation, has a mandate to improve access to financial services. The Trust also supports research and development work on demand- and supply-side factors such as:

- Product design and delivery channels
- Reduction in transaction cost of financial services through operational innovations, including technology applications
- Improving institutional ability to respond to financial needs of low-income households
- Generating sustainable demand for useful financial services
- Improving competition and responsible practices among financial service providers

7.67 The IFMR Trust is working at the village level to flip the literacy debate on its head. It believes that financial education of the customer is important, but more important is the education of the banker or the product manufacturer and distributor. The Trust has currently rolled out a ground-up project that is working on the following model:

- Developing products that solve specific local lifecycle problems related to money.
- Pitching the product so designed to bids by product manufacturers like banks, mutual funds and insurance companies.
- Using their network of salaried employees (no commissions or fees), who are wealth managers from the local rural community, to sell products.

7.68 In order to ensure that the wealth manager spends time in ‘educating’ customers about the product and how it solves their problems, there is an ex-post check, with a paper-trail system in place.

7.69 The following example was narrated by Bindu Ananth, President of IFMR Trust, to this Committee as an example of building in checks after the sale of a product: “A woman client, with five dependant family members, was a customer of the rural wealth manager of a village in Tamil Nadu. She had kept her jewellery as collateral and taken a loan through this wealth manager. She died and it was discovered that she had no life cover. The ex-post enquiry showed that the wealth manager had not specifically offered a life cover to her. The institution did a review and saw this as an error by the wealth manager. The loan was waived, not as an instance of pity, but as an acknowledgment of an error while dealing with the client.”

7.70 Nachiket Mor, Chairman of the IFMR Trust, says: “If the net outcome of a transaction is bad, the presumption is that of guilt.” The Trust is working to develop a financial distribution model that offers products that suit the consumer, and then takes an ex-post responsibility route to build in responsible sales practices. This, the Trust believes, will place the onus on product manufacturers to first educate the distributor, who will then spend time and effort to educate the customer.

MelJol

7.71 This child-centric NGO is the India partner of a global movement called Aflatoun, which provides children aged 6-14 years with social and financial education. Aflatoun says that it reaches over 540,000 children and helps over 200,000 children in 23 countries make savings. It also works to provide children with basic life skills, encouraging them to save their resources, and start social and financial micro-enterprises.

Access Development Service

7.72 This Delhi-based institution works in the area of micro-finance support. It currently works with 131 micro-finance institutions, which have a total of 4 million clients. Access’ CEO Vipin Sharma believes that unless financial education is embedded

as a strategy in micro-finance, it will be costly and impractical to implement. He believes that the education drive can ride the existing linkages and use them to push the literacy work out.

7.73 Access has been active in this field, and has chosen two partners in Madhya Pradesh (MP) and Orissa for its financial education effort. In MP, Access has covered 20,000 people, using workbooks that explain concepts like saving, investment, inflation, real rate of interest and cash flow management. The Orissa project is under implementation as of May 2009.

Plural

7.74 A relatively new micro-finance support NGO, its aim is to strengthen the financial literacy quotient of the micro-borrower. According to Plural, the main goal of their financial education programme is to adopt good money management practices associated with earning, spending, saving, borrowing and investing. Their training content is focused on:

- Financial literacy: numeracy and basic calculation
- Differentiation between household and business expenses
- How to ensure that livelihood brings a positive return
- Distinction between short-, medium- and long-term expenses
- Separation of necessary and discretionary expenses
- Information on banking services: savings, loans, insurance

Educational and Training Institutions

7.75 Financial education aimed at financial literacy is needed not just for retail customers, but also for manufacturers and sellers of financial products. A huge task lies ahead to properly educate the sales force that is more used to vending products rather than offering solutions to household financial

problems. These institutions don't strictly operate in last-mile financial education; rather, they build the skill sets of intermediaries, and other financial product and service producers and distributors.

College of Agricultural Banking (CAB)

7.76 Promoted by the RBI, CAB has a Financial Inclusion and Financial Literacy Cell. This cell provides a database of banks with special programmes on financial literacy. It also conducts workshops among its constituents to spread financial literacy. <http://www.cab.org.in/FILCPortal/default.aspx>.

IL&FS Education & Technology Services Limited (IETS)

7.77 This is the education, technology and training arm of Infrastructure Leasing & Financial Services (IL&FS), a company that undertakes development of physical and social infrastructure projects in PPP (public-private partnership) format. IETS focuses on building human capital of the country through targeted interventions in the areas of school education, teacher development, vocational education and soft-skills training.

7.78 Its activities include multimedia, print and web-based content, curriculum development, teacher training, publishing, education consulting, m-learning, education infrastructure, IT and e-learning applications. In the area of financial inclusion and literacy, IETS has:

- Worked with the government of Rajasthan to roll out the Bhamashah Financial Empowerment Scheme, which targets 4.5 million rural BPL families.
- Tied up with CNBC-TV18 to roll out a financial literacy programme for school children.
- Worked with several leading banks and insurance companies to train over 110,000 employees and agents in various technical and soft-skills programmes.
- Accredited by the Indian Institute of Banking and Finance to train debt recovery agents.

Invest India Economic Foundation (IIEF)

7.79 Since 1990, IIEF has built competencies in

promoting financial literacy among the public and in conducting related public education programmes. Past activities in these areas include a non-random financial literacy and investor behaviour study (with a sample of 2,300 financial customers, 2002).

7.80 IIEF has also written and published a financial literacy course for individual investors (titled 'ABC of Money'), and produced two handbooks (one on financial markets and concepts, and the other on mutual funds).

7.81 It has conducted 13 mass outreach campaigns across India to promote a better understanding of financial sector issues among individual investors. It has also held over 150 investor education seminars across the country, which were attended by over 100,000 individual investors.

7.82 Under its financial education practice, IIEF has also delivered over 350 financial certification courses to over 50,000 financial intermediaries and financial product distributors (bank employees and mutual fund/insurance agents) across 27 cities.

Centre for Investment Education and Learning (CIEL)

7.83 It provides education and learning in the investment space to managers, advisors and investors. It has prepared content for the customer education initiatives of ICICI Bank, Disha and ICICI Prudential AMC. It is also working with NISM for the courseware for mandatory certification of intermediaries.

Other Market Participants

7.84 India has the unique problem of having an over-served financial customer in the metros, but under-served in smaller cities, towns and villages. After the first rush of private sector offerings, the low-hanging fruit of the rich customers are over. To go one step below needs a great deal of market development. In the financial sector, market development takes the form of financial education. An array of players working in their own areas to disseminate financial education are discussed below:

Reliance Money

7.85 Reliance Money has rolled out a financial education project that aims to expand the market it operates in: make people aware of financial products and how to use them. The firm looks beyond the over-served metros, at 'B' and 'C' towns. It uses a combination of personal visits and the visual medium to get the multiplier effect.

7.86 Residents welfare associations, nurses in Wockhardt Hospital, defence personnel and campuses were some of the locations of these financial education camps. At each location, TV channels were used to get a multiplier effect of the seminar. Over the last two years, the firm says it has carried out over 250 ground-level meetings of an average of 300 people each. The TV multiplier, according to the company, is 50 times. This makes a coverage of about 3.5 million people, as claimed by the company. Reliance Money has come to the following conclusion after this experience:

- There is confusion about insurance products.
- The exact function of mutual funds is not known.
- People do not know the importance of financial planning.

7.87 Reliance Money is working with partners like UTVi, CNBC Awaaz, NSE and NSDL to sponsor financial education material. Two books sponsored are:

- 'Investor Guide on Financial Independence', with UTVi as partner.
- 'A Beginner's Guide to Investing', with CNBC Awaaz, NSE and NSDL as partners.

7.88 GE Money has set up a public service website called Saaf Saaf, an effort to make information about financial matters available to all easily via the Internet.

7.89 Association of Mutual Funds in India (Amfi) has published a handbook on understanding mutual funds called 'Making Mutual Funds Work for You'.

7.90 www.Money4you.in is a joint financial education initiative by the Indian Banks' Association, India Cards Council and MasterCard.

7.91 Some Websites

<http://www.myiris.com/>
<http://www.rupeetimes.com/>
<http://www.personalfinanceideas.com/>
<http://www.iloveindia.com/finance/index.html>
<http://www.apnapaisa.com/>
<http://www.cardbhai.com/>
<http://www.insurancemall.in/>
<http://www.getmeinsure.com/>
<http://www.insurancepandit.com/>
<http://www.policybazaar.com/>
<http://www.valueresearchonline.com/>
<http://www.mutualfundsindia.com/>
<http://www.creditcards-india.com/>
<http://www.comparecards.in/>
<http://www.ecompare.co.in/>
<http://www.deal4loans.com/>
<http://www.bankbazaar.com/>
<http://www.loanraja.com/>
<http://www.indianpropertyloans.com/>
<http://financialtraining.in/>

7.92 Blogs

<http://ideasmoney.blogspot.com/>
<http://desimoney.blogspot.com/>
<http://www.blog.personalfinance201.com/>

Global Financial Education Initiatives: The US Experience

7.93 The need for financial education, with the objective of making individuals financially literate, was recognised in the mid-1990s in the US. It was found that in spite of years of low inflation, steady economic growth and a rising stock market, the average American was under-prepared for retirement.

7.94 Experts could see the 'ticking demographic time bomb'. Pensions had moved from a system of defined benefits to one of defined contributions. There was also the impending threat from the demographic bulge of the boomers, 70 million of whom were to retire by 2010. The need for some base level of financial literacy of the average citizen was so palpable that spontaneous drives began to fill the financial literacy gap. By the year 2000, there were 90

programmes that were included in a financial literacy status report made by the Institute of Socio-Financial Studies. These included four US military programmes, seven community-college programmes, eight faith-based programmes, 18 workplace programmes, 24 co-operative extension service programmes, 29 community programmes and 150 Internet sites.

7.95 While the spontaneous individual organisation-led work in financial education has been consistent in the US since the early-1990s, the first formal collaborative effort began in 1995. Called the American Savings Education Council (ASEC), this was a coalition of private and public sector institutions that aimed to raise public awareness about the need for increased personal savings. It was a joint venture between the Department of Labor, the Treasury Department and 65 public and private organisations.

7.96 The year 1995 also saw the Jump\$tart Coalition for Personal Financial Literacy begin work to promote personal finance in schools, and improve the financial knowledge and abilities of children and young adults. A total of 90 partners worked together to teach financial literacy courseware to school children as part of this effort. In 1998, the Securities and Exchange Commission (SEC) launched the 'Get the Facts on Saving and Investing Campaign'. The campaign was organised by nearly 50 government agencies, financial industry associations and consumer organisations. In April 2000, the then Treasury Secretary Lawrence Summers formed the National Partners for Financial Empowerment (NPFE), which was a public-private partnership to promote the development of personal financial skills for all Americans.

Financial Literacy and Education Commission

7.97 A decade of efforts came together in 2003, when the Financial Literacy and Education Improvement Act, under Title V of the Fair and Accurate Credit Transactions (FACT) Act of 2003 (P.L. 108-159), came into being. Its specific objective was to establish a Financial Literacy and Education Commission (Flec), with a mandate to improve the financial literacy and education of people in the United States through a national strategy.

7.98 The Congress designated the Treasury Department's Office of Financial Education (OFE) to lend its expertise and provide primary support to the Commission, which is chaired by the Secretary of the Treasury. The Act requires the Commission to undertake certain activities. These include:

- Developing a national strategy to promote financial literacy and education for all Americans.
- Establishing a financial education website (www.mymoney.gov) to provide information about federal financial literacy education programmes and grants.
- Establishing a toll-free hotline, 1-888-MyMoney.
- Identifying areas of overlap and duplication among federal activities and coordinating federal efforts to implement the national strategy.
- Assessing the availability, utilisation and impact of federal financial literacy and education material.
- Promoting partnerships among federal, state and local governments, non-profit organisations, and private enterprises.

7.99 The Act requires that the national strategy be reviewed and modified at least once a year. It also requires the Secretary of the Treasury to develop, implement and pilot a national public service multimedia campaign to enhance the state of financial literacy and education in the US.

Organisational Structure of Flec

7.100 Flec is composed of the Secretary of the Treasury, and the heads of 19 other federal departments and agencies; further, it allows the President to appoint up to five additional members. Members of Flec include representatives from the Departments of Agriculture, Defense, Education, Health and Human Services, Housing and Urban Development, Labour, the Treasury, Veterans Affairs, the Commodity Futures Trading Commission, Federal Deposit Insurance Corporation, Federal Reserve Board, Federal Trade Commission, General Services

Administration, National Credit Union Administration, Office of the Comptroller of the Currency, Office of Personnel Management, Office of Thrift Supervision, Securities and Exchange Commission, Small Business Administration and Social Security Administration.

7.101 Flec has found that any effective national strategy must encompass four crucial areas. Future evaluations of the strategy will work on the progress made in these areas, which are:

- Building public awareness of available resources.
- Developing tailored, targeted materials and dissemination strategies.
- Tapping into public-private and private-private partnerships.
- Research and evaluation of financial education programmes.

President's Advisory Council on Financial Literacy

7.102 In order to demonstrate the seriousness of the government in dealing with issues of financial literacy, on January 22, 2008, the then US President George W Bush signed an Executive Order creating a President's Advisory Council on Financial Literacy. "It is the policy of the Federal government to encourage financial literacy among the American people," the order said.

7.103 The objective of the Council was clear: improve financial literacy among all Americans. The President and the Secretary of the Treasury told the Council to work with the public and the private sector to increase financial education efforts for the youth in schools and for adults at the workplace. Further, increase access to financial services, establish measures of national financial literacy, conduct research on financial knowledge, and help strengthen public and private sector financial education programmes.

7.104 President Bush wrote this as the mission statement of the Council: "We want people to own assets; we want people to be able to manage their assets. We want people to understand basic financial concepts, how credit cards work and how credit scores affect you, how you can benefit from a savings

account or a bank account. That's what we want. And this group of citizens has taken the lead, and I really thank them...When we look back at this council... people will say we're glad that the administration took the action it took because somebody's life is going to be better as a result of it."

7.105 Under the chairmanship of Charles R Schwab, Chairman and Founder, The Charles Schwab Corporation, the Council members represent a diversity of organisations, including private firms, listed firms, non-profits, faith-based groups, state government agencies, regulatory authorities and academic institutions. Some key accomplishments of the Council in 2008 are:

- It launched a National Financial Literacy Challenge, an exam on personal finance issues administered by the Treasury Department. This exam was taken by about 46,000 American high-school students in May 2008. A second exam was for the teachers in November 2008, and more than 75,000 individuals took this exam.
- It has endorsed 'Money Math: Lessons for Life', an easy-to-use, readily available financial literacy curriculum that integrates personal finance concepts into maths lessons for middle-school students. This has been downloaded more than 191,000 times from the Council's website.
- It has endorsed a 'Statement of Principles and Recommendations for the Future of Sub-prime Lending'. This included three foundational principles: financial literacy must be at the foundation of all sub-prime lending; a key goal of all sub-prime lending must be to move sub-prime borrowers to prime borrowers; and lending products should have straightforward disclosures and should be understandable to the consumer.
- The Council has approved a national survey of financial capability and literacy of adult consumers.
- It has participated in the first-ever White House Roundtable on Financial Literacy, which brought together nearly 150 government officials, policymakers, business leaders,

foundation representatives, philanthropists, and faith-based and community leaders in a discussion of the most effective means to improve financial literacy.

The UK Experience

7.106 Work in UK began in a focused manner, with the apex regulator—the Financial Services Authority (FSA)—being given the responsibility of “promoting public understanding of the financial system”. This was one of its four statutory objectives, as laid out in the Financial Services and Markets Act, 2000.

7.107 The FSA leads the National Strategy for Financial Capability, with the aim to help people across the UK become informed and confident with money matters. The belief is that better informed, more educated and confident citizens are able to take greater responsibility for their financial affairs and play a more active role in the market for financial services.

7.108 The FSA is the main statutory regulator for the UK financial services industry. Since it is established by Parliament, it has the scope of authority and is accountable to Treasury ministers, but is operationally independent of the government. It is fully funded by the industry it regulates and receives no funding from the taxpayer. The FSA levies a fee on all authorised firms that carry on the activities it regulates.

7.109 In 2003, the FSA brought together a partnership of key people and organisations in government, financial services industry, employers, trade unions, and the educational and voluntary sectors to establish a roadmap that would ensure better financial capability of the UK population.

7.110 As a first step to develop a coordinated approach, the FSA carried out a large survey, in association with the Personal Finance Research Centre at Bristol University. Called the Financial Capability Survey, this effort polled over 5,300 people to develop an understanding of how citizens make ends meet, keep track of their finances, plan ahead, choose financial products and stay informed about financial matters.

7.111 The survey results formed an important input for defining the priorities of the National Strategy for Financial Capability. The FSA intends to repeat the survey every four to five years to measure the impact over time of initiatives to improve financial capability. The survey brought into focus four challenges for the FSA:

- Unless action is taken, the UK population will store up problems for the future. The survey found that while most people do not make a provision for an unexpected drop in income or major expenses, such events are fairly common even in a favourable economic environment, and often push people into difficulties. Also, as the population moved from defined benefits to defined contribution, there is danger ahead.
- A small change in circumstances could tip many people into financial difficulty. Two million households are only just managing even when the times are good. Given the general tendency not to plan ahead adequately, many could be pushed into financial difficulty if interest rates or unemployment rates rise, or simply if their personal circumstances change.
- Many people are taking on inappropriate risks and not shopping around to get a good deal. Product knowledge remains sketchy and the ground work to get the best product is not done.
- The greatest demands are placed on those least equipped to deal with them. The under-40s face a considerably more demanding environment than their parents did, and consequently can ill-afford to make mistakes or ignore the need to take action. There is, therefore, a pressing need to equip them with greater financial capability.

7.112 The current strategy involves the FSA spending about £10 million a year across a seven-point plan. The aim is to reach 10 million people by 2010. FSA tracks its progress with this barometer displayed on its website: the priority is to get to the 10 million mark, with general mass media-driven solutions and through situational interventions as well. It targets:

7.112.1 New parents. The birth of a child in a household is a good time to push across a financial literacy message. Understanding this, the FSA has developed a 'Money Box', which will be given to new and prospective parents. It will serve as a single, comprehensive and accessible source telling them what they need to know on several subjects: employees' maternity and paternity rights, government communications on saving initiatives (such as child trust funds, tax credit entitlements and other forms of assistance like subsidised nursery places), and material for the child to reinforce the financial capability message at a young age (such as a chart to record pocket money or a simple story book about money). It will be complemented by web-based calculators to help budget for a baby and calculate the cost of returning to work, and will signpost to other useful sources of information. The Money Box will initially be distributed through the human resource departments of employers involved in the 'Make the Most of Your Money' initiative.

7.112.2 Schools. Globally, embedding financial education into the school curriculum is the first choice of financial literacy advocates. The UK is no different and 'Learning Money Matters' aims to target children in the classroom. The FSA recommends that the government include financial capability as part of the national curriculum to help students with money capability. A web-based guide can be seen at http://www.fsa.gov.uk/financial_capability/pdfs/money_for_life_guide.pdf.

7.112.3 Young adults. 'Helping Young Adults Make Sense of Money' enables organisations that work with young people to help them manage their money. The programme was launched in March 2006.

7.112.4 Workplace. The workplace as an entry point for financial literacy drives is also a popular way to reach out to a largely captive audience in the workplace. 'Make the Most of Your Money' is an initiative to do just that. It

provides employees with financial education in their place of work. It involves a trained presenter visiting a worksite, free of charge, to deliver seminars to employees. All employees at the worksite are invited to attend, and everyone receives a financial information pack covering the same ground as the seminars: budgeting, managing debt, and long-term planning for the future (including pensions). The budget for five years is over £10 million.

7.112.5 Consumer communications. The power of the Internet is being used across the world to push out the financial literacy message and to give ready-to-use tools to those interested. A consumer website, Money Made Clear, was launched in 2006. The government and the FSA have also launched a £12 million Money Guidance pathfinder programme, offering online help on money issues, over the phone and face-to-face across the North-West and North-East of England. The pathfinder builds on the FSA's Money Made Clear website and helpline, which people can access wherever they are in the UK.

7.112.6 Online tools. FSA has developed and launched two online tools to take the web initiative forward. The first is the Financial Health Check, which helps consumers understand their financial needs and take control of their finances. It helps people sort out their financial priorities and provides tips for a healthier financial lifestyle. Users don't need to dig out bank statements or old insurance policies—they just need to answer a few simple questions.

The second is the Debt Test. Launched in January 2006, it helps consumers assess how likely they are to become over-indebted within the next year or so. By asking simple questions, it helps people with credit agreements (loans, credit cards, mortgages and other debts) to consider whether they have, or are likely to have, problems with their borrowings. It provides tips on how to avoid debt problems, and helps people tackle problems if they have already arisen.

7.112.7 Money advice. This aims to get people to understand, in general terms, what financial issues they need to focus on, and what kind of financial products or services could help them do this. It differs from regulated advice, which has to be provided by authorised advisors and includes recommendations on specific products from specific providers.

The Australia Experience

7.113 The Australian government established a National Consumer and Financial Literacy Taskforce in 2004, which recommended the establishment of the Financial Literacy Foundation in 2005. The task force also recognised the need for a social marketing campaign. The aim of the Foundation was to give all Australians the opportunity to better manage their money, to raise awareness of financial literacy and its benefits, and create opportunities for Australians of all ages to learn more about money—at school, through vocational and higher education, in the workplace and in the community.

7.114 As part of its work, the Foundation commissioned a survey of 7,500 Australians, aged 12 to 75, aimed at building a better understanding of how they think about and manage their money. While the process of the survey was on, the Australian government created a website ‘Understanding Money’ in mid-2006, to help individuals deal with their money life and choices better.

7.115 The survey report, tabled in 2007, found that:

- The gap between self-assessed ability to deal with a particular issue and recognition of the importance of learning more gives a more nuanced insight into people’s ‘operational’ confidence in dealing with money issues. Not surprisingly, overall confidence levels, as measured on this basis, are higher for less complex or frequently encountered money management issues like budgeting, saving, dealing with credit cards and managing debt, and lower for more complex and less frequently encountered issues like investing,

understanding financial language and ensuring enough money for retirement.

- Although Australians are generally confident in their ability to manage money, some do not have good money management habits. This is particularly true in areas where they are less confident, such as investing, but also in areas where recognition of the importance of learning is relatively low. There are a variety of possible explanations for the tendency of money behaviour to be at odds with self-assessed ability. Just because, for example, a person may have the ability to prepare a budget or commit to a regular savings plan doesn’t necessarily mean that they will budget or save on a regular basis. Undoubtedly, procrastination will be a factor. As with most money issues, typically, there will be little or no adverse short-term consequences in someone recognising that they should, say, put a savings plan in place and having the capacity to do so, but putting it off until another day.
- More generally, the survey reveals a range of money attitudes and beliefs that are inimical to people investing the time and effort required in taking the steps to improve their money skills and behaviour. As the survey indicates, stress and discomfort, boredom and disinterest, and personal relevance and procrastination, are commonly held attitudes and beliefs when it comes to money.

7.116 The survey pointed to the way forward for the work of the Foundation by focusing on the main weaknesses. Based on the results of the survey, the Foundation works in the following areas:

7.116.1 Raising awareness. The Understanding Money media campaign ran between July and December 2006 to raise awareness about financial literacy and its benefits, and encourage people to find out more about how to make the most of their money.

7.116.2 Working with schools. The Foundation is working with all state and territory education authorities to get financial literacy included in the

curriculum for Years K-10. The education and training site of the Foundation provides access to quality education support material.

7.116.3 Understanding Money website.

This offers a wide range of financial literacy information for people who want to find out more about managing their money. It has tools such as budget planner and financial health check, as well as practical and simple-to-use calculators, information on money-related issues and links to other useful websites.

7.116.4 Education in workplaces. The Foundation worked with employers, and the vocational and technical education sector, to increase access to financial literacy education in workplaces. The Foundation has developed Financial Literacy Resources Australia, a web-based database of financial literacy programmes and resources.

7.116.5 Financial Literacy Resources. The database brings together a comprehensive listing of financial literacy programmes and resources. It is available to those who develop and deliver financial literacy programmes and resources, and those with an interest in advancing financial literacy.

7.117 On July 1, 2008, the functions of the Financial Literacy Foundation were transferred to the consumer protection regulator for financial services, the Australian Securities and Investments Commission (ASIC), including the Understanding Money website. In this role, the ASIC protects investors, retired people, depositors and insurance policy holders. One of the ways it reaches out to retail customers is through a website with a dingo mascot, Fido.

7.118 In November 2008, the ASIC began dissemination on Your Money Starter-Insurance and Super: a financial literacy resource for secondary schools, which includes interactive online games. This is currently being distributed to every secondary school in Australia. The kit includes a variety of innovative classroom material, activities

and multimedia elements designed to make learning about financial services relevant and attractive to teenagers. The material is available in hard copy and on CD-ROM and can be downloaded, free of charge, from ASIC's consumer website, FIDO, at www.fido.gov.au/yourmoneystarter.

The New Zealand Experience

7.119 The financial education efforts in New Zealand have concentrated on retirement planning and getting individuals to be better prepared for their non-earning years. One of the initial moves was in 1993, when the Todd Task Force was set up to look into the issue of whether the country needed a financial education effort. The task force recommended that a Retirement Commission be established.

7.120 The idea and effort evolved such that by 2001, the decision was made to move to an educational website called Sorted. In 2004, The Retirement Commission and ANZ launched New Zealand's second financial literacy survey. Kiwi Saver is a savings initiative to make citizens more aware of the need for retirement planning.

The Canada Experience

7.121 Canada takes the route of prudential regulation complemented by financial education. Wrote James Flaherty, Minister of Finance, in the 2008 OECD-US Treasury International Conference on Financial Education Report: "Just as our strong economic fundamentals, balanced budgets and tax relief have helped us deal with global challenges, so too have the traditional strengths of our financial system."

7.122 It is a system that conducts statutory five-year reviews of financial institution legislation. Canada is working on improving financial literacy of citizens by building on the Financial Consumer Agency of Canada, which was set up in 2001 to ensure that financial institutions adhere to consumer protection policies. The Agency develops educational material (available on its website) and conducts various activities to educate consumers.

The OECD Experience

7.123 The Organisation for Economic Co-operation and Development (OECD) has taken the lead in consolidating, organising and benchmarking a global financial education programme. The OECD's role is that of a facilitator, a depository of resources and education aids and experiences. It also helps governments respond to concerns of financial illiteracy.

7.124 Research conducted for the OECD's study on financial education indicates that the level of financial literacy is low in most countries, including in developed countries. Its scan of national financial literacy surveys throws some interesting facts on the global discussion table:

- In Japan, 71 per cent of adults surveyed knew nothing about investing in equities and bonds.
- Surveys in the US and Korea found that high-school students failed a test designed to measure students' ability to choose and manage a credit card or save for retirement.
- Consumers often overestimate how much they know. In an Australian survey, 67 per cent of those taking part claimed to understand the concept of compound interest, but only 28 per cent could find the correct answer to a problem using the concept.
- The level of financial literacy tends to vary according to education and income levels, but the evidence shows that well-educated consumers with high incomes can be just as ignorant about financial issues as less-educated, lower-income consumers. Countries are increasingly aware of the importance of financial education and are already providing a variety of financial education programmes, ranging from websites and pamphlets or brochures to training courses and media campaigns. They cover issues such as credit, insurance, investment and retirement saving.
- Getting consumers interested in financial education is no easy task. People taking part in

a survey in Canada said they thought choosing the right investment for a retirement savings plan was more stressful than a visit to the dentist.

7.125 The OECD concludes from its scan of country-specific surveys that before governments try to roll out a financial literacy plan, they will have to first persuade their citizens that financial education is needed.

7.126 After examining the financial literacy surveys of member countries, the OECD released the first major international study on financial education, titled 'Improving Financial Literacy: Analysis of Issues and Policies'.

7.127 It also released the world's first practical guidelines on good practices in financial education and awareness. These are addressed to all countries, developed and developing, that are interested in financial education. They are designed to help them structure and implement effective financial education programmes. These guidelines, in the form of a non-binding recommendation, are drawn from the experience of the OECD countries on best practices in this area.

7.128 They promote the role of all the main stakeholders in financial education: governments, financial institutions, employers, trade unions and consumer groups. They call for a number of actions to improve financial education, from basic savings and private debt management to assessing whether the pension savings are adequate. The recommendations also make a clear distinction between public information provided by government and regulatory authorities, and that provided by private sector investment advisors such as banks and brokers.

7.129 Specifically, the OECD's 'Recommendation on Principles and Good Practices for Financial Education and Awareness' includes the following advice to governments:

- Governments and all stakeholders concerned should promote unbiased, fair and coordinated financial education.

- Financial education should start at school so that people are educated as early as possible.
- Financial education should be part of the good governance of financial institutions, whose accountability and responsibility should be encouraged. Financial education should be clearly distinguished from commercial advice; codes of conduct for the staff of financial institutions should be developed.
- Financial institutions should be encouraged to check that clients read and understand information, especially when related to long-term commitments or financial services with potentially significant financial consequences. Small print and abstruse documentation should be discouraged.
- Financial education programmes should focus on important life-planning aspects such as basic savings, debt, insurance or pensions.
- Programmes should be oriented towards financial capacity building. Where appropriate, it should be targeted on specific groups and made as personalised as possible.
- Future retirees should be made aware of the need to assess the financial adequacy of their current public and private pension schemes.
- National campaigns, specific websites, free information services and warning systems on high-risk issues for financial consumers should be promoted.

7.130 As a validation of the OECD's work, the G8 Finance Ministers' meeting in St Petersburg in June 2006 recognised the importance of financial education. They welcomed "the ongoing work in the OECD on the Financial Education Project and call(ed) for further development of financial literacy guidelines based on best practices."

7.131 In March 2008, the OECD launched the International Gateway for Financial Education, which serves as a clearing-house for financial education programmes, information and research worldwide.

Analysis Of The Global Effort In Financial Literacy

7.132 There is an increasing understanding across the globe that unless the final financial product and service consumer is educated on product choices and their long-term direct and side impact, the price will be paid by all—governments, the financial sector and, of course, the large groups of the population that alternate between feeling left out and cheated.

7.133 The common steps countries have taken to deal with this issue are:

- The government as the aggregator and nodal agency to promote literacy.
- A system of nationwide surveys to articulate the problem and then monitor its progress.
- Use of multi-agency cooperation to maximise the financial literacy effort.
- Embedding the financial education material in the school curriculum.
- Intervening in individual lives at key transition points, as the UK has done.
- Using the workplace as an entry point into individual mindscape.
- Using the mass media as a partner in this effort.

Conclusion

7.134 We set out to take stock of financial education efforts in India that would lead to a more financially literate population. We first defined financial education and literacy, then looked at what countries with mature literacy programmes on the ground were doing, before turning to look inwards at the Indian situation.

7.135 Here, we see some action on the ground. In terms of absolute numbers, we may, as a very rough guide, get a one-time coverage of 3-5 million people, which is a tiny fraction of the number than needs this life skill. And, as John Tiner, Chief Executive,

Financial Services Authority, UK, said: “Building financial capability is about long-term change. There are no silver bullets...”

Analysis Of The Evidence From Abroad

7.136 An examination of the financial education efforts of the US, UK, Australia and the OECD experience shows some common features. The role of the government is key as the aggregator and nodal agency to promote financial literacy. A structured approach begins with a system of nationwide surveys to first articulate the problem and to then monitor progress. Every serious project uses multi-agency cooperation to maximise the financial literacy effort. Every project aims to embed financial education material in the school curriculum. Another route used is intervening in individual lives at key transition points. All programmes extensively use the mass media as a partner to get a multiplier audience in the financial education work. Some specific inferences:

- The US experience showed that individual agency work in financial education culminates in a government-led formal financial literacy mission, with multi-agency and department participation and cooperation.
- The UK used its apex market regulator, FSA, to utilise funds from the industry to put together a coordinated financial education programme.
- Australia has gone the same way. In 2008, the Financial Literacy Foundation was transferred to the apex regulator, ASIC.
- The OECD has taken a lead in consolidating, organising and benchmarking a global financial education programme. Its role is that of a facilitator, a depository of resources, education aids and experiences. It also helps governments respond to concerns of financial illiteracy.

Analysis Of The Indian Experience

7.137 There is buzzing activity in select pockets, with a lot of passion and goodwill. A desire to work on the ground and genuinely make a difference are the quick inferences. The surprising part is that this sense of mission is not restricted to the NGO sector, the usual repository of words like ‘mission’ and ‘purpose’, but extends to regulators, corporations, market institutions and individuals connected with financial consumer rights and retail investors. Some specific views:

- A coordinated approach to financial education is missing. Each agency is working largely in isolation, sometimes in the same space. Sharing of resources, content and expertise that would build capacity reciprocally is missing.
- Except for the micro-finance embedded education, most other efforts are building capacity in specific areas that are relevant to the educator.
- There is a need to educate product manufacturers and distributors along with, if not before, individuals.
- There are no national benchmarks on financial education. The goal of who is a financially literate person is undefined. Till a national definition is there, individual efforts will be at cross-purposes.
- Education by itself will not be enough. It needs to be complemented by regulatory action on sharp sales practices.
- Evidence from mature economies and the OECD experience points to a government-led national financial literacy mission that works with all stakeholders in the area, including government departments, regulators, market participants, financial sector companies, NGOs, education and training firms, media and individuals.



8

Global Review of Projects Operating

8.1 Chapter 7 documented the status of financial education efforts in India and did a survey of global projects to examine the experience of countries with on-ground and running national-level financial education projects. Before India establishes its national-level financial education effort, it would be instructive to examine closely the experience of two of the world's largest financial education projects.

8.2 This chapter looks at the organisational structures and impact of the national financial education agencies in the US and UK. The US may have pointers that deal with size-of-the market issues, which India will have. The UK has institutional structures that are closer to the ones India understands. This chapter will also look at an emerging branch of financial education called edutainment, where financial education is embedded in various means of entertainment like films, music, stage shows, serials, game shows and so on.

The US

8.3 Free markets are about unfettered choice. They are about informed economic agents, who make

optimal, rational choices in an environment of perfect disclosure of all material information. The consumer shows similar behaviour.

8.4 One part of this equation, however, needs work. The notion of the consumer being motivated enough to upgrade her literacy skills does not work in real life. Understanding that financial literacy was lacking in the average American and needed to be improved, the US saw a mushrooming of individual efforts in financial education around the mid-1990s.

8.5 To give financial education a structured national direction, the US government, through the Financial Literacy and Education Improvement Act, set up the Financial Literacy and Education Commission (Flec) in 2003. Comprising 20 federal agencies, with the Secretary of the Treasury as its head, the Flec was seen as the vehicle that would help Americans get fully equipped to take financial decisions. The Flec was supposed to:

- Develop a national strategy to promote financial literacy and education.

- Establish a financial education website to provide information about the federal financial literacy education programmes and grants.
- Establish a toll-free hotline.
- Identify areas of overlap and duplication among federal activities and coordinate federal efforts to implement the national strategy.
- Assess the availability, utilisation, and impact of federal financial literacy and education materials.
- Promote partnerships among federal, state and local governments, non-profit organisations, and private enterprises.

8.6 Noble objectives, but how did they pan out? The US Government Accountability Office (GAO), in April 2009, had this to say on the operations of Flec¹:

8.6.1 The National Strategy remains largely descriptive. GAO's 2006 report noted that the Commission's National Strategy for Financial Literacy was largely descriptive rather than strategic. Generally, it did not include a plan for implementation, and only partially addressed or defined elements such as performance measures, resource needs, and roles and responsibilities. Revisions to the strategy made since GAO's last report include new "calls to action", but do not represent a fundamental shift in approach that incorporates specific recommendations on roles, funding and activities. As a result, the document still does not serve as a true functional strategy.

8.6.2 Progress has been made in fostering partnerships. The creation of the National Financial Education Network, which focuses on the state and local level, and the President's Advisory Council on Financial Literacy, which focuses on the private and non-profit sectors, has been a positive step towards developing mutually beneficial partnerships that are sustainable over the long term.

8.6.3 Independent reviews have been partially

initiated. The US Treasury has enlisted a volunteer doctoral student to conduct independent reviews on overlap of federal activities and availability of financial literacy material, but the student will not assess the impact of the material, as called for in the Act. The Treasury staff told GAO that they used a volunteer because they lacked the funds to hire a paid professional.

8.6.4 The Commission has measured customer satisfaction through its website, but it has not yet tested usability. Responding to GAO's recommendation, the Commission conducted a survey of users of its website, www.mymoney.gov, though only 144 surveys. The Commission has not conducted usability testing, a recommended best practice for federal websites; it says it is looking to do so later this year.

8.7 One of the big hurdles before Flec has been the lack of funds, since it has no independent budget and the Congress has not provided funds since 2005. The GAO report also documents the challenges faced by the Flec, as it has to coordinate the activities of 20 federal agencies, each with its own set of interests, resources and constituencies. For a variety of reasons, it took Flec till 2007 to even define financial literacy and financial education, after the 2006 GOA audit recommended that it do so. The other recommendations of formulating clear and specific goals, performance measures and benchmarks, an action plan, and a documentation of the resources needed to do this remained unmet.

8.8 One accomplishment of Flec has been the launch of the My Money website (mymoney.gov). But even in this, GAO has issues with the way best practices are not being followed. Flec set up a consumer hotline (1-888-MyMoney) in October 2004. But all a consumer can do is order a free 'tool-kit' of publications. There is no problem solving at this number. The other efforts of Flec have been media campaigns to spread literacy among young adults.

8.9 The US has had a better outcome in its national

¹ GAO Testimony <http://www.gao.gov/new.items/d09638t.pdf>.

financial literacy effort through the President's Advisory Council on Financial Literacy, which was created in January 2008 as a public, private and non-profit partnership. The council, which has a two-year term, got off the ground quickly. In its first meeting, it formed five committees to focus on key areas of financial literacy: youth, the workplace, outreach, research and underserved populations.

8.10 The President's Council's 15 recommendations are in the direction of a more coherent plan. Reports the GAO: "Thus far it appears that the Council's efforts have been productive and beneficial, particularly in helping to focus high-level attention on financial literacy among leaders in non-governmental sectors and in facilitating strategic alliances among federal, private and non-profit enterprises."

8.11 The US has a good record of individual efforts in financial education. These are run by government departments, regulators, not-for-profits, corporations, start-ups, faith-based efforts and individuals, to name a few.

What India Can Use

8.12 The content created by individual organisations is good and can be used as a reference point.

The UK

8.13 In the UK, it is the job of the market regulator, the Financial Services Authority (FSA), to promote public understanding of the financial system. As a first step, the FSA conducted a large survey to document the base level of financial capability and to identify the gaps that the education effort would aim to fill. The survey identified the challenges before the FSA that had to be overcome.

8.14 A strategy that would construct the content and training, and deliver it, was built. Efficacy tests were built into the training modules. Next, the goal set was articulated: the financial capability effort must reach 10 million people by 2010-11; a measuring rod to monitor progress year after year was put up on its website. It identified sources of funds and built a budget for the programme.

8.15 The FSA, though its Financial Capability Department, works through intervention in key life stages so that the input reaches people when they want it the most. It has a five-pronged strategy:

8.15.1 Measure financial capability. In 2005, a large nationwide survey was conducted to fix the areas that need attention. The next survey is due in 2010-11 since the FSA targets to repeat the survey every four to five years.

8.15.2 Set targets. The target of 10 million financially capable people by 2010 will be revisited at the time of the next survey.

8.15.3 Define the path. It has worked out an organisational structure and a roadmap of outreach.

8.15.4 Allocate resources. The budgets started small—£2 million when the FSA began the initiative; for 2009-10, it is £22.7 million.

8.15.5 Measure performance. 10 per cent of the budget of any initiative is marked out to measure efficacy of the programme and for project evaluation. This is done through feedback forms, focus group discussions, evaluation teams and phone calls. Special research companies are hired to do this.

8.16 The actual work of building financial capability is delivered through seven channels. These are aimed at catching people in life stages where they are more open to financial education (students) or they are at a life stage where such inputs are needed. The seven channels are:

8.16.1 Schools: learning money matters. This aims to embed personal financial education into the national school curriculum. FSA outsources the school initiative to the Personal Finance Education Group (PFEG).

8.16.2 Workplace: maximising money potential. This aims to catch the person in her place of work and inculcate good money habits, to help her maximise the potential of her money. The initiative is developed by the FSA, which

has 3-4 master trainers. They, in turn, train the 300-400 volunteers to deliver these trainings.

8.16.3 Young Adults: helping young adults make sense of money. This looks at covering students in institutions of higher learning and those who are outside the system of education or employment.

8.16.4 Consumer communications. This uses the web, phone and one-on-one help sessions to solve individual issues relating to money.

8.16.5 New parents: money box. In order to catch couples or single parents at a time when they need help with money matters, this approach works through the hospital and mid-wife network.

8.16.6 Money advice. Working to ensure that consumers have access to money advice that is relevant, engaging and good quality.

8.16.7 Online tools. The reach of the web for a literate and web-enabled population is being used extensively by the FSA.

8.17 The FSA works through a 15-member central steering group. These members are drawn from across professions. They include teachers, a mid-wife, financial sector employees, not-for-profit sector professionals, individuals and trade union personnel, among others.

8.18 The FSA takes a partnership approach to build and deliver the content in financial education. The regulator is the nodal expert. Some of the training work is done in-house and some of it is outsourced.

8.19 The content is structured around managing money, managing risk, product planning and product descriptions. It does not recommend products, but aims to build an understanding of the relevant product types. For example, it will describe the attributes of a good product, but it will not name any particular product. With the help of comparison tables, it demonstrates products that are better suited to a person.

Audit Report

8.20 In April 2007, the UK audit office, the National Audit Office (NAO), put out a report on the efficiency and effectiveness of the FSA². Part 5 of the document is an audit report of the Financial Capability arm of the FSA. The NAO found that the work done by the FSA in building financial capability “put the FSA ahead of most of its international peers in financial capability. For various reasons, including resources and remit, most comparable international organisations generally confine themselves to providing information and raising awareness.”

8.21 The NAO found that not only had concrete targets been built, but a costing of the programme, per person reached, was also documented. For example, FSA has budgeted £18.6 million for the school arm of the capability plan, with the target to reach 1.8 million children from 2006-11. The cost per child is £10.33. The workplace plan of £3.33 per person has a budget of £13.3 million to reach 4 million people with information and 500,000 through a seminar. The NAO found the FSA to be a “world leader in financial capability.”

What India Can Use

8.22 There are several areas in which India can look deeper into the FSA style of working. The process of deciding on benchmarks, fixing targets and then providing the resources to move towards those targets are worth examining further.

Innovative Ideas From Across The World

8.23 Individual, corporate and not-for-profit efforts across the world are using innovative methods to spread financial education. The use of games, music, films, mass media to spread financial education is a vibrant field of work.

Poland

8.24 Poland has experimented with using mass media to raise financial literacy standards in the

² A review under Section 12 of the Financial Services and Markets Act, 2000, Part Five, NAO

country. It has identified edutainment as a strategy: embed financial education in programming, games and events of mass appeal. Some initiatives:

8.24.1 Gold For The Bold-Poles And Money

2006. A 120-minute TV show was broadcast in February 2006 on the country's most popular private TV channel. Viewers could test their knowledge of financial concepts by logging on to a website while watching the show. Testing was aimed at the average person. To make it more attractive, each of the 30 questions was illustrated with clippings from famous Polish films. An in-studio game, compered by celebrities, added to the mass appeal. About 8 million viewers watched the show, 250,000 visited the website and 102,000 completed the test during the broadcast. Supporting media like radio and print added to the build up and the post-show events. After the show, financial test material was sent to 2,500 high schools. About 53,000 students completed the test. Tests to measure their effectiveness showed that the average increase in knowledge was 5.6 per cent among adults and 10.1 per cent among children.

8.24.2 The Motel Halfway. In November 2006, a radio novel called Motel Halfway was launched on Polish Public Radio. The first season was 30 weekly episodes of 23 minutes each, focused on micro-entrepreneurs. Famous Polish actors read out the parts. Scenarios were prepared under the supervision of the National Bank of Poland staff. Over a million listeners followed the radio series. The increase in knowledge was 29.3 per cent among adults and 19.3 per cent among young people.

8.24.3 The Wallet Portrait. This three-and-a-half week TV campaign ran at the end of 2006 into

early-2007. Six edu-vertisments were broadcast 266 times on four channels. About 10.5 million people watched at least three episodes. While the use of edutainment is attractive, with high visibility and media attention, an obvious red flag to these high-intensity outreach programming is the lack of a follow up. Unless the momentum is sustained or is channelled into a maintenance mode, the gains can be frittered away.

Private Enterprise in Edutainment

8.25 Financial education is being imparted to the public in imaginative ways. Three such examples:

8.25.1 Money XLive³. This MTV financial education event is designed to help the young avoid common money mistakes. The events combine celebrities, entertainers and live bands, the idea being that participants will be entertained as they pick up the financial skills they need.

8.25.2 The Financial Literacy Music Curriculum⁴. This uses hip-hop music. It goes beyond simply telling the story, to also offer solutions. The combine of courseware and music album aims to transform the process of becoming financially literate into a hip and edutaining process.

8.25.3 EverFi⁵. EverFi and NogginLabs use cutting-edge technology to get young adults to avoid the next Ponzi Scheme and teach students core concepts of financial literacy. Their e-learning solution combines new media with the latest thinking in instructional design. They do web-based tours of the New York Stock Exchange, and give explanations of compound interest, and savings pitfalls of bad credit and consumer fraud.

³ <http://www.MoneyXLive.com>

⁴ <http://www.financialliteracymusic.com/home.php>

⁵ <http://www.everfi.com/>

9

Red Flags

9.1 Before India allocates resources to financial literacy, it is important to look at the red flags. A financial education drive is not a one-time effort. It will not lead to a perfect world of fully informed customers who buy products from firms that make all disclosures. In fact, **this report cautions against allowing the corporate sector to use financial education efforts as a means to transfer responsibility to the consumer. It also cautions against substituting financial literacy for effective regulation to rein in sharp selling practices and badly constructed products.**

The Global Experience

9.2 Globally, efficacy of financial education remains conclusively untested. The jury is still out on the cost-benefit ratio of financial literacy efforts. Although the broad direction says that financial education intervention is needed, what exactly works and how much is still not totally clear.

9.3 The Australian Securities Regulator and the nodal agency for financial education, ASIC, considers efficacy testing as “probably one of the greatest challenges¹.” ASIC is interested in the behavioural change component to ensure that people manage their money better and make responsible decisions after financial education.

9.4 The UK spends up to 10 per cent of the budget of any programme to test the efficacy of the initiative. It will test the efficacy of the current education drive in its next nationwide survey, which is due in 2010-11.

9.5 The US does not have a nationwide government-oriented testing scheme, but academics have been working by themselves. The early results show:

9.5.1 There is a link between financial education and increasing saving rates. Writes Dartmouth College professor of Economics and financial literacy expert Annamaria Lusardi²: “The

¹ ASIC interview to this report.

² Overcoming the Saving Slump: How to Increase the Effectiveness of Financial Education and Saving Programs, edited by Annamaria Lusardi, 2009, University of Chicago Press

evidence gathered in this book...shows that financial education programmes can be effective and that increased literacy does result in better saving habits.” At the base level, financial education does induce people to save more.

9.5.2 The link between financial literacy in school and better money management is not clear. Shawn Cole and Gauri Kartini Shastry³ show that a set of financial literacy education programmes, mandated by state governments, did not have an effect on individual savings decisions. Those who graduated just prior to the imposition of mandates (and, therefore, were not exposed to financial literacy education) have identical participation rates as those who graduated following the mandates (and were, therefore, exposed to the programme). The authors conclude that this could be linked to the programmes being too short. They suggest further testing before concluding that financial literacy makes no impact in schools.

9.5.3 Utility-based programmes work for adults. Finance professor Lewis Mandell⁴ documents that just-in-time education—particularly education delivered at the point of sale or that obtained by highly motivated consumers—is useful for adults who are about to make an important financial decision. In the case of students, there may be no immediate increase in scores, but the training imparted could be a factor in shaping better financial choices later on when faced with a real-life situation.

9.5.4 Edutainment works. Jump\$start surveys⁵ have consistently shown that high-school

students who play a stock market game are significantly more financially literate than those who do not. This implies that classes that are interactive, relevant and fun may be more effective than those that are purely didactic.

9.5.5 Relevance works. Research⁶ shows that students in financial education classes do better if they are properly motivated to understand why personal financial management is important to their future.

9.5.6 Nudges work better in product choice. Behavioural finance professor Richard Thaler⁷ believes that “while economic literacy is a noble goal, and should be taught in schools, the sad truth is that it is essentially an impossible goal. The world has become so complicated that even sophisticated people have trouble sorting out which is the best mobile calling plan, mortgage or credit card. The ‘nudge approach’ is to work instead toward making it easier.” This method looks at default products and a mandatory offering of plain-vanilla products before a more complicated product is sold.

9.5.7 The trap of using financial literacy to transfer responsibility to the consumer is flagged by Penn Law School professor Lauren E Willis⁸. He warns against the vision “of educated consumers handling their own credit, insurance, and retirement planning matters by confidently navigating the bountiful unrestricted marketplace.” Given the velocity of change in the financial market place, he writes, any financial education effort will lag behind the industry. If regulators find it difficult to keep pace with products designed to obfuscate, how can

³ Smart Money: The Effect of Education, Cognitive Ability, and Financial Literacy on Financial Market Participation, Shawn Cole, Gauri Kartini Shastry, Harvard Business School, 2009

⁴ Does Just-in-Time Instruction Improve Financial Literacy?, Lewis Mandell, http://www.cuna.org/download/svgtn06_d.pdf

⁵ Mandell, 2006

⁶ The Impact of Financial Literacy Education on Subsequent Financial Behaviour, Lewis Mandell and Linda Schmid Klein. Journal of Financial Counseling and Planning Volume 20, Issue 1 2009

⁷ Richard Thaler in a comment to this report

⁸ Against Financial Literacy Education, Lauren E Willis, Public Law and Legal Theory Research Paper Series Research Paper No. #08-10

educationists and others be expected to keep pace. He further argues: “Consumers generally do not serve as their own doctors and lawyers. For reasons of efficient division of labour alone, they generally should not serve as their own financial experts. The search for effective financial literacy education should be replaced by a search for policies more conducive to good consumer financial outcomes.”

What India Needs

9.6 The research, till this point, has some clear policy directions for India.

9.6.1 Unless the private sector, NGOs and those already working in the area of financial education are involved at the national level, it may be a non-starter. These are people with actual experience of running financial education programmes, and their inputs and participation will make the process robust.

9.6.2 Financial education at a base level is needed to help a population that is used to guaranteed-return products make the transition to understanding risk.

9.6.3 Financial education in India should not aim to help people choose the best product from a bouquet. Rather, it should aim to empower them to ask the right questions.

9.6.4 Financial education should have a utility-based approach rather than a theoretical one.

9.6.5 The use of innovative teaching methods, including edutainment, is worth experimenting with.

9.6.6 A low-cost way will have to be found to deliver content since channel creation is the most intensive part of any outreach programme.



PART C: Investor Protection and Investor Awareness

10

Joint Recommendations

India needs a coordinated approach to address the twin issues of investor protection and investor awareness. The research done for this report shows that education and order in the advisor marketplace are two sides of the same coin. Additionally, there are global best practices that collapse these two goals into one executive organisation. Based on research, interviews with key market participants—including regulators, heads of financial institutions, mutual funds, insurance companies, banks, distribution houses, financial planning entities and others—a survey of the financial sector¹ and a review of global best practices, this Committee proposes the following:

Recommendation 1. The objectives of greater financial literacy for Indians and establishing a system of common minimum standards for financial advisors should be met by a single organisation. **Financial Well-Being Board of India (FINWEB)**, the proposed organisation, will have the twin objectives of building

a financially literate population and bringing order to the advisor market to facilitate good financial outcomes from financial decisions. With an outcome written into its very name, FINWEB is envisaged to be truly working in the interests of consumers of financial products and services.

Recommendation 2. FINWEB should consist of two operational arms. The **Self-Regulatory Organisation (SRO)** will work to bring financial advisors under one common standard. The **Financial Literacy Cell** will work to make Indians financially literate.

Recommendation 3. The organisational structure of FINWEB should be geared towards a cost-efficient model, with minimal staffing, using outsourcing of functions to experts as an organisational structure device.

Recommendation 4. FINWEB should be a participative organisation, with representatives from government

¹ The Committee mailed around 100 companies a common questionnaire, asking for opinions, views and suggestions in the twin areas of investor awareness and investor protection. It got 25 responses.

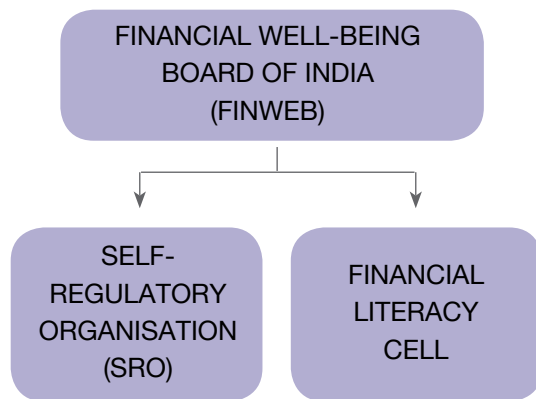
ministries and departments, regulators, industry associations and financial organisations active in the field of financial literacy and investor protection.

Recommendation 5. Its board of directors should be drawn from the existing regulators, Ministry of Finance, financial sector, industry associations, independent entities, experts and academics.

Funding. FINWEB should have independent funding. There are two options for this: it could either be funded by the government or by regulators. In both instances, either a capital grant is made to FINWEB or its budget deficit is covered each year.

Recommendation 6. FINWEB should be funded by the government through a capital grant, drawing upon the monies available in the investor protection funds, if necessary.

The Organisational Structure Of FINWEB



FINWEB: SRO Cell

Regulators can be seen in the same way as parents who handle teenage kids. There are those that over-prescribe, who get into every little market crevice and in every transaction of market participants. There are those that lay down the broad desirable outcomes and then step back to let market forces take over; yet, they are always present in the background, policing the markets. This translates into two broad thoughts behind regulation.

Rule-Based Regulation

Rule-based regulation is where the regulator tries to be present in each and every transaction that takes place, through an extensive rulebook, tight policing and penal system. The regulator tries to anticipate every possibility, every change, every innovation in the market, and then writes rules around it.

Principle-Based Regulation

Principle-based regulation is where the regulator is more focused on the outcome of the regulation. The regulator will articulate broad principles and allow market players to innovate around them, keeping the outcome (as defined in the principles) sacrosanct.

This approach does not completely do away with the need for rules. There will still be rules to follow in any regulatory system, but it does eliminate the practice of compliance officers using the 'checklist' approach to staying within the letter of the law. Checklist compliance harms customers, as there may be no case of regulatory violation, yet there may be mis-selling and malpractice. **In such an environment, compliance officers are not working towards a desired outcome for the customer, but to outwit regulators.** Once a regulatory loophole is discovered, it becomes a race to the bottom, with the rest of the industry following.

Using Financial Incentives Instead Of Regulation

There is a third way to look at regulation: **the market incentive structure is used to take most of the reasons behind misconduct out of the market and then use a principle-based approach to target an outcome.** The challenge is to find the holy grail of regulation that allows for market innovation, while taking away the incentive and power that the advisor has over the customer due to a skewed incentive structure and knowledge. One of the tools for such regulation is to use financial incentives in a manner that nudge participants into doing the right thing.

Today, the commission and reward system makes advisors the agents of financial product manufacturers, though their compensation comes from the customer. This must change for the advisor to look after the consumer of financial products. The consumer, too, will have to learn to pay directly.

Market reviews, opinions, views, the survey and global best practices all point to the fact that India is ready for a statutory body to bring all financial advisors under a common minimum standard of regulation. The rule-based entry thresholds and documentation already in the market, and the industry practices around them, point to 'checklist' compliance by product manufacturers and distributors; only in some cases is there evidence of a real effort to reach out to the customer with material facts. **This report leans towards a principle-based approach, while flagging the issue that to translate principles into rules that work would be a huge challenge in a market as vast and diverse as India.**

Who Will Be Regulated?

The Indian investor is served by agents, banks, post offices, financial planners and, now, through the employer and retail chains as well. The common minimum standards should apply to any person who sells financial products, provides advice, or directly or indirectly profits from recommending and selling retail financial products. This will include individual agents selling mutual funds and insurance, financial advisors, financial planners, bank employees, direct selling agents from banks who sell banking and credit products like fixed deposits, credit cards, home loans and car loans.

The banking and credit products currently do not show signs of mis-selling. But they do come under the scope of over-the-counter retail finance products and are included for work, if needed, at a future

date. Today, the pressing need in the market is a regulatory structure for sellers and advisors of mutual fund, insurance and pension products. **The report will focus on sellers and advisors in these three product categories.**

Recommendation 7. There should be a common minimum standard for all sellers and advisors on mutual funds, insurance products (life and general), pension products and those products of commodities markets which are purely financial in nature. Pro-bono advice will not be under the purview of FINWEB.

The Roadmap

Recommendation 8. **An SRO-driven regulatory system should be adopted for financial advisors².**

Recommendation 9. All retail financial products should go no-load by April 1, 2011. The pension product in the NPS is already no-load. Mutual funds have become no-load with effect from August 1, 2009. Sellers of insurance policies need to remove the bias towards selling the policy with the highest commission. Because there are almost three million small agents who will have to adjust to a new way of earning an income, **it is suggested that the upfront commission embedded in the premium paid should be cut in a gradual manner to become zero by April 1, 2011.** The interim period should be used by insurance companies to help their agents make the transition to a fee-based model of selling and advising.

Following a public hearing on September 9, 2009, the Committee adds the following:

Recommendation 9.1. Consumers should be given the choice to pay the fee (agreed upon as outside of the investment amount) through a cheque or debit to the product manufacturer. The manufacturer will, in turn, remit the fee to the seller. This is purely for operational ease of collecting the fee by the seller. The choice

² FPSB India has presented a workable SRO model to the Committee. Also, RBI has commented that given the current level of heterogeneity in the market, initial handholding of the SRO is needed from regulators. The Business Correspondent model developed by the RBI can serve as a starting point of reference.

to pay separately through a cheque will, of course, exist.

Recommendation 9.2. In order to take care of consumers who might not know how to evaluate the services of financial advisors, FINWEB will set the fees in a price band linked to the service provided. Similar products will be clubbed into comparable price bands. This will be based on research in the Indian market and on global best practices.

To meet the social needs of effective risk cover for the life of the principal breadwinner, the commission earned on the pure life insurance product, called 'term plan', will get special treatment under FINWEB. Since insurance penetration is a national goal and a term plan is the cheapest and most effective protection against the untimely demise of a person, the Committee recommends the following:

Recommendation 9.3. Commissions on the term-insurance product (pure life cover, with zero investment or money-back/return of premium component) will be reduced in a gradual manner till they reach 5 per cent of premium by April 1, 2011. This 5 per cent commission will continue till pure life insurance (without an investment component) penetration reaches targets set by the government.

Recommendation 10. **The overarching outcome of the SRO arm of FINWEB should be financial health.** The outcome of financial health can be broken down into the **outcomes of safety, fairness and trust**, which will have **goals around education, conduct, disclosures, reporting, punitive action and dispute redress.** **The existing mechanisms for dispute redress must be strengthened.**

Safety. Consumers should feel safe while dealing with, transacting and doing business in the retail financial products and services market.

Fairness. Consumers should not feel cheated, but should get a sense of fair treatment in their interactions and transactions.

Trust. Consumers should feel confident, rather than cynical, about the redress mechanism.

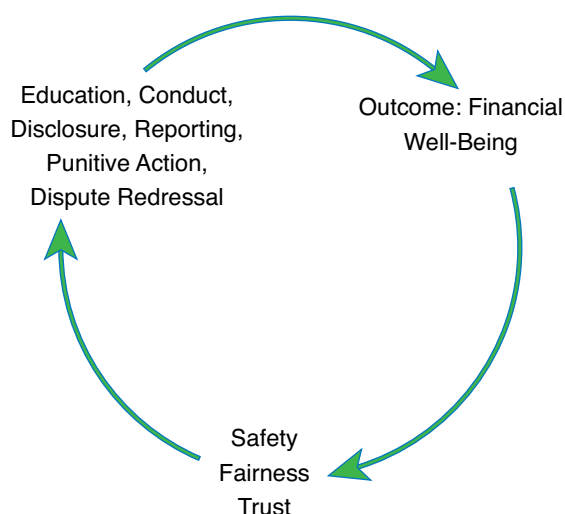
The outcomes above will be achieved by setting outcome goals in the following six areas: education, conduct, disclosures, reporting, punitive action and dispute redress. Each of these is linked to one of the three outcomes of safety, fairness and trust. It is beyond the scope of this report to flesh out each of these, but a broad framework could look like this:

1. Education. Outcome: Safety

Recommendation 11. There should be a common minimum entry barrier for all financial advisors. The entry barrier should comprise a minimum knowledge-linked training programme, which specifies a set of knowledge outcomes rather than number of hours of study.

Recommendation 12. An individual must clear a common examination, with several modules, before beginning to sell financial products to retail consumers. The existing examinations in mutual funds, insurance and others will continue as different modules within the outcome-specific goals of FINWEB. In addition, the SRO will give a threshold certification to any seller or advisor of a financial product that results in the consumer paying a transaction cost (including commission and fee).

The Outcomes



Recommendation 13. A new benchmark qualification should be introduced that will license an advisor to operate in the market. There should be a graded qualification matrix that will link more complicated products to a higher level of education and testing. The nature of the license will determine what products or what level of service an advisor can provide.

Recommendation 14. There should be a system of continuing education. The license should come up for renewal every five years, through a refresher exam. This will be available for each level of the qualification matrix.

Recommendation 15. There should be a system of educating not just individual advisors, but also employees working for a financial entity that intermediates. Anybody facing the customer must be a licensed entity. A corporate license is not enough—the entire sales team will need to acquire the qualification³.

2. Professional Conduct. Outcome: Safety

A trade becomes a profession when there is development of a formal qualification based on education and examination, and an emergence of a regulatory body with the power to admit, discipline and demit members. Intermediation, currently, is a low-value trade with little respect in society. The conversion into a profession will need, apart from the education and examination thresholds mentioned above, a code of conduct that ensures a minimum common threshold of service expectation.

Recommendation 16. All advisors should be registered with FINWEB and should be governed by a code of ethics that is standard across products and organisations. While formulating the code of ethics, note will be taken of the structure put in place by the RBI for its business correspondents standards. The code of conduct should have principles of integrity, privacy and honesty as key goals.

3. Disclosures. Outcome: Fairness

To remove the last shred of doubt about the intent of the advisor, India needs a minimum common standard of disclosures. This must address costs, risks, product features and realistic potential outcomes. The disclosures should reveal the total cost, current and ongoing, that will be borne by the consumer of the product. The disclosures should give a reasonable picture of the risk the product carries. The disclosures should contain third-party benchmarks to compare past performance. The disclosures should ensure the customer understands the product outcome. Product labelling⁴ should be used innovatively to inform consumers what they are buying.

Recommendation 17. FINWEB should develop a disclosure template that has consumer understanding as an outcome.

Recommendation 17.1. The disclosures should reveal the income—direct or indirect—that an advisor earns from the sale and maintenance of a product, both from consumers and from product manufacturers.

Recommendation 17.2. A one-page note, with the product's most important terms and conditions, should be part of the disclosures to ensure the customer understands the product and its impact fully.

4. Reporting. Outcome: Fairness

In many instances, today, there is a mismatch between what the advisor verbally tells the customer and what the final product has the ability to achieve. Verbal consent must be followed up with written documentation. The negative option and free-look period are causing trouble to consumers and have become a nursery for ghost insurance policies. These policies are issued without the customer's application and knowledge, and a huge premium is charged. Irda

³ RBI had reservations about this recommendation

⁴ http://www.nytimes.com/2009/05/24/opinion/24gibson.html?_r=1

should bar this and substitute express consent in writing. The BCSBI code stipulates this for banks⁵. Unless there is a paper trail that affixes a name to the advice given and product sold, the practice of 'hit-and-run' financial products (where an advisor will sell a product to a customer and disappear) will continue, eroding confidence in financial markets.

Recommendation 18. The sales process should be documented. A customer-profiling process should be put in place, as should a documentation of the process that led to the product selection.

5. Punitive Action. Outcome: Trust

A key requirement of a trade transforming into a profession is the ability of a consumer to get redress from the professional body that regulates the profession. A well-defined system of affixing penalties in cases of misconduct, mis-selling or otherwise causing a bad financial outcome must be put in place.

Recommendation 19. There should be a well-defined process to affix responsibility for loss attributable to wrong and misleading advice.

6. Dispute Redress. Outcome: Trust

An accessible system of dispute redress must be in place. Today, when customers have a complaint, they go back to their agents, who are not accountable in any manner. Even when they approach call centres to register or track a complaint, customers lose a lot of time when they are guided from one call centre employee to another. There should be a robust system that makes it easy for consumers with a genuine complaint to file it, track it, and be able to explain why and how they feel cheated.

Recommendation 20. Consumers should have a common interface to complain about financial products, service and outcomes. A time-bound redress system should be put in place.

FINWEB: The Financial Literacy Cell

Transforming India's financially challenged millions into an informed consumer base is no easy task. There is no immediate solution. Further, any solution will not be easy to conceptualise or implement. The newness of the subject and the lack of empirical evidence on what will work makes the task that much more challenging. The good part is that there is a broad agreement on the need for a nodal national agency to be at the heart of the national financial literacy initiative. What it should be like, what work it should do and not do, how it will reach the millions across the length and breadth of the country is the subject matter of the following recommendations. The RBI suggests examining the FSA model of institutionalising the Independent Financial Advisors in the UK, where they are expected to form the bulwark of financial education.

Recommendation 21. **FINWEB should be at the centre of all financial literacy initiatives in the country.** It is from the knowledge and expertise of FINWEB that willing agencies active in the field of financial literacy should draw material, conceptual knowledge, expert trainer and testing.

Recommendation 22. FINWEB will engage key professionals and experts in various steering groups to drive specific financial education programmes in identified areas of intervention.

Recommendation 23. **FINWEB will not prevent any financial literacy initiative from carrying on its work in its chosen area of interest.** Its aim is to be a knowledge and resource partner; not a regulator of financial literacy, but a standards setting body.

The aim of FINWEB is not to educate people to choose between, say, mutual fund A and mutual fund B. That is the work of the financial advisor. The aim is not to substitute financial education for effective advisor and product regulation. The goal

⁵ Comment from the RBI

of FINWEB would be to enable individuals, at their level of need, to understand the role of money in their lives, the need and use of savings, the various options available in the market they can access to convert their savings into investments, and a realistic recognition of the attributes of these options.

FINWEB would consider its work well done if the financially literate person knows enough to be able to ask the right questions of the person selling financial products.

Content

An alternate school called Mirambika, based in New Delhi, does not introduce written language to children till age six. Sometime between the age of six and seven, they are introduced to the shapes of letters and the sounds that go with them in a random manner. There is no chronological recitation of the alphabet. Once they know most of the sounds and can connect it to the shape, they are encouraged to join them to write down the names of their classmates. Then, one or two lines on what they like most about their classmates. Children learn reading and writing in two weeks with this method. Linear and structured learning takes much longer to achieve this.

A review of most current financial education initiatives show that they are largely in the linear, structured space, where teaching is around defining a stock market, a mutual fund, a bank and so on. Could non-linear, concept- and utility-based learning work better in financial education?

Recent academic work on financial education⁶ shows that utility-based learning is more useful in changing behaviour. Unless the recipients of financial education are clear about how this material and training will help them, and they are able to connect it to what they are doing in their lives, the retention is usually very low. Merely learning the structure of a market or how a mutual fund works is alienating. It is quickly forgotten once the class is over. The other reason for taking

a concept-centric route is that there is constant innovation happening in the financial sector. By the time the knowledge and understanding of a new type of a product trickles down, it is already old.

Recommendation 24. This report recommends an alternative approach to financial education in India. **The content plan should focus on utility- and concept-based learning.** The key question to be asked before developing any material or conducting any training will be: how will this connect with the desired audience and of what use is it in a person's financial life in a practical way? While definitions and descriptions are important, they come as an aside.

Utility-based learning. A group of health workers were trying to get women of a remote village in India to understand age-weight benchmarks for children. The idea was to encourage them to feed kids who were below the benchmarks better. The NGO workers plotted the ideal age-weight line in the mud in the village square. For age three, the ideal weight is this; at age four, it should be this much; and so on. Next, they plotted the names of the kids by age and weight, above or below the line. Everyone could see whose kids were under-nourished and whose kids were adequately nourished. The mothers of the under-nourished kids could ask the mothers of the kids who were adequately nourished on what they were feeding their kids, and begin doing the same. No structured class could have achieved such an outcome, in such short time.

FINWEB should use a utility-based approach to develop content and training programmes. These should explain the lifecycle of money in a person's life, with earning, spending, budgeting, insurance, saving, investing and credit as key areas of work. Asset classes, markets, products will fit into the utility-based paradigm, rather than being taught separately.

Concept-based learning. Finance rests on concepts. These concepts can be seen as

⁶ The Impact of Financial Literacy Education on Subsequent Financial Behaviour, Lewis Mandell and Linda Schmid Klein. Journal of Financial Counselling and Planning Volume 20, Issue 1 2009

alphabets. Once understood, they can be strung together to simply sign a name or write books. Every part of the market—banking, insurance, capital market, loans—uses certain finance concepts in product construction. A regular investment-saving product will use the concepts of present value, future value and rate of return. A life insurance product will use concepts of mortality—probability of people dying at a certain age. A mutual fund will use the concept of risk and reward. While these sound complex, their usage is not. **It will be a challenge that FINWEB will have to take up to convert these concepts into mind maps, pictures, stories and examples that will explain without alienating the learner.**

*Recommendation 25. **FINWEB will identify, after consultation with various parts of the market, a set of concepts that are basic to financial products. These will then be innovatively worked on by a small group of finance experts.***

The challenge for FINWEB is core content development that is applicable at various gradations. These are concepts that can be scaled up or down the understanding ladder, with no change in the basic message. But its communication will have to be made specific to the group the particular literacy effort is trying to reach. For instance, a person making a savings deposit and one investing in an exchange-traded fund (ETF) are both using the concepts of present value, future value and risk. Only the gradations are different. The material and the training would have to scale the concept up or down to be in tune with the needs of the particular group being targeted. The concept-led approach will allow a certain amount of cohesion in the financial education efforts of various partners of FINWEB.

Reaching It

Distribution is the game-changer for a corporation. A company can have the best product, but unless it

populates the market, it will remain in the warehouse. Distribution chains are expensive to create, especially in a country as vast as India. Rather than create a network of arteries that will carry financial empowerment across the length and breadth of India, it will be cheaper and more effective to embed the existing networks with customised content and training.

FINWEB will not create an army of financial literacy staff. Rather, it will work with a small core team of content developers and trainers, who will then partner willing institutions, groups, organisations, NGOs and micro-finance companies. The idea is to first empower the nodal agency's staff with financial education. Once the recipients understand and use the concepts in their own financial life, they can pass on the training much better than some theoretical recitation of facts. Disparities along regional, cultural, religious, gender, social, economic and political lines would have already been resolved by the existing pipelines. FINWEB will need to be nimble to be able to customise training and content to suit specific pipeline needs.

Recommendation 26. Financial literacy modules and training should be embedded in existing pipelines, namely:

26.1: Advisors. They are a key piece of the literacy work. They are the lowest-cost, highest-impact way to get the attention of investors at a time when they are most open to education. **The time of a product sale is a well-documented, 'teachable moment'. This is a crucial piece of the financial literacy plan.**

An interesting model⁷ in financial education is the institutionalisation of independent financial advisors (IFAs) in the UK, who are individuals regulated by the FSA. The main purpose of a financial advisor is to assist clients in the planning and arrangement of their financial affairs, such as savings, retirement

⁷ Comment from the RBI

provisions, tax treatment and wills. (Non-independent advisors are company representatives who can only recommend products approved by their company.) It is a central and defining criterion that an IFA must be willing, able and, crucially, authorised by the FSA to accept payment from clients by fee rather than by commission, and this must be outlined in the introductory meeting. Advisors who are only willing or able to be remunerated by commission cannot call themselves independent. IFAs are expected to form the bulwark of financial education in UK. Over time, the model of IFAs in the UK may be looked at more closely for introduction in India.

In India, there are around 3 million insurance and mutual fund agents. Add the banking staff that sells products and the direct selling agents to this, and the numbers increase further. These product sellers reach about 188 million consumers today. They will reach another 200 million in some years. If financial advisors can be made a participant in financial education, we have one of the least-cost ways to achieving a financially capable population. But for advisors to do this, a set of changes is needed in the incentive structures that motivate them. India will have to move from a model of the product manufacturer using the customer's money to compensate the agent to the customer paying directly for the service.

26.2: Government programmes. There are mass outreach programmes of the government that, if willing, can be embedded into financial education. Again, this is not an imposition. But if the head of the outreach programme considers this valuable, FINWEB will develop customised material and training for the training staff of the programme.

26.3: School curriculum. The school curriculum is one key area of work for FINWEB and efforts will be made to work with the relevant departments to facilitate this. Along with focusing on continuing the efforts to embed financial education in the school curriculum, FINWEB will also use an alternative approach. **By simply converting the relevant maths problems into financial literacy-embedded problems, children could**

be introduced to financial literacy in a non-intrusive way. Educationists and financial sector experts will need to work together to construct these problems.

26.4: Post-class XII. FINWEB will work with universities and nodal higher education points to encourage young adults to become financially literate. The method, again, is demand-pull, rather than push.

26.5: HR departments. FINWEB will work with HR departments of willing large corporations to embed financial education into their existing training and HR programmes. Special modules for those entering the workforce, considering a job change or retirement will be developed.

26.6: Life transition points. A person is most open to financial education at a life-transition point, like marriage, birth of a child, first job, job loss, retirement or even a home loan. These are the best 'teachable moments'. FINWEB will work on developing some of these as channel partners to carry financial education.

26.7: Social organisations. FINWEB will work with organisations like Rotary Club to spread education. Willing residents' welfare associations (RWAs) could be involved in the financial education initiative.

26.8: NGOs. FINWEB will work with NGOs to develop specialised content for specific areas of work. HelpAge India, for instance, should be keen to partner an entity such as FINWEB, as it feels the need for customised content and expertise in the area of old-age financial management and product choice.

26.9: Micro-finance companies. Over 80 million people have been covered through micro-finance in India. FINWEB will work with this large network of organisations to take financial education to the excluded population. One of the concerns in the micro-finance sector is the handing over of a large sum of cash, maybe for

the first time, to a person. A financial education module embedded in the lending process will give inputs on how to use it.

26.10: Existing efforts. FINWEB will offer its expertise to existing financial education efforts that are already on the ground with projects running and use their expertise in fine-tuning its own work.

Recommendation 27. FINWEB will have an outcome-specific role. Any intervention by FINWEB will result in a basic skill set getting created.

Recommendation 28. The content and training modules will have efficacy parameters as part of the programme.

Recommendation 29. FINWEB will develop a website that will become the clearing-house for all financial education efforts. **The material developed by FINWEB will be put on the website for downloading by anybody who wants to use it.** It may encourage smaller organisations to use it by moulding it to their own needs.

Recommendation 30. FINWEB will operate in three distinct ways. One, it will engage with those who are already doing work. Two, it will reach out to large arteries who could carry this. Three, it will be available as a resource house for any organisation that may want customisation for its specific purpose.

Measuring It

It is essential to measure each intervention. It is probably only pure research that can have non-measurable results of years of work. A system where public money will be used must have accountability and an outcome-linked mandate.

Recommendation 31. To measure the change in behaviour, FINWEB will carry out a nationwide survey to fix benchmarks of current behaviour. Only then will subsequent surveys determine efficacy.

FINWEB will have an outcome-specific role. Any intervention by FINWEB will result in a basic skill set getting created. Each intervention will be tested with a view to measuring efficacy.



ANNEXURE 1

Customers

A1.1

Shalini Vig Wadhwa**General Manager, Corporate Communications,
DLF**

I have a Ulip pension policy. It was sold to me by my bank. The policy number is RPG1696773, dated September 28, 2007. I took this policy last year when the bank people introduced the insurance company and its product offerings to me. It turned out to be a case of mis-selling.

The sales manager visited my office and told me that I have to pay a single premium for a big cover; further, after 5 years, I can withdraw the money at minimum 20% growth. And along with that, I will get risk cover for five years. The sales manager gave me a verbal assurance that I will get about Rs 12 lakh after 5 years of the policy term.

Later, I realised, it is a regular-premium policy, not a single-premium one. This year, when my premium became due, a bank employee told me that I will have to pay a premium of Rs 6 lakh a year for the next 10 years. I told him that I can't pay Rs 6 lakh this year. He said I could skip this year's premium and my policy will remain active. On checking with a friend, I understood I would have to pay 12 lakh next year if I fail to pay the premium this year.

I was sceptical about this product. But after continuous perusal and assurances by the bank employees and follow-up calls by the insurance company's sales personnel, I decided to opt for it. I trusted them, but I'm disappointed with their false commitments. During the entire year, neither have I got any statement from the insurance company nor heard from anyone on the status of my policy and investment. Only a demand for another Rs 6 lakh.

A1.2

Nilofer Kaul**B-26, Gulmohar Park, New Delhi-110049**

In May 2006, we (my husband Pankaj Butalia and I) were approached by investment officers of one bank to invest our money in various kinds of instruments. In particular, an officer (name and agent code withheld), who used to come from the Hauz Khas branch of the above bank and offer different investment options.

It was he who suggested to us that we invest Rs 2 lakh per year in a policy of an insurance company, which would not only give us a tax deduction, but also good returns as it was a growth fund.

He assured us that we needed to pay only two annual premiums of Rs 2 lakh each, after which our money was available for us to take back, subject to some deductions from the initial premium, as had happened in the two other policies I had taken from the same insurance company in 2003 and 2004.

I paid my second premium of Rs 2 lakh directly from my savings account (number 971356) at my bank in Hauz Khas, New Delhi, sometime in 2007.

Today, when I went to the bank to ask for the NAV of my fund, I was told that my fund value was about Rs 89,000. I was shocked because the market was almost at the same level as when the fund value was Rs 4.2 lakh. I asked how the value of my holding had declined 80%. I was told by the bank officials that this policy was a special vehicle, in which the policyholder had to pay premiums for 10-15 years, or else heavy penalties would be levied.

I could not understand this, as I had been told by the agent categorically that only a small amount would be deducted from the initial Rs 2 lakh.

This is a clear case of cheating using an instrument

that the policyholder does not comprehend. The details and small print in the policy are so complex that they are impossible to understand.

I took this policy because I trusted the investment officer of the bank, but now I find that most of my capital has been eaten up by the insurance company.

A1.3

Army officer stationed in Jammu & Kashmir

A rather persistent agent conned me into buying an insurance policy. At the time of taking the policy, the agent promised me the earth, including a gift worth Rs 5,000. At the time of filling up the forms, he split the intended sum assured across two separate policies (in order to increase his target).

When the policy documents came, I found a few discrepancies in them. After considerable effort, I was able to contact the agent. He promised to get the needful done, but nothing has happened yet. I have paid a total premium of Rs 10,000 till date and discontinued paying premiums immediately thereafter. Neither the agent nor the company has sent me any reminders or policy termination intimation till date. I, thereafter, got busy with work and have not been able to pursue the issue.

A1.4

Delhi-based woman school teacher

I'm not well-versed with investments, and am often at a loss when friends direct insurance agents and other such intermediaries to me to buy various policies. I had one such person sent by a friend a lot more knowledgeable than me to buy an insurance-cum-investment policy for children.

I asked some questions and was given some mumbo-jumbo, which I did not understand; I was told by the person, aggressively, that this was the best choice in the market. I was given to understand that a certain amount would be available at the end of a certain

number of years.

Two years later, when this policy was looked at by a friend, I was told that the amount quoted was very low and that it was not a good option. When I questioned the agent, he again managed to convince me, quoting figures, that I had made a good choice. After that he tried to sell me other policies as well. I bought one more, but I returned it immediately and got my money back once appraised of its many flaws.

Since then, I have stopped buying anything from this agent. Instead, I now have a financial planner. Things are looking better. One, I feel more in control of my own money. I can ask for explanations and I get responses that are easy to understand and make sense. I have also seen my money grow. Second, the investments that we do now are part of a big plan keeping in mind our age, responsibilities and income. We are constantly being encouraged to invest more and reduce the money we keep in the bank as well as the money we spend. There are no random savings and investments anymore.

A1.5

VK Madhavan
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Phones: +91 5942 285738 and +91 9412085732
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About a year ago, we received a telephone call from the Haldwani office of one of India's better-known insurance companies. The sales person wanted to know if Chirag, a registered society, was willing to invest money in a new scheme they had on offer. The scheme, according to her, would give us a guaranteed return of 20% on our investment.

At a time when the economy was beginning to go into a slump, this sounded terrific. Sure enough, we asked the salesperson as to what the investment plan was that could guarantee a 20% return on investment.

The call was transferred to a person further up in the information chain/hierarchy of the insurance company. The person said they would invest our savings in securities, but was not willing to divulge information on what the investment pattern would be, and seemed upset at our query. We politely told them that if they wanted us to invest in their product and were not even willing to tell us what the investment plan would be, then how could we even consider investing in them? The conversation ended abruptly.

Less than 10 days later, we got a call from another branch of the same company in Kumaun. They were rather persistent and insisted on coming over to discuss multiple products with us—for our staff, for the organisation and for communities that we worked with. Two individuals, including the branch manager, arrived with literature on their products. The products on offer were essentially insurance-cum-savings products, and we collected the information. We then enquired about the ‘magical’ investment product they were offering that could give a 20% guaranteed return. They were taken aback, and said that the product could give a 10% return, but they could not guarantee this. The product literature confirmed that there was no guarantee. We mentioned the fact that representatives of their company were mis-selling products.

We have not considered any of these products. This is not the first instance of mis-selling by reputed companies in rural and semi-urban areas, where consumers are essentially used to purchasing money-back insurance policies. A few years ago, there was a similar instance in Haldwani. Several of our colleagues ended up investing in an insurance-cum-investment product after they were told by the representatives of the insurance company that they had to pay three equal annual instalments and that they would get a fantastic return after 10 years. None of the actual documents reflected the returns that were promised.

In areas with little or no financial literacy, and in particular when selling to the relatively poor, the responsibility of insurers should be much greater. Investing in inefficient savings and insurance products is a huge burden for the poor, but obviously, the incentive for agents to sell inefficient products is much more. This becomes complicated since in rural areas, the ‘spoken word’ still has more value than the ‘written word’. In effect, an inaccurate promotion of a product with selective usage of words like ‘guaranteed returns’ exposes people to poor choices.

A1.6

**Dr Bharati Dave, Delhi University Professor
Saket, New Delhi**

My evening house-help, Malati Rani Das, was sold an insurance-linked pension plan in March 2008. The due date of the last premium is March 17, 2025. She has to pay an annual premium of Rs 12,000. Her monthly income when she bought it was Rs 2,500 a month. She is unmarried.

Malati says she agreed to buy this policy as the agent told her that if she paid Rs 12,000 a year for three years, she would get Rs 60,000 after three years. After her first premium, she lost her full-time day job. She had to borrow to pay the second premium. And she had no idea that she had to pay premiums till 2025.

She says the agent who sold her the policy is a trusted person of her community. When she asked the agent, he told her that she will have to pay premiums for three years to get her money back. But the policy document, which I have seen, says that even after three years, she will get back only 98 per cent of her money. She is an uneducated person and is unable to take this up in any manner for help.



ANNEXURE 2

Interviews And Survey Overview

Interviews

The research team carried out interviews with key market participants, and regulatory and market veterans. The aim was to get a broad sense of the opinions and arguments of those who have been engaging with the markets and their functioning in some depth. While these interviews are not appended to the report, it draws heavily from the ideas, views, concerns and red flags shared. Some others shared their views, but requested their names be kept out of the published list below.

- CB Bhavé, Chairman, Sebi
- Usha Thorat, Deputy Governor, RBI
- RH Patil, Chairman, CCIL
- Ravi Narain, Chairman, NSE
- J Hari Narayan, Chairman, Irda
- PJ Nayak, former Chairman, Axis Bank
- SB Mathur, Secretary General, Life Insurance Council
- Deepak Satwalekar, ex-CEO, HDFC Standard Life
- Rajesh Relan, Managing Director, MetLife Insurance
- Nilesh Shah, Chief Operating Officer, ICICI Prudential AMC
- Ashu Suyash, Managing Director and Country Head, Fidelity AMC
- Krishnamurthy Vijayan, CEO, JP Morgan AMC
- Sandesh Kirkire, CEO, Kotak Mahindra AMC
- AP Kurien, Chairman, Amfi
- Shailesh Haribhakti, former Chairman, FPSB India
- J Rajagopalan, Managing Director, Bluechip Corporate Investment Centre
- Nachiket Mor, Chairman, ICICI Foundation
- Bindu Ananth, President, IFMR Trust

Survey

Besides these one-on-one interactions, an e-mail survey of mutual funds, life and general insurance companies, banks, brokerage houses and financial planners was carried out. The broad objectives were to get information on specific sales practices and views on regulating financial intermediaries. The survey was e-mailed to about 100 entities. The aim of the survey was three-fold:

1. To get a sketch of the product sales lifecycle, both from the point of view of the manufacturer and the seller.
 - What is the typical sales process you follow to sell your scheme to investors? Is it demand-pull or sales-push?
 - How long, on an average, does it take to make a sale?
2. To get information on some best practices in terms of disclosure to the customer at the point of sale.
 - What is the paperwork at the point of sale?
 - Is there a customer-profiling process in place? If yes, please send a copy of the format that you use.
 - Are costs/fees/other expenses disclosed at the point of sale? If yes, please share the format of the disclosure form.
 - Is there a disclosure to the customer of the risk the product carries? If yes, please attach a copy of the paperwork that enables this.
 - Is there a product description that documents the key features of the product? If yes, please attach a copy of this.

3. Views and opinions on the need for a common set of regulations for financial intermediaries in India.

- What makes a robust distribution process that takes into account the interests of the customer?
- Do you think a set of regulations is needed for financial advisors? (Since a load-bearing product has advice embedded in it, a seller of a load product is effectively an advisor.)
- If yes, do you have any suggestions for a robust regulatory structure for financial advisors?

Respondents

The Committee received 25 responses. From many others, we got a confirmation mail that the questionnaire had been received, but nothing further. The respondents...

AMCs

Benchmark AMC
Birla Sun Life AMC
Fidelity AMC
Franklin Templeton India
Kotak Mahindra AMC
UTI AMC

Life Insurance Companies

Birla Sun Life Insurance
HDFC Standard Life Insurance

ICICI Prudential Life Insurance
MetLife Insurance

General Insurance Companies

HDFC ERGO General Insurance
Reliance General Insurance
Star Health & Allied Insurance

Banks

Axis Bank
Citi Bank
Dhanalakshmi Bank
HDFC Bank
SBI

Distribution Houses And Others

B Srinivasan, Financial Planner
Birla Sun Life Distribution
CAMS
Dalmia Advisory Services
iTrust
Reliance Money Limited
SKP Securities

Global Review: Inputs from...

Australian Securities & Investments Commission (ASIC), Australia
Finra, US
Financial Services Authority, UK

Annexure 3 contains the responses of the 25 entities that took the e-mail survey.



ANNEXURE 3

Product Manufacturers, Sellers And Advisors

Of the 100-odd product manufacturers, sellers and advisors this survey was sent to, 25 responded. Their responses, arranged alphabetically by segment, are published in this annexure.

A3.1 Asset Management Companies

1. Benchmark Asset Management Company

What is the typical sales process you follow to sell your schemes to investors? Is it demand-pull or sales-push?

Combination of demand-pull and sales-push.

How long, on an average, does it take to make a sale?

We don't know, as we don't interact directly with the end-client.

What is the paperwork at the point of sale? Is there a customer-profiling process in place?

Most of our mutual funds are in the form of exchange-traded funds (ETFs), for which, no paperwork is required. For other open-ended funds, investors fill the standard application form that is part of the KIM.

Are costs/fees/other expenses disclosed at the point of sale?

Our funds don't have entry loads. For ETFs, the execution cost is the brokerage, which is part of the contract note given to the client after execution. For other funds, there are no entry loads and, hence, no upfront charges.

Is there a disclosure to the customer of the risk the product carries?

The KIM, which goes to the customer, covers disclosure of risk.

Is there a product description that documents the key features of the product?

The KIM.

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

The key is last-mile contact—the financial advisor/distributor. They should be regulated directly as advisors, independent of the product they are selling. Currently, they are regulated by Amfi for mutual funds, by Irda for insurance, by stock exchanges for the secondary market, and by no one for company fixed deposits and government savings schemes. The malpractice should be curbed at the source. Also, the financial advisor should answer to a single regulator, ideally Sebi.

Do you think a set of regulations is needed for retail financial intermediaries?

Yes.

If yes, how should it look?

A new self-regulatory organisation (SRO) called NAFA (National Association of Financial Advisors) should be created. All financial advisors should become a part of it, including stockbrokers, sub-brokers, mutual fund agents, insurance agents, sellers of company fixed deposits, commodity-market brokers, people selling international financial products to Indian investors, sellers of portfolio management scheme (PMS) products, and sellers of venture capital funds, among others.

NAFA should be under Sebi. It should be loosely modelled on the lines of the Financial Industry Regulatory Authority (Finra) in the US, which regulates 600,000 registered representatives from about 4,000 firms. It should conduct exams for investment advisor license, with advanced versions for product groups like derivatives. Financial advisors will need to obtain a license from only one authority, NAFA.

2. Birla Sun Life Asset Management Company

What is the typical sales process you follow to sell your schemes to investors? Is it demand-pull or sales-push?

Sales-push.

How long, on an average, does it take to make a sale?

It depends on the product. Across-the-counter closures may happen. Or, there could be closures that require follow-ups. It could be anywhere between one day and upwards.

What is the paperwork at the point of sale? Is there a customer-profiling process in place?

The paperwork is application form, cheque, KYC documents. Since the distributor is the sales agent, it may do one at its end to recommend a product. This is non-mandated from a regulatory perspective.

Are costs/fees/other expenses disclosed at the point of sale?

Yes.

Is there a disclosure to the customer of the risk the product carries?

Yes.

Is there a product description that documents the key features of the product?

Yes. It is there in the application form.

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

Any robust distribution process that keeps customers at the centre is welcome. Some suggestions: a process where a welcome call is made to customers to verify they are aware of all the features of the product they are buying, simplicity of products and communication, leveraging sales kits and tools in customer language to aid distributors.

Do you think a set of regulations is needed for retail financial intermediaries?

Yes. Anything that can help increase transparency, convenience and quality in the distribution process, while keeping it cost-effective, is welcome.

If yes, how should it look?

Mandatory refresher training, with a special focus on financial advisory to customers.

3. FIL (Fidelity AMC)

What is the typical sales process you follow to sell your schemes to investors? Is it demand-pull or sales-push?

Mutual fund sales are primarily made through distributors. These include banks (public sector, private sector and foreign), broker-dealers (organisations that are registered stock brokers), financial services companies and national networks that sell multiple financial products (including insurance) and IFAs. These distributors sell/market mutual funds to their clients.

The process largely tends to be sales-push oriented, given the relatively lower levels of awareness of mutual funds among investors. The sales process differs from distributor to distributor. Most banks and large distributors, typically, profile their customers and decide on an appropriate asset allocation, before offering advice or ideas on where they should invest their monies. Once the initial process is completed, follow-up meetings are done with clients to review all investments (portfolio) and decide on new investments, redemptions and/or top-ups.

How long, on an average, does it take to make a sale?

The sales process takes a few weeks longer for first-time investors as compared to existing mutual fund investors. The sales process for first-time investors in equity funds is longer as compared to that in fixed-income funds.

What is the paperwork at the point of sale?

The paperwork at the point of sale includes filling up the KYC form if it's a first-time investor and obtaining the required documents. The documents are a copy of the PAN card and/or other documents for an identity check, as well as documents to aid address checks. In addition, an application form for the fund(s) where investments are being made needs to be filled up and a cheque for the amount to be invested given. The cheque and application form are forwarded to the registrar/mutual fund office, where

the applications are processed, while the KYC form goes to CVL for processing. Existing investors who have completed the KYC check beforehand are required only to fill in the fund application form.

Is there a customer-profiling process in place?

Most banks and large non-bank distributors go through a consumer-profiling process. The process and form varies from distributor to distributor.

Are costs/fees/other expenses disclosed at the point of sale?

Given the new Sebi regulation, mutual fund distributors are now starting to disclose commissions, including trail to the customer. We are given to understand that some follow a written process, while others make a verbal disclosure.

Is there a disclosure to the customer of the risk the product carries?

All distributors share a copy of the KIM at the minimum with their customer. This carries details of all risk factors and necessary disclaimers as prescribed by Sebi.

Is there a product description that documents the key features of the product?

In the case of banks, they produce appropriate literature that helps compare various funds on offer. In the case of other distributors, the sales material provided by the fund house is typically used. The KIM also carries details of the product.

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

India is a very nascent market. It is also complex in terms of its structure. Awareness levels differ across various cities and towns. A few suggestions that would go a long way in protecting the interests of investors are outlined two questions later.

Do you think a set of regulations is needed for retail financial intermediaries?

Regulating distributors across all financial products sold to retail customers to ensure accountability is a pre-requisite for a robust distribution process and a key need of the hour. The next question offers

suggestions on distinguishing an execution-only service from advice. In cases where advice is offered, it is recommended that the advisor follows a more structured sales process, where customer profiling and disclosure of fees charged and/or earned by way of the sale are made upfront in the process. In addition, it would be helpful if some simple steps of financial planning are followed as well.

If yes, how should it look?

Recommendation 1: Establish common regulation for all financial intermediaries.

In order to ensure that retail investors are provided with the necessary information that makes them aware of the products available, the right tools to make a choice among products and protection in the event that such standards are not followed, it is important that a common regulation for financial intermediaries be issued.

Such a regulation could set out minimum distribution standards to be followed by an advisor or anyone by whatever name called when selling to retail customers. It could be financial investment-oriented products, including (but not limited to) mutual funds, investment-oriented insurance products like Ulips, bonds and debentures, equities, portfolio management schemes, structured products and company fixed deposits.

Recommendation 2: Enhance the professionalism of advisors.

We believe it is reasonable for consumers to expect their financial advisor to have a practising certificate, like a lawyer or an accountant. All individuals and organisations involved with selling financial products should be required to register themselves with a common regulatory body. All members of this body should be governed by a code of ethics, which mandates that the principles set out in the 'Guidelines for Financial Intermediaries' be followed, irrespective of the individual/organisation being a distributor or an advisor.

It may be sensible for the qualification structure to be organised in a way that requires those advising on more complex products to have a higher level of

qualifications. So, a tiered system of qualifications for advisors, coupled with continuing education requirements for advisors, may be considered.

Recommendation 3: Establish a disclosure template.

There are a number of ways to legislate to improve the situation for retail consumers. These range from the direct and very interventionist to those that rely more on improved market practices and principle-based regulation. A number of options could be discussed. However, we believe that improved disclosure is most likely to offer regulators a mechanism to achieve a better outcome for consumers.

We would see disclosure as focusing more on improved market practices and principle-based regulation end of the spectrum, although there are other more direct and interventionist approaches that can be envisaged. It would be helpful if the disclosure template covered description of the product, status of the distributor (advisor, underwriter, stockbroker), commission charged to the customer and overall commission earned on the product.

Recommendation 4: Embed a disclosure template at the front-end of the sales/advice process.

It is critical to understand that if disclosure is going to be the main regulatory tool to empower consumers, it needs to be embedded in the sales/advice processes. It should take an upfront role: intermediaries should be required to follow a disclosure template so that disclosures drive the process instead of being relegated to the status of administration at the end of the sales/advice processes.

Too often it is possible to relegate disclosures to the point in the sales process where they become ineffective. If disclosures are to be the main regulatory tool, it is important that consumers have the full range of sales/advice options explained to them, even if some/all of these options are not available from the supplier that the customer has initially chosen. In other words, the consumer should be told whether the advisor is advising from a limited suite of in-house products or reviewing the entire market.

Recommendation 5: Provide clarity on the nature of the service offered.

When consumers turn to advisors and other intermediaries for assistance, there can be a lack of clarity about the nature of that service. Even before a fact-find begins or enquiries are made on product suitability, the consumer should be clear about which side of the fence the intermediary is sitting on and whose agenda is driving the relationship. Is the intermediary acting as the agent of the consumer or as the agent of the product provider?

This question is important because it sets the agenda for the basis of the relationship between the intermediary and the consumer. An intermediary offering assistance in helping to select from a limited family of in-house products should be regarded as a salesperson and its recommendation should be treated as a sales recommendation. An intermediary looking at the entire market on behalf of the client, carrying out a full fact-find, should be regarded as an advisor and the recommendation as advice.

This is not just a question of semantics. It is vital for the consumer to understand whether the intermediary is acting for her or on behalf of the product provider. This has to be supported by transparency, expressed in very simple terms, around the remuneration that the advisor and the advisor's company will receive such that, in the case of advice, a customer can have a very high degree of confidence that no conflict of interest exists. If the intermediary is working as an agent of the client, the starting point is what works for the client. That is unlikely to be constrained by a product range or a specific company's business priorities.

Recommendation 6: Promote transparency around competing products through a Key Features Document.

There should be a clear benchmark of the standard for mandatory disclosures—a Key Features Document—across all competing retail investment or savings products. This will provide a harmonised format, facilitating comparisons across all products available to a retail investor, including (but not limited to) mutual funds, insurance products, company deposits and structured banking products.

Recommendation 7: Promote transparency around the cost of advice and cost of distribution.

Consumers should be able to distinguish the cost of the product from the cost of advice. This will empower consumers to assess the value-for-money of the advice separately from the value-for-money analysis of the product, and make meaningful comparisons. Without this information, consumers are not in a position to make informed decisions—and therefore, they cannot become a strong economic force in the market.

Further, for investment products that have some element of capital protection or insurance (for example, Ulips), the cost of the unit should be segregated from the cost of insurance. It should be made clear to the customer as to how much of the cost will go towards upfront and ongoing commissions, how much towards investment and how much towards insurance.

Recommendation 8: Know your customer to be made mandatory.

Make it a regulatory requirement for advisors to know their customers and understand their risk profile/appetite. It should also be made mandatory for the advisor to make customers aware that their capital could be at risk.

Recommendation 9: Choice to be made available to retail customers on all long-term savings products to allow them to select what works best for them.

A key point to note is that all the above arguments may or may not work when choice is not available to consumers on long-term savings. A good example of such lack of choice is apparent in the case of Ulips and other such investment-oriented insurance products, as well as in the case of pensions. When a customer buys a Ulip from an insurance company today, it does not provide her the ability to choose her investment manager, as in other markets. She cannot choose her manager/product with a track-record, placing her at an disadvantage.

Even in the case of the NPS, pension plans require a completely new investment capability to be created.

The benefits of scale of existing mutual funds are not being leveraged. In the interest of investors, the government and the regulators could consider allowing insurance companies and pension fund managers to appoint third-party managers with a track-record and/or bundle existing units with a track-record within the product.

This would make it an open architecture regime. It will also provide the customer with choice, and facilitate better disclosures, as the underlying units would have to follow mutual fund disclosure requirements. Over time, the cost of such products for investors could come down on account of economies of scale. Even in the case of provident funds, the same lack of clarity exists.

Recommendation 10: Level-playing field across similar financial products.

In the current environment, we have varied standards, disclosure requirements and commission structures across investment products, though the risk associated with them is similar. A good example of this is that units of mutual funds follow different standards—perhaps more exhaustive disclosure standards—than units of Ulips or pension plans. This is in spite of the fact that all three invest in the capital market and are therefore subject to similar market risks, and are sold to the same retail customer. Creating a level-playing field will ensure that customers are aware of what they are buying and the associated risks.

4. FTI (Franklin Templeton Asset Management)

What is the typical sales process you follow to sell your schemes to investors? Is it demand-pull or sales-push?

We follow a third party-led distribution model, wherein the distributor (banks/broker-dealers/IFAs) advises the client on the investment options available to them. From our side, we continuously update our partners on the various options available and the suitability of the same to their clients. With customers having limited knowledge of financial products in general, and mutual funds in particular, currently mutual fund sales in India are more sales-push than demand-pull.

How long, on an average, does it take to make a sale?

Given that we do not interact with investors, as mentioned above, we would not be able to give an accurate response to the question.

What is the paperwork at the point of sale? Is there a customer-profiling process in place?

Customer profiling is done at the distributor level (bank/broker-dealer/IFA) rather than at the manufacturer (mutual fund) level. At the manufacturer level, it is mandatory to complete the KYC process before accepting the investment.

Are costs/fees/other expenses disclosed at the point of sale?

Both the offer document and the KIM mention the costs/fees/other expenses a mutual fund can charge to a particular scheme. Sebi has already announced a regulation with effect from August 1, 2009, wherein there would be no entry load in mutual fund schemes and the investor would be required to share the commission earned from the mutual fund. In addition, the distributor is also free to charge the investor a mutually agreed fee for the services rendered.

Is there a disclosure to the customer of the risk the product carries?

Both the offer document and the KIM mention the risks associated with investing in mutual fund schemes.

Is there a product description that documents the key features of the product?

Apart from the KIM and the offer document, the fact sheet (published at monthly intervals) also carries all the key information of the schemes. In addition, we also print sales ideas (for distributors), product brochures and flyers, carrying the key features of the scheme.

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

With the vast population and a country the size of India, we need a distribution model with a presence in all parts of the country. We feel that banks

(especially public sector banks, including the Department of Post), broker-dealers and IFAs can play a vital role in reaching out to retail investors. We also need to look at technology (online platforms) to increase the reach of mutual funds in the country. In addition, we need to evolve a common operational platform for ease of transacting for investors who currently have to deal separately with different fund houses. Further, to protect the interests of the client, customer profiling should be made mandatory, based on which the distributor should provide financial advice to the client.

Do you think a set of regulations is needed for retail financial intermediaries?

Yes, a regulation governing financial advisors, covering all financial products under one platform, would help both investors and financial advisors. Apart from the above, at some stage, there is a need to have a certification course for intermediaries beyond the current Amfi and Irda exams. This course or examination would go beyond the existing scope and cover the entire financial-planning process.

If yes, how should it look?

As stated above, the regulatory structure should encompass all available financial and investment options. It should define and make profiling of customers (understanding their needs/goals, risk appetite, age, dependants, etc) mandatory before providing them financial advice/options.

5. Kotak Mahindra Asset Management Company

Yes, financial intermediaries have to be regulated. We have manufacturers being regulated, but not distributors, even when they are the ones in touch with clients and present a distinct possibility of mis-selling. The issue is: how does one regulate them?

We need to have a single regulation for all financial intermediaries. As the assets under management (AUM) of these distributors vary significantly, from a few lakh to crores of rupees, one may need a different way to monitor such intermediaries. There are about 3 million insurance-tied agents. How does one regulate them?

The only regulation a mutual fund distributor or an insurance agent is subject to is the test they take or the renewal that happens every few years. Since distributors are the last link, there has to be regulation here. As a first step, there has to be an open architecture for distribution, with the customer being the focus. This could also reduce the cost of distribution. Further, we need simpler products, especially in insurance. Complicated products could be offered only to qualified investors, the ones with larger amounts.

6. UTI Mutual Fund

What is the typical sales process you follow to sell your schemes to investors? Is it demand-pull or sales-push?

Mutual funds are predominantly sales-push products. However, there is demand-pull for certain categories of products like tax-saving schemes and NFOs. Mutual fund sales can take place through two routes: direct (through a fund's own offices and through the Internet) and indirect (through intermediaries like banks, post offices, distributors and IFAs).

Till August 1, 2009, the AMCs paid intermediaries a sales commission. This commission had two parts: upfront and trail. The upfront commission was paid only once, when the customer invested, and was in the range of 2.25-3 per cent of the investment amount. The trail commission is paid on an annual basis, and is around 0.40 per cent of the investment amount. After August 1, 2009, the intermediary and the investor will decide on the commission the investor is willing to pay to the intermediary for the services rendered.

Mutual funds predominantly sell equity and debt schemes. All schemes have an explicit 'investment objective' stated in the scheme information document (SID) and in the key information memorandum (KIM). The scheme objective determines the investment strategy of the fund. Whenever an AMC communicates a scheme to investors, either directly or through its intermediaries, it communicates the scheme objective and indicates the target group that is best suited to invest in this scheme.

The share of mutual funds in the gross household financial savings of the country is only 7.7 per cent, compared to 17.5 per cent of insurance (RBI annual report, 2007-08). One of the primary reasons for this is the significantly higher commission paid by insurance companies, as compared to mutual funds, to intermediaries. The other reason is the high marketing and advertising spends of insurance companies, which mutual funds cannot match due to the limit on expenses. Mutual funds need better investor education to drive home the fact that they play an important role in financial planning, and thereby make them a demand-pull product.

How long, on an average, does it take to make a sale?

The average time taken to make a sale varies for different products and options. For example, a systematic investment plan (SIP), which requires periodic and committed investment, needs at least four to five IFA interactions, over three weeks. For a lump-sum investment in an existing scheme, it may take around three to four visits over two weeks to close a sale.

What is the paperwork at the point of sale? Is there a customer-profiling process in place?

Yes. KYC (know your customer) provides the customer profiling. The application form submitted by the customer also provides insights into the customer's financials. The Amfi handbook and the Amfi exam (the mandatory exam mutual fund intermediaries need to pass) also cover the customer-profiling process.

Are costs/fees/other expenses disclosed at the point of sale?

Yes. Expenses and costs charged by a mutual fund are transparent, in accordance with Sebi guidelines, and disclosures are made. The expenses are mentioned explicitly in the SID and in the KIM-cum-application form, which is given to the investor at the time of investment.

Is there a disclosure to the customer of the risk the product carries?

Yes. The scheme-specific risk factors are mentioned

in the KIM and general risk factors are mentioned in the SID.

Is there a product description that documents the key features of the product?

Yes. Every scheme has an explicit 'investment objective', which gives the investment strategy, the sectors where the fund will invest and the asset allocation—that is, how much it will invest in different categories (debt, equity, mid cap, large cap, etc). The risk profile of these categories is also mentioned. The investment objective and the asset allocation are given in the KIM and the SID. The regulator has mandated that a scheme's investment should be made as per its investment objective.

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

Financial planners should take into account the lifecycle needs of an investor and her financial goals, and suggest an optimal asset allocation for her in tune with her needs. Based on the asset allocation prescribed, suitable products matching her risk-return profile should be suggested, taking into account her tax planning.

Thus, financial planners need to be doctors rather than chemists (distributors). Financial planners will perform the role of prescribing medicines and indicating the acceptable range of brands for that medicine. Similarly, based on the customer's requirements, they should recommend to her a category/product from mutual funds, insurance or pension plans. They can then give a shortlist of funds where she can invest. She pays the financial planners a fee based on the services rendered.

Today, unfortunately, when she needs an investment, a distributor sells her a Ulip, rather than a mutual fund, as insurance commissions are higher. This is despite the fact that a Ulip is likely to return less than a mutual fund in the long run. But if the distributor got a fixed commission from the investor, rather than from the insurance company or the mutual fund, the distributor will suggest a product that works best for the investor.

Sebi, the regulator for mutual funds, has brought in regulations that ban mutual funds from paying upfront commissions to distributors. This will remove the bias a distributor has for any particular fund house. Similar regulations need to be introduced in insurance too. This will remove both the intra-industry bias and the inter-industry bias a distributor might have.

This has been done by the Financial Services Authority (FSA) in the UK, which plans to ban mutual funds, insurance and pension funds from paying upfront commissions to distributors. This is to be implemented by 2012. Newspaper reports also mention that the US Securities and Exchange Commission is contemplating similar moves. Financial planners should be trained and well-equipped to provide investment advisory services. There should be a minimum educational qualification requirement for them and they should be required to pass industry exams. There should also be a regular requirement of appearing for refresher exams.

Do you think a set of regulations is needed for retail financial intermediaries?

Although industry bodies like Amfi have put in place a code of conduct for intermediaries of mutual funds and these have been recommended by Sebi (Mutual Funds) Regulations, the regulator has not set any specific regulations. Therefore, there is a need for specific regulations across the financial sector, including mutual funds, insurance, banks, primary and secondary markets, and others.

If yes, how should it look?

There should be similar regulations for financial advisors selling similar financial products in mutual funds, pensions and insurance. For example, mutual fund schemes and Ulips; or mutual fund retirement plans, insurance retirement plans and the New Pension System (NPS).

There should be a hierarchy of agencies—for example, corporate, individual, banks. There should be separate regulations for qualifications, capital/net worth requirements, fees and penalties, training requirement for each category. Regulations should mandate the ceiling for fees and other expenses that

can be paid to distributors, by the customer and by the company. There should be a strict penalty clause for default. Periodic renewal should be made compulsory.

A3.2 Life Insurance Companies

1. Birla Sun Life Insurance

What is the typical sales process you follow to sell your plans to consumers? Is it demand-pull or sales-push?

Sales-push.

How long, on an average, does it take to make a sale?

Typically, insurance products don't see an across-the-counter closure. They may need follow-up. Thus, a closure could take more than a week.

What is the paperwork at the point of sale?

Needs analyser and brochure.

Is there a customer-profiling process in place?

Need analyser, fact finder and sales presenter.

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

The key intent should be to ensure consumers get the message clearly. To ensure that, we should look at simplified communication, better training processes, clearer benefit illustrations and a customer-on-board process, which takes customers through the details of the choices made by them.

Do you think a set of regulations is needed for retail financial intermediaries?

Yes. Anything that help brings greater transparency, convenience and quality to the distribution process, while keeping it cost-effective, is welcome.

If yes, how should it look?

(Sellers and advisors) must be made to renew their license periodically. They must run the risk of suspension or loss of license if consumer complaints are recorded against them. Also, a common call-centre run by the industry should exist to record

consumer complaints; further, if the complaints are not being attended to by the company, the call centre should address them.

2. HDFC Standard Life Insurance

What is the typical sales process you follow to sell your plans to consumers? Is it demand-pull or sales-push?

We follow a needs-based selling process, which is a combination of sales-push and demand-pull. Current data indicates that the penetration of life insurance in India is very low compared with some developed markets. The reason is a lack of awareness of benefits and low inclination of potential clients to build long-term financial assets through long-term financial products.

Advertising and educational campaigns bring about some awareness on the benefits and options available under life insurance and pensions. A sales push helps reach out to clients who don't overtly express their willingness to buy an insurance plan or don't reach out to an insurance company to seek solutions for their needs. Once clients are approached, the process seeks to stimulate the needs recognition (present and future) of the client, and helps them reach a decision based on their needs. Hence, push helps in reaching out to clients more proactively, and then a needs-based selling process helps create demand at the point of client interface.

How long, on an average, does it take to make a sale?

On an average, it takes four to five meetings with a client to close a sale. First meeting: we introduce the services and solutions we provide, our approach, how it will benefit the customer and establish credibility. Second meeting: we analyse the needs of the customer, help them prioritise, explain how we can help and the solutions we can offer. Third meeting: present the solution. Fourth meeting: closure of the sales process. Fifth meeting: documentation.

The above does not cover any customer interactions, post-sales closure with clients such as during medical examination, explaining policy provisions and self-service facilities, and so on.

What is the paperwork at the point of sale? Is there a customer-profiling process in place?

Yes.

Are costs/fees/other expenses disclosed at the point of sale?

The charges to be borne by the client (which includes the commission paid to the agent) are disclosed and the impact is explained. This is done through a sales aid handed over to the client and a benefits illustration provided on the company's letterhead. The benefit illustrations provided by us also indicates the total reduction in yield (RIY) the client will suffer over the life of the policy on account of the various charges. In fact, if the RIY happens to exceed 4 per cent, the illustration carries a warning for the customer. We do not issue a benefit illustration if the RIY exceeds the rate assumed (6 per cent) in the illustration.

The client who has submitted a proposal for a life insurance policy also receives a welcome call from us. We, inter alia, confirm whether the charges and policy provisions have been explained, and check the client's understanding of the same.

Commissions are not specifically required to be disclosed to clients. As indicated above, the total charges being borne by the client (including commission) are disclosed and explained. This is also to protect against the prevalent illegal practice of demanding commission rebates, as happens in other financial products (where there is no regulatory restriction on rebating).

Is there a disclosure to the customer of the risk that the product carries?

Various risks inherent in the products are explained to clients in two ways: through the benefits illustration and through the sales aids. Risks such as investment risks, market risks and exclusions in the policy are explained in detail.

Is there a product description that documents the key features of the product?

The sales aids provides details of the key features, charges, risks and benefits of the product.

What are your suggestions for a robust distribution

process that takes into account the interests of the customer?

The distribution process will depend on the kind of financial solution being offered to the client. We could broadly segregate this into financial products that require advice and products that do not require advice. The distribution process should take this into account. The essential elements that would determine the robustness of the distribution process would be: professional standards for the distributor/advisor, quality of advice offered to the client, disclosure requirements (charges, commissions), and responsibility for good advice.

Do you think a set of regulations is needed for retail financial intermediaries?

Yes. The regulations governing financial advisors should essentially focus on minimum professional qualifications and continuing professional development. The need to improve financial literacy in India is well-accepted. This would be possible only with a professional distribution force.

Given the developments in the life insurance, pension and mutual fund industries, now may be an appropriate time to consider a Professional Standards Committee in India—maybe as a Board set up under the aegis of the High-Level Coordination Committee (HLCC) of the RBI, Irda, Sebi and PFRDA—to look into professional requirements for advisors/distributors in all segments of the financial markets.

It is apparent that higher professional standards will result in higher intermediation costs. This needs to be taken into account to ensure that we do not cut out a large part of the customer base that may not be able to afford fully-priced advice.

In a related context, the Financial Services Authority, UK, is contemplating the establishment of an independent Professional Standards Board to set up and implement a higher and consistent standard for the industry in the area of qualifications, ethics and continuing professional development. This is being done as part of the Retail Distribution Review being carried out in the UK and is to be implemented by 2012.

If yes, how should it look?

The regulatory structure should cover, among other things, the following: professional standards, informed advice, disclosure requirements, financial responsibility (capital, liabilities) and code of conduct.

3. ICICI Prudential Life Insurance Company**What is the typical sales process you follow to sell your plans to investors? Is it demand-pull or sales-push?**

The life insurance sales process in India has traditionally been a selling proposition from the advisor (agent). This is slowly evolving through the selling transaction between the consumer and the advisor, and we are observing a definite shift to actual buying from the consumer's end.

With the number of products available to the consumer growing exponentially, there is a slow but clear transition in the advisor's approach to selling products. Advisors are moving away from a traditional tax-saving proposition, which was clearly for the short-term, to a needs-based approach. This approach is based on the individual's human life value and her financial goals, be it education for a child, wealth creation or pension.

Also, there are new emerging channels such as the Internet, wherein the customer, on her own will, opts to buy online without the help of an intermediary. While the share of such sales is currently low, it is expected to become a key buying option for consumers in times to come. This will be relevant especially for simpler and low-service products, where awareness on their need and benefits are both growing at a high pace.

How long, on an average, does it take to make a sale?

It is difficult to put a number since there are several inter-dependencies.

Advisor pedigree: Newer advisors, typically, spend three to four months, sometimes more, depending on their skills, time invested and speed of the customer's buying decision. Such advisors are generally assisted by managers from the insurance company, who

accompany them on their sales calls. Advisors who have an experience of more than 9-12 months in offering this service generally take lesser time—say, one to two months.

Type of consumer: The greater the number of products a consumer is exposed to, the longer will be the buying decision. The consumer would want to make comparisons to ensure the highest value for her investments and the best fit for her needs.

Season: Buying happens faster towards the last quarter of the financial year, where the consumer may not want to let go of the tax benefit that she could derive for the fiscal.

External factors: Due to a large number of products being market-linked, factors such as interest rates, savings rates (affordability) and the state of the market also have a bearing on the consumer's buying decision.

Lifelong advisors: Generally, most of the experienced and long-term advisors are in touch with customers throughout their lives. A constant dialogue happens between them on financial planning. In such cases, the planning cycle is longer and keeps evolving continuously.

What is the paperwork at the point of sale? Is there a customer-profiling process in place?

Yes. The Client Profiler is the recommended and practised tool that collates all information about the consumer before the advisor shares her advice. We are also utilising a more evolved tool (Life Planner) to capture relevant client data.

Are costs/fees/other expenses disclosed at the point of sale?

Yes. The electronic benefit illustration (EBI) clearly describes, calculates and shows the impact of all charges that a product may carry. This is important to ensure that the consumer is clear on the returns and benefits of her policy.

Is there a disclosure to the customer of the risk that the product carries?

Yes. Besides the product brochure, the EBI clearly

mentions the risks that are associated with the product, if applicable. In case of market-linked products, the brochures carry a clear message, marked in bold, stating that the investment risk is borne by the policyholder.

Is there a product description that documents the key features of the product?

Yes. The product description is done at two stages: in the product brochure at the time of sale and in the Key Features Document as part of the policy kit.

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

Life insurance companies are playing a big role in this. Probably the most important aspect of ensuring better consumer interest is training for the channel constituents. Depending on the product that is sold and the skill set of the advisor, it is important to have a segmented training architecture that promotes the approach of selling based on the consumer's financial needs over her lifetime, combined with the element of life cover based on human life value.

To gain consumer confidence, ensuring complete transparency in the product (charges, benefits, surrender value, flexibility) and the process (medical check-up requirements) at the time of sale is a critical requirement. This comes with constant training and a robust sales process. There has been a clear evolution (read improvement) in the quality of such transparency in the life insurance sales process.

To make complex products easier to understand for the consumer, life insurance advisors have evolved into using some new generation tools similar to what their counterparts worldwide are doing. The Life Planner and the Client Profiler have had tremendous impact in gaining the customer's confidence, improving the quality of the sale and also reducing the period of the buying cycle.

Selling a life insurance policy requires not only product knowledge, but also an industry perspective, and an understanding of the financial markets and the products available. At ICICI Prudential Life, we've achieved this by encouraging our advisors to

opt for both national and international certification courses such as NCFM (NSE's Certification in Financial Markets) and Life Underwriter Training Council Fellow (LUTCF, offered by the American College). Currently, we have around 400 of our top advisors who have successfully cleared the LUTCF certification and 4,700 advisors who have achieved the NCFM distinction.

In addition to all this, the consumer can avail of the free-look offer, wherein she is free to terminate the insurance contract within 15 days of receiving the policy document should she feel that it is not as per her expectation/requirement. This option is communicated to the consumer and helps ensure advisors follow the recommended sales process.

Do you think a set of regulations is needed for retail financial intermediaries?

At ICICI Prudential Life, we've successfully used the training approach, both internal and external, to achieve this objective. The load on the product, we feel, is a market-driven factor. As has happened in the past, it will continue to evolve with the changing dynamics of the market.

If yes, how should it look?

The training approach is recommended since it has worked well for us. We feel that a robust training programme for our advisors, a transparent sales process, and clear and transparent communication to the customer (both pre- and post-sales) takes care of all possible needs. We feel that continuing to focus on these will ensure that interests of all stakeholders are taken care of.

4. MetLife India Insurance

What is the typical sales process you follow to sell your scheme to investors? Is it demand-pull or sales-push?

It is a combination of market demand and sales recommendation. We promote a customised, need-based selling culture, through a combination of tools and training provided to our sales staff. In our sales process, the primary intent is to understand the needs of a customer based on age, life stage, financial goals and security needs. Once the needs analysis is

complete, the right product from the product suite is recommended to the customer.

How long, on an average, does it take to make a sale?

A typical sales process involves needs analysis, discussion on two to three suitable product options and completion of requirements/documentation. This may take 2-15 days. The process could be further extended due to medical tests.

Are costs/fees/other expenses disclosed at the point of sale?

It is part of the benefits illustration, which is shared with the customer before the finalisation of the contract. This document has to be signed by the customer and is attached with the application form. A copy of the signed illustration is also sent for customer records, along with the policy bond.

Is there a disclosure to the customer of the risk that the product carries?

These scenarios are given in the benefits illustration and have been standardised by the regulator. Regulations require all sales material of market-linked products to prominently disclose in the heading that, in this policy, the investment risk is borne by the policyholder.

Is there a product description that documents the key features of the product?

Besides the detailed product description, and terms and conditions, sent along with the policy bond, there is a welcome letter mentioning the key details of the contract. This summarises the benefits that the customer has bought.

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

Do you think a set of regulations is needed for retail financial intermediaries? If yes, how should it look?

Our suggestions:

- Customer education and general awareness about insurance and other financial products has to be improved.

- Sharing of financial advisor database with customers should be enabled so that financial advisor details are available in a transparent manner.
- Basis of rating/certification (in addition to licensing) of financial advisors, their past records and complaints on mis-selling should be publicly available to consumers.
- Frequent shifting of financial advisors between competitors should be streamlined and discouraged.
- IFAs who sell products from multiple companies and across financial categories should be encouraged.

A3.3 General Insurance Companies

1. HDFC ERGO General Insurance Company

What is the typical sales process you follow to sell your scheme to investors? Is it demand-pull or sales-push?

General insurance products are a mix of pull and push products. There are a set of products that are mandatory in nature, like motor third-party insurance. A large number of loan-based products again are mandated, though that requirement is not necessarily enforced. Products on the accident and health side are push products, where intermediation plays a major role in effecting the sale.

How long, on an average, does it take to make a sale?

The sales process depends on the product and the complexity of the risk to be covered. Typically, corporate policies are complex and time-consuming since they involve risk inspection, structuring of coverage and arranging for reinsurance from the international market. SME and retail policies, which are pre-underwritten, can be sold over-the-counter, while some that may require medical tests or pre-inspection may take a couple of days.

The trend is to try and move towards instant policies for retail. The sales process for retail products is simple. It comprises filling up and signing of a proposal,

calculation of premium/quotation, acceptance of terms and payment of premium, and issuance of a protection note.

What is the paperwork at the point of sale? Is there a customer-profiling process in place?

The general insurance business, for long, had been highly regulated, leaving little scope for differentiated products and pricing. It's only last year that the business has been completely deregulated. Not many companies have started profile-based pricing. Our company uses pricing based on age and profession for the motor business. For the accident and health business, the profiling is done based on age, income, profession and medical history.

Are costs/fees/other expenses disclosed at the point of sale?

Policies in the general insurance industry do not have a savings component or a refund component. Therefore, a composite premium is charged, which is the cost of providing the cover. There is no break-up of claims cost, operating expenses or other cost elements. The total premium charged is shown on the face of the policy, including mandatory taxes.

Is there a disclosure to the customer of the risk that the product carries?

General insurance products are not investment-linked products. They cover the risks to life and property against stated perils, which are mentioned in the policy copy. All exclusions are part of the contract and detailed therein.

Is there a product description that documents the key features of the product?

Standard sales material includes product brochures, which captures the key features of the proposed insurance cover. All the sales material has to be approved by the regulator before it can be used in the market.

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

The penetration of non-life insurance stands at 0.6 per cent of GDP. To give impetus to the industry, Irda had set up the Govardhan Committee

to review the distribution architecture of the industry and suggest suitable modifications. The Govardhan Committee submitted its report in April 2008 and the same is under review by Irda. The report has focused on improving distribution reach of insurance, both in urban and rural India, with a view to increasing insurance penetration, while safeguarding the interests of the policyholder.

Do you think a set of regulations is needed for retail financial intermediaries? If yes, how should it look?

The role of insurance intermediaries is well-defined and regulated in the insurance industry. There are rules for qualification, training and licensing of these intermediaries. The Govardhan Committee report has recommended easing of regulations in terms of intermediaries. It has also suggested another category of retail agents to sell over-the-counter retail products.

2. Reliance General Insurance Company

What is the typical sales process you follow to sell your policies to investors? Is it demand-pull or sales-push?

For product lines like motor and health, it is a demand-pull process. For other products like package policies (householder, shopkeeper), we adopt a sales-push process through awareness campaigns. The closure of the sale is done through our sales managers or agents.

How long, on an average, does it take to make a sale?

On lead generation and submission of proposal/related documents, it takes five to eight days, depending on the product type and underwriting norms.

What is the paperwork at the point of sale? Is there a customer-profiling process in place?

We don't do any generic customer-profiling, but risk-related details (age/number of family members) for underwriting purpose are captured in respective proposal forms by product.

Are costs/fees/other expenses disclosed at the point of sale?

As per Irda norms, we do not charge anything apart from premium (including applicable taxes). There are no related disclosures.

Is there a disclosure to the customer of the risk that the product carries?

On receipt of proposal with premium, we issue a policy schedule with related policy wordings. This describes all terms, inclusions and exclusions for the risk covered.

Is there a product description that documents the key features of the product?

Pre-sales/sales-related product brochures are available.

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

General insurance is under-penetrated in India (0.6 per cent of GDP) as compared to other financial products and services. Towards this end, industry players and the regulator can work together to educate and spread awareness among customers. Alternative channels of distribution, which provide greater transparency and reach to customers, need to be encouraged. For the retail segment, industry forums need to work with the regulator to review eligibility criteria for individual and corporate agents.

Do you think a set of regulations is needed for retail financial intermediaries?

In general insurance, Irda has strict existing regulations that cover this aspect.

If yes, how should it look?

There are several different regulators who govern varied financial services providers. A unified body covering the varied financial services providers and distributors across product lines will ultimately simplify the customer interaction process and lead to better service levels.

3. Star Health & Allied Insurance

What is the typical sales process you follow to sell your policies to investors? Is it demand-pull or sales-push?

Sales-push at the lower age band and demand-pull at the higher age band.

How long, on an average, does it take to make a sale?

Two to three visits per customer. In terms of time, 15-21 days.

What is the paperwork at the point of sale? Is there a customer-profiling process in place?

Yes, there is a detailed proposal form. This seeks information about the customer, his/her occupation, health status and family health history. All this is obtained prior to the sale.

Are costs/fees/other expenses disclosed at the point of sale?

The premium is disclosed in the brochure given to the customer before sale. But information about fees and other remuneration are generally not disclosed. Where the customer asks for details of fees/remuneration paid to intermediaries, it is provided to them.

Is there a disclosure to the customer of the risk that the product carries?

The information about important exclusions under the policy is provided in the brochure.

Is there a product description that documents the key features of the product?

Yes. Product features and benefits are provided in the brochure.

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

Those who have professional qualifications (like chartered accountants, chartered financial analysts and qualified mutual fund product marketers) should be exempt from the mandatory qualifying examination. The nomenclature of 'agent' should be replaced by 'advisor' (the term 'agent' generally tends to get obscured and misunderstood as commission agent). Under bancassurance, one bank can market products of different insurance companies. A broker may be permitted to design company-specific products that are simple and can be offered off the shelf.

Do you think a set of regulations is needed for retail financial intermediaries? If yes, how should it look?

Yes. The existing regulations must be simplified. The present cap on intermediation fees should be removed and should be left to the discretion of the companies. The overall solvency margin and other provisions of the Insurance Act relating to management expenses will be sufficient to take care of the financial health of an insurance company.

A3.4 Banks

1. Axis Bank

Banks in India have emerged, over the last few years, as trusted financial intermediaries and have helped take financial solutions to customers in cities beyond the top 20. We know that, across the world, sellers of financial products, whether individuals or others, are regulated by a common set of rules. It is good there is a move in India to do the same. We welcome this move and are sure that it would lead to better governance all around.

2. Citibank

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

There is a need to homogenise regulation across the insurance, mutual fund and pension sectors to eliminate certain inconsistencies that exist across product lines. Investors should get the same good feeling on disclosures and sales processes, irrespective of which product they purchase. A nodal regulatory agency is needed to ensure consistency in disclosure practices on products under the purview of different regulators. If it is not immediately possible to constitute such an agency, as a starting point, Sebi and Irda can work together in terms of formulating consistent practices.

Do you think a set of regulations is needed for retail financial intermediaries?

In order to have a robust distribution process that takes into account the interests of the customer, the following needs to be done:

- Regulators should ensure that for every product sold in the market, due diligence is done and there is a regulatory filing through which each product goes through before being sold to the public. There is need for uniformity in filing and use of products across the space of investments and insurance. Mutual funds and insurance go through the Sebi/Irda filing and approval process. However, portfolio management products can be sold without a formal approval. There is also a need for a unified product approval process across regulators.
- Disclosure norms, including risks, charges and pre-term penalties, need to be uniformly disclosed to the investor. The insurance illustration is a detailed document that discloses all charges, minimum benefit values and surrender charges. Similar norms may be considered when applied to mutual funds, structured products and PMS. Such disclosures, with a mandate that the investor signs on a piece of paper akin to insurance, should become the norm for mutual funds, PMS and structured products.
- Intermediaries need to adopt the AML and KYC practices that the RBI has mandated for banks and move towards a standard codification in this area as well.

If yes, how should it look?

- A lot needs to be done on financial advisor training:
- Regulators should ensure certification and registration with a centralised body for good administration.
- In India, for an individual to sell investment products, she has to be Amfi-licensed. An attempt could be made to assimilate best practices from other developed markets, and enhance the rigour of the Amfi training and licensing process. A regulatory framework could be created to ensure an appropriate level of quality assurance in the entire certification process.

- There should be a sales process set up for non-depository products that looks at needs analysis of an individual, dovetails the same with the profile of the individual, creates an asset allocation model, and then recommends a product or suite of products commensurate with customer sophistication.
- In addition to disclosure norms and training of advisors, there should be an approach towards a uniform code of conduct by way of suitability practices, which profile customer needs and sophistication in relation to products being sold. As a further point, suitable guidance needs to be formulated for incentive schemes of financial advisors. Citi can help present a model that can be used to define a standard for the industry.

3. Dhanlakshmi Bank

What is the typical sales process you follow to sell your scheme to investors? Is it demand-pull or sales-push?

The bank's products are designed keeping in mind the needs and demands of the customer. While the design is primarily focused on customer needs, the bank does have a specialised team of sales executives to convert the sales.

How long, on an average, does it take to make a sale?

It varies from product to product. A savings bank account, for instance, may take one to two days, while a current account may even take up to a few weeks. Similarly, an insurance deal may take two to three calls, spread over five to seven days.

What is the paperwork at the point of sale? Is there a customer-profiling process in place?

Yes, basic customer profiling is done.

Are costs/fees/other expenses disclosed at the point of sale?

Yes, the officials inform the basic fees/expense structure to the customer. The product brochure carries the same.

Is there a disclosure to the customer of the risk that the product carries?

Yes. The customer is told that the returns in a unit-linked product are indicative and are subject to market fluctuations. Customers get the detailed product update along with the policy document. If they are unsatisfied, they have the option to return the same within 15 days and take the full refund.

Is there a product description that documents the key features of the product?

Yes. All insurance products need to be sold only after explaining the illustration. As per the guidelines, the illustrations are made at 6 per cent and 10 per cent returns only.

Your suggestions on a robust distribution process that takes into account the interests of the customer?

Offer a better product, with transparency.

Do you think a set of regulations is needed for retail financial intermediaries?

Yes.

If yes, how should it look?

Firstly, pass-backs, which are quite common with some agents of large companies, need to be checked. Secondly, uniform charges needs to be collected from the investor. In mutual funds, entry load charged by the fund house has been abolished, and the regulator wants the distributor to recover the fees from the customer separately. So, if a bank wants to charge 2 per cent from the investor, there are other advisors in the market who are ready to do the same business at 1 per cent, even 0.50 per cent.

4. HDFC Bank

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

A robust distribution process must not focus on a one-size-fits-all advisory approach. Rather, it must revolve around hybrid models, varying from an entry-level model for an investor beginning the investment process to a high-end advisory model for investors who use different products regularly. The objective

should be to ensure that a wider group of customers use investment products efficiently.

From a customer perspective:

- The distribution process should target new customers constantly so that more and more people gain from the benefits of investment.
- Guidance levels for customers should be fair, in line with the needs of the customer segment and their understanding.
- Costs should be transparent.
- Process should validate the need for the investment.

A robust distribution system, in our view, should have two components:

1. A distribution model based on the concept of a supermarket, where customers can come in and select products from the various options available, in an environment of basic financial awareness.

- If we have 1,500 branches across 500 cities, then a customer should be able to walk into any branch and choose from a wide number of offerings available.
- The objective of the model is to ensure that the distributor creates reach for manufacturers, creates financial literacy on a generalised basis for investors (since it is unlikely that customers actually understand the basics of investments uniformly), and offers them options in line with basic products structured around general needs.
- These could be like an SIP for long-term mutual fund investors, or a children's plan for child needs, or a pension plan for a retirement need.
- From the customers' perspective, the challenge is to ensure that there is proper training and support given to the front-end sales staff around a basic level of financial literacy that is created. Product documents and other literature should carry enough information for customers to decide on the usefulness of the product and make a decision.
- This segment is the key to reach a constantly

expanding set of new investors. When they start, they would need basic products to inculcate the habit of investing in forms around systematic investing, covers or basic needs.

2. An advisory model that targets a base of investors with different forms of advice to ensure that there is asset allocation, profiling, selection of suitable products, research support, monitoring of portfolio and ongoing guidance. Typically, these investors are financially more literate, and constantly evaluate options and monitor performance.

Such a system constantly expands the base of new investors into investment tools good for them. And, as they evolve, move them into systematic methods of advise. The key factors for success in this model are:

- Strong support from manufacturers to ensure that reach of a network is covered.
- Product evolution and training on a constant basis so that products aligned to the needs of investors are designed (basic for distribution model and evolved for advisory model).
- Environment of financial understanding (basic for distribution model and evolved for advisory model).
- Recognition that the distribution model carries a heavy cost of infrastructure creation. This involves a basic cost built into the product, which is something not understood by customers (since their awareness of products, as also interest in good products, is still at a nascent stage in India). In distribution, it involves creating reach; in advice, it involves creating the platform and method of advice.
- A distribution model can easily shrink in size if the cost of infrastructure is not factored into manufacturer products at a logical level in comparison to competing banking and investment products.

A distribution model should have a blanket around financial literacy. The external environment of financial literacy should be such that concepts

like bank deposits are embedded on every customer, irrespective of the distributor. A high level of involvement is needed from a joint panel of distributors, regulators, manufacturers and customers to generate ongoing financial literacy externally, as well as internally within organisations. Initiate the involvement at the school level so that this is an evolving process.

Do you think a set of regulations is needed for retail financial intermediaries?

Regulations are needed, though the form and method would need to differ depending on the segment being considered.

If yes, how should it look?

i. For channels that support distribution, basic, entry-level regulations around:

- Products like mutual funds and insurance
- Financial planning

It should be renewed every three years.

ii. For channels that support advice:

- Advisor-based regulations covering all aspects
- Refreshers every year

iii. In the distribution model, manufacturer- and distributor-based checking models should be built:

- For order validation
- Confirmation of sale through independent departments
- Audits of divisions involved in sale through independent parameters

iv. In the advisory models:

- Customer approvals on profiles
- Confirmation of complicated sales through independent departments and checking of individual customer files
- Confirmation of ongoing service quality through independent departments
- Advisor-level accountability mechanisms

5. SBI

The various entities that act as advisors to customers buying financial products and the type of risk the latter run are summarised in the table below.

Advisors	Risks involved
Broker	• High churn • Lack product knowledge
Agent	• Biased towards issuer (for high commission)
Dealer	• High transaction costs
FA/IFA [^]	• Push high-commission products
Media	• Biased information

[^] FA: Financial Advisors; IFA: Independent Financial Advisors

Clearly, the ideal situation is that buyers of financial products get a single-point advice for a fee. This will ensure there is no linkage between the financial intermediary with the seller/issuer in monetary terms. Reaching this goal, however, will take time. Meanwhile, the following broad plan can be adopted to protect investors.

Investor education by regulatory bodies and investment intermediaries on various issues relating to investors' interests.

a. For example, RBI's prescription on disclosure of charges on bank services and regulations for recovery agents have both proven successful. We can emulate the same.

b. Various banks are running campaigns to educate customers—for example, advertisement series run by SBI and ICICI Bank. Sellers of all financial products can be mandated to emulate the same. The institution of an award for excellence in running such campaigns could have the desired impact in making such campaigns meaningful.

c. In the immediate term, Sebi can start an education series covering:

- i. Taxation of various asset classes.
- ii. Asset class management for a given risk profile.
- iii. Basic understanding of disclosures and disclaimers.

A long-term goal should, however, be to mandate a qualification and a code of conduct for a financial advisor. We may have to evaluate the agencies offering such qualifications and encourage the best among them to follow standards that would be evolved by investor protection bodies.

What makes a robust distribution process that takes into account interests of customers?

In dealing with the client, it is necessary for the financial intermediary and its sales personnel to clearly disclose the intermediary's specific role in the transaction so that the client is able to place the intermediary's participation in the proper context. The financial intermediary should disclose whether it is acting as a broker, dealer or agent. Each specific role has specific implications for the client:

- Broker: Merely matching a seller of instruments with a buyer
- Agent: Usually acting on behalf of the issuer. In that case, the intermediary's primary concern is the attainment of the issuer's objectives.
- Dealer: Strikes a deal between an issuer and a customer.

While potential conflict of interest is not assumed—that is, as dealer, the intermediary may have adverse information regarding the issuer of the securities; or as agent, the intermediary is perhaps more loyal to its principal—the client is nevertheless informed of the intermediary's capacity so as to make a better assessment of the investment transaction, and act accordingly.

In addition to clearly disclosing their role in the transaction, the following measures would ensure the distribution process takes into account the rights of investors.

- Communicate right.
- Recommend appropriate and suitable product.

- Maintain arm's-length relationship with counter-parties and provide risk disclosure.
- Disclosure of financial intermediary's relationship with parties involved in a placement or offer.
- Mention disclaimer clauses.
- Provide sensitivity analysis (if required or asked by customer/investor).
- Declare their stake/interest in the transaction—for example, commission, etc.

Do you think a set of regulations is needed for financial advisors?

The recent Sebi regulation abolishing entry load on mutual funds is the kind of regulation that will protect investors' interest. Similar regulations need to follow for other financial products in due course. This will ensure that in the medium-term at least, advisors get compensated only for their role, and not for any commission embedded in the product itself. While we traverse the path towards this objective, investor education and stricter disclosures could serve investors' interests. The long-term goal, as discussed above, remains.

If yes, do you have any suggestions for an outcome-based regulatory structure for financial advisors?

Moving towards a fee-based structure would help in an unbiased recommendation coming from a financial advisor, who should also be regulated by a defined/prescribed regulatory body.

All categories of currently registered intermediary investment advisors such as portfolio managers, brokers, etc, and the non-registered investment advisors should be subjected to one umbrella regulation in respect of their investment advice function. But regulation of all non-registered entities rendering investment advice to specific clients will require enormous resources and reach.

A separate regulatory body away from frontline regulator, Sebi, could be created to be the first level regulator. This body, once formed, may regulate by defining the process for regulation and registration,

entry and exit, reporting and market conduct. These should include regulations on advertising, performance reporting and presentation, disclosure of conduct, experience and conflicts, disclosure of services and fees, prices and commissions, and fair dealing.

The media also plays an important part in influencing investment decisions. They can be encouraged to go in for self-regulation.

But, as shared in the beginning, till the ideal situation is reached, a combination of investor education, stricter disclosure and capping commission would serve the immediate needs of investors.

A3.5 Distribution Houses and Others

1. B Srinivasan, Financial Planner

What is the typical sales process you follow to sell your scheme to investors? Is it demand-pull or sales-push?

In general, in pure distribution, it is sales-push. But in financial planning, it is 50:50. Once a need is generated, we have seen a genuine interest in further investments towards the goal.

How long, on an average, does it take to make a sale?

For distribution, it may be 1-10 days. For financial planning, it normally takes two weeks to two months.

What is the paperwork at the point of sale? Is there a customer-profiling process in place?

Yes. The profiling for most clients, till now, has been done by me personally. It is done in the first or second meeting, which takes anywhere from two hours to sometimes even six hours. Further, at the time of submitting the plan, it will start with all the existing information, which we ask them to confirm.

Are costs/fees/other expenses disclosed at the point of sale?

As of now, there is nothing in writing. We generally explain to them the revenues we get from various

institutions and products. The products offered to clients are generally need-based, grounded in financial planning and asset allocation.

Is there a product description that documents the key features of the product?

Yes. But again, it is not in a written format. Various asset classes are explained with the related risk. Allocation is done based on the ability to take the risk, the period of the investment and the nature of requirement.

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

- The regulator should increase the reach of investor education programmes drastically.
- The regulator should encourage a culture of 'pay-for-advice' more seriously than by just abolishing loads.
- There should be an awareness campaign at every level to differentiate between long-term and short-term investment options. In fact, if possible, the products should have clearly differentiated characteristics. None of the long-term products like insurance should have any characteristics of short-term nature.
- Disclosure by product manufacturers and again by brokers is duplication. A common disclosure format should be designed and made mandatory for the product manufacturer to disclose all relevant factors using appropriate media.
- A minimum level of remuneration should be made mandatory for basic functions performed by an advisor.

Do you think a set of regulations is needed for retail financial intermediaries?

Common regulation for advisors is necessary. Also, the difference between a product seller and advisor has to be clearly outlined by the regulator. Product sellers should be barred from advising without adequate qualifications, training and experience.

It would be ideal if products are categorised as

non-advisory products (post office schemes, fixed deposits) and advice-based products (insurance, mutual funds). Only qualified advisors should be allowed to sell advice-embedded products. The current way of licensing advisors for selling insurance and mutual fund is inadequate. It only produces ill-equipped financial intermediaries and would result in mis-selling.

If yes, how should it look?

We need to have proper compliance procedures. But at the same, we should not overdo it. Whenever we do any legislation or compliance, we always think of the worst-case scenario and prepare for that. Kindly remember good and genuine advisors also exist, and ensure that the new rules and regulations do not chase them away.

2. Birla Sun Life Distribution

What is the typical sales process you follow to sell your scheme to investors? Is it demand-pull or sales-push?

Sales-push. However, the core of our sales process is profile-based selling so that there is no unnecessary product thrust upon the unknowing customer.

How long, on an average, does it take to make a sale?

It varies from a week in case of retail to even a month for wealth management customers.

What is the paperwork at the point of sale? Is there a customer-profiling process in place?

Since we are not a manufacturer, we follow the paperwork as suggested by the product manufacturer. For wealth management, we get a customer registration form filled with a copy of the PAN card.

Are costs/fees/other expenses disclosed at the point of sale?

As a distributor, we currently do not charge any fee to offer our services. However, the manufacturer mentions all costs/loads in the product brochures.

Is there a disclosure to the customer of the risk that the product carries?

All risks associated with the product are conveyed while selling the product. These are derived from the terms and conditions of the product as given by the manufacturer.

Is there a product description that documents the key features of the product?

We use product brochures as given by the manufacturer for this.

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

It is important to do profile-based selling, coupled with clarity on tenures and cost effectiveness (for example, loads).

Do you think a set of regulations is needed for retail financial intermediaries?

Regulations are welcome if they take into consideration the welfare of customers and the economics of the business. And they should be simple and practical to execute.

If yes, how should it look?

Standardised guidelines for disclosures while selling, certification and training requirement for sales.

3. Computer Age Management Services (CAMS)

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

The present architecture of licensing by Amfi is adequate, provided it is enforced in letter and in spirit.

Do you think a set of regulations is needed for retail sellers and advisors?

Yes, provided it covers all products under the same set of regulations and provides a level-playing field across various product types (insurance, small savings, mutual funds).

If yes, how should it look? .

It makes sense to consult with the advisory community.

4. Dalmia Advisory Services

What is the typical sales process you follow to sell your scheme to investors? Is it demand-pull or sales-push?

Identify the product. Do a due diligence on it at our end as an independent product. Relate it to client need. Advise and sell the product. Clients seldom call to enquire or demand a product. We, as an advisor, create the need; recommend them products, which they approve. 75 per cent is acceptance (demand).

How long, on an average, does it take to make a sale?

One day to one year. It depends.

What is the paperwork at the point of sale? Is there a customer-profiling process in place?

We understand the client over a period of time with continuous interaction, apart from first meeting profiling. Yes, we do profiling.

Are costs/fees/other expenses disclosed at the point of sale?

Till now, there was no such regulation and disclosure was voluntary basis from our side. We informed clients when they asked. But now, we are planning to disclose all product commissions to the client.

Is there a disclosure to the customer of the risk that the product carries?

There is no written disclosure per se. However, we make sure that it suits the client and the client understands the product before they buy it.

Is there a product description that documents the key features of the product?

Sometimes, yes.

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

More disclosures with less paperwork. This is possible only when a client pays a fixed fee to the advisor. No matter what, if a fixed fee is not paid, there will be some bias in the advisory. Once advisors are sure of their remuneration, they

will work more independently and with a client's interest in mind.

Do you think a set of regulations is needed for retail financial intermediaries?

Yes. Strong regulation is needed.

If yes, how should it look?

Commissions should be disclosed on the product itself by the product manufacturer. Possibly, eliminate the commission totally from the product. Let the client pay. Difficult, but that's the ultimate solution for robust growth for the industry and serious players.

5. iTrust

What is the typical sales process you follow to sell your scheme to investors? Is it demand-pull or sales-push?

Since we are product distributors, the process varies across products:

Real estate: demand-pull

Home loans: demand-pull

Mutual funds: sales-push and/or demand-pull (especially during Section 80C investing season)

Life insurance: sales-push, except during Section 80C investment season

Health insurance: demand-pull and sales-push

How long, on an average, does it take to make a sale?

Again, it varies by product. Generally speaking, it could mean up to three visits to the client.

What is the paperwork at the point of sale? Is there a customer-profiling process in place?

We do intensive paperwork at the point of sale with the client, but prefer to call it point of interaction and advice. We start with a detailed client profiling and data gathering on the personal financial situation of the client. This initial exercise forms the basis of future interactions and services rendered.

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

Step 1: Needs assessment.

Step 2: Mapping of product to the needs of the client.

Step 3: Present different choices of manufacturers, pros and cons of each product, disclosure of fees.

Step 4: After-sales compliance check that the sale was carried out in a correct manner.

Do you think a set of regulations is needed for retail financial intermediaries?

Yes, regulations are needed for financial advisors. Amfi and Irda rules ought to be properly enforced so that quality is maintained. Testing for advisors should not just stop at the preliminary certification tests. Rather, it should be held at least every six months to ensure that advisors are up to speed and well-informed, like it happens in other jurisdictions. The CFP certification is one certification that can also be used, although it has not caught on in a mass way. There could be a fast-track process introduced for parishioners in the field, rather than the current accelerated programme that allows only MBAs to take the exam under this status.

6. Reliance Money

What is the typical sales process you follow to sell your scheme to investors? Is it demand-pull or sales-push?

Sales-push.

How long, on an average, does it take to make a sale?

It depends on the product. For example, if it's a wealth management product, closure may take a fortnight. In case of a demat account, it could be a week. The NPS is around two days.

What is the paperwork at the point of sale?

Taking an example of the NPS, we are listing the paperwork involved.

Is there a customer-profiling process in place?

Yes. It is integrated in our back office. The format is the same as that of the NPS subscriber registration form, released by PFRDA and available on its website.

Are costs/fees/other expenses disclosed at the point of sale?

Yes, the disclosure is the same as that released by PFRDA and available on its website.

Is there a disclosure to the customer of the risk that the product carries?

Yes, the risk disclosure forms a part of the offer document, and is released by PFRDA and is available on its website.

Is there a product description that documents the key features of the product?

Yes. The welcome document released by PFRDA documents the key features. The welcome document is available on the PFRDA website.

Do you think a set of regulations is needed for retail financial intermediaries?

Yes. Just because a load-bearing document has all the advice in fine-print does not necessarily mean that the financial advisor has communicated exactly that to the customer. There must be a set of regulations to ensure financial advisors do not mislead the customer or misinterpret the advice given in the offer document/product brochure. They should adhere to the highest moral and ethical standards while providing financial advice.

If yes, how should it look?

All financial advisors must receive adequate and recognised training before they can offer financial advice to customers. Courses like CFA (US) and CFP (offered by FPSB in India) ensure that financial advisors have complete and thorough understanding of the product. Also, a customer can lodge a complaint against a practising CFA or CFP if they violate any of the terms of their respective charters. Appropriate action may be taken if they are found guilty.

Similar bodies and training programmes must be incorporated for each type of financial product in India. The Insurance Institute of India, Sebi and Amfi already have some certification programmes in place.

Financial advisors must be obliged to declare the financial advice they have provided on the sale of every financial product. The declaration should be countersigned by the customer, acknowledging the declaration made by the financial advisor.

7. SKP Securities

What is the typical sales process you follow to sell your scheme to investors? Is it demand-pull or sales-push?

Sales-push first, followed by demand-pull, based on good advice and service.

How long, on an average, does it take to make a sale?

It varies from case to case, client to client, product/service to product/service.

What is the paperwork at the point of sale? Is there a customer-profiling process in place?

Yes, a consumer-profiling process is in place. But it is not always adhered to.

Are costs/fees/other expenses disclosed at the point of sale?

Since costs are generally pre-negotiated with the client, no disclosure is necessary (they know it). Still, when required, disclosure is verbal, unless asked for in writing in the rarest of rare cases.

Is there a disclosure to the customer of the risk that the product carries?

Yes, there is a disclosure of risk. It's part of the KYC documents in case of broking services, of the offer document and application form for mutual funds, and of the research reports/advice recommendations prepared in writing by us.

Is there a product description that documents the key features of the product?

No.

What are your suggestions for a robust distribution process that takes into account the interests of the customer?

Either a consultative process (advisor and client discuss together) or a documented process (if decision-making is left to the advisor).

Do you think a set of regulations is needed for retail financial intermediaries?

With the load becoming a thing of the past, this question has lost relevance.

If yes, how should it look?

It will be a tightrope walk to strike a balance between development of this industry/deeper penetration and regulating it.



ANNEXURE 4

Suggestions Made in the Public Hearing

In the public hearing held on September 9, 2009, the following suggestions were made on Recommendation 9.

Why It Will Not Work

1. It is too early for a fee-only model in India.
2. The Indian consumer will not pay.
3. Investors prefer bundled pricing.
4. This will affect the livelihood of lakhs of agents.
5. Small investors will not get advice, as their transaction size is too small.
6. It will stunt the growth of the industry.
7. It has not happened in any part of the world and, in fact, commissions are higher abroad.

Why It Is Good

1. Several regulators across the world have taken the view that the nexus between the product manufacturer and the seller is the reason for mis-selling.
2. If consumers are already paying something, why won't they pay in a different form?
3. To file our tax returns, we pay a fee; the income-tax department does not give a commission.
4. The judiciary is also of the view that agents, today, look after their own interests, not that of consumers.

5. The service tax ruling also shows that the agent services the principal, not the consumer.

6. A commission system assumes that each person gives the same level of service, which may not be the case.

Specific Suggestions

1. Let consumers have an option to pay through one cheque. The fee is paid to the manufacturer through the same cheque as the investment and the manufacturer remits it to the agent.
2. Products that are simple, like default, continue to be sold with commission. Others that need advice are fee-based.
3. We do not need another government department, but a statutory body.

General Suggestions

1. In addition to agents, product manufacturers must also be held responsible for products that encourage mis-selling.
2. India needs an investor database. Today, the information is scattered and there is duplication of the investor.
3. Include real estate.
4. Need a definition of a 'small investor'.



IRDA's Comments

The following are Irda's comments, made in June 2009, on the consultation paper on 'minimum common standards for financial intermediaries and financial education' put in the public domain. This draft subsequently evolved into this report.

I. The suggested integrated approach to impart financial education to the general public is highly welcome. Insurance, being one of the branches of financial sectors, can also achieve the ultimate objective of inculcating insurance awareness through the proposed approach. However, it is reiterated that certain conceptual issues pertaining to the insurance domain like insurable interest, human value concept and risk mitigation need to be addressed with sufficient expertise, which the proposed FINWEB is expected to achieve.

II. As regards the proposal to establish a system of 'minimum common standards for financial intermediaries', the following concerns need to be kept in mind.

1. The integrated approach among all sectors of the financial sector has its own drawbacks owing to varying product classes, industry objectives, customer profiles, etc. While the product objective of mutual funds need not be long-term, the product profile of the life insurance industry is to be with a very long-term objective, and so the industry objectives in identifying the market segments. Across the globe, insurance is a product that is sold and rarely bought.

Insurance awareness levels are one of the benchmarks that establish the roadmap for the industry in the years ahead. Insurance penetrations levels in India are still at a lower level when compared to advanced markets. There is a marked progress of insurance levels since the opening up of the sector. Insurance penetration (premium as

a percentage of GDP), which was 1.99 per cent in 1999, reached 4.60 per cent in 2008.

Traditionally, individual insurance agents have played a pivotal role in driving insurance products among the retail sector. As regards the commission payments to insurance intermediaries, though the statutory ceilings are in the range of 35-40% in the first year for long-term regular premium insurance contracts and 2% for single-premium contracts, in effect, the commission expenses ratio are in the range of 10% in the first year and 1.4% for single-premium policies for the year ending 2007-08.

It is observed that the commission expense ratios are being soothed out gradually. It is appropriate to mention that the average overall commission expense ratios stood at 7.3% for the year ending 2007-08. On its part, IRDA has initiated various measures like putting an overall cap on charges of ULIP products, which result in further soothing of the commission expenses over the long run. IRDA has also removed the surrender charge beyond 5 years, which, in effect, results in zero exit load.

2. While observing the transformational changes taking place in the remunerative pattern proposed to financial intermediaries, both domestic and abroad, IRDA is of the opinion that insurance intermediation still has to play a pivotal role in driving insurance penetration. Recommendation 10 states that all retail financial products to go no-load by April 2011. In light of the reasons stated above, it is to reiterate that managing the period of transition is an issue for the insurance industry. The following are further issues relating to the proposed no-load approach:

a. In the existing business environment of the insurance industry, intermediary arrangements are a must. Since insurance contracts generally have

longer maturity, unlike deposits, which are short-term, agents are also responsible for servicing insurance policies that were sold.

b. The gestation period for closure of an insurance sale is relatively longer. An insurance intermediary may make multiple calls to the prospect before concluding an insurance sale. And again the conversion rate of a canvas into an actual sale is only a chance. It is to be attributed to the fact that insurance needs are rarely felt by individuals directly, but instilled by insurance intermediaries.

c. The principal-agent relationship between an insurance company and the insurance agent, which was developed over time, clearly puts the responsibility of any mis-selling of the product by the agent squarely on the agent. On its part, IRDA has put in place a policyholder-friendly prescription of 'Free Look Option', under which policyholders can cancel their life insurance policy within 15 days from the date of receipt of the policy and seek refund of premiums.

d. IRDA shall ensure that the no-load approach results in passing of the benefits to retail policyholders by way of lower levels of premiums. Hence, practically, there will be only one financial year left to the proposed deadline. Further, a change in the product pricing structure will have an impact on the existing in-force policies, leading to higher lapsation.

As on March 2009, there were 29 crore in-force individual policies in the life insurance industry. A sudden disparity among various generations of policyholders may distort the business structure of the life insurance business. To align the regime more practically with the objectives, it is ideal to extensively consult the industry in advance and put up a time-frame. The other aspect to be kept in view is the retail penetration of the insurance industry, which is mainly spearheaded by individual agents on the concept of selling and not buying. Insurance needs are rarely felt, even by the elite sections of the Indian society. Hence, a deviation from the established norms in the insurance industry is to be transformed in a phased manner.

e. It is in this context this matter may be left to IRDA on advisory lines.

f. It is not desirable at this stage to create an additional regulatory layer.

3. Certain recommendations relating to 'minimum common standards for financial intermediaries' may lead to regulatory overlaps. As outlined above, as the objectives of various branches of financial sector distinctly vary, it is advised that the regulatory issues concerning the intermediaries may be left to the respective regulatory bodies.

a. For instance, in Recommendation 12, it is stated that a common examination pattern is a pre condition for taking up agency in individual sectors like insurance, mutual funds, etc. As various sectors like insurance, mutual funds, etc, put in place regulatory processes of qualification, training and pre-license test suitable to their respective industries, to align the same with one more common examination pattern may lead to the escalation of regulatory costs among the regulated entities (for example, to both insurers and insurance intermediaries). It is an area of concern to the insurance industry, where the focus is in bringing down costs. At present, there are over 3 million insurance agents operating. The insurance agency is gradually moving towards attaining the professional status, and an additional common examination would not be a value addition.

b. Instead, the committee may suggest that common minimum norms of syllabi are to be laid down by FINWEB for all financial sector intermediaries. On their part, the respective regulators would integrate the suggested syllabi with the existing one.

c. In effect the 'standard norms' lay down by FINWEB shall be on advisory lines to the regulators.

4. A multi-layer regulatory approach to various intermediaries of the financial sector, with different regulatory prescriptions, may lead to a regulatory arbitrage. Hence, it would be better if the minimum

common standards are designed more on advisory lines, leaving scope for the respective regulators for a due intervention at an appropriate time. The common advisory standards designed on those lines may also help in strengthening the existing regulatory system.

5. As regards the draft recommendations, the following inconsistencies are observed.

a) In Page 6, Para 3, it is mentioned that while an agent is regulated, it is the advisor who is not. This concept is not totally correct. In the insurance industry, two sets of intermediaries—one that are regulated and the other that are not—are not in existence. Section 2 (i) of IRDA Act, 1999, also covers insurance consultants as insurance intermediaries. Section 42 (7) of Insurance Act, 1938, restricts any person to act as an insurance agent without holding a valid license. Similarly, it also bars insurers in employing any person as an insurance agent without having a valid licence.

b) On Page 7, Para 2, there is a reference to a lapsation rate of 80%. The percentage referred to in the Annual Report, Statement 53, pertains to a specific insurance company and to a specific line of business (non-linked), which is a minute portion of its overall portfolio. Hence, an extreme event. It would be pertinent to quote the industry average, which was 6.64% during 2006-07, as per the lapsation study report of IRDA.

c) On Page 17, under the sub-head 'who will be regulated', it is stated that there is a pressing need for a regulatory structure also for insurance sellers and advisors. It is pertinent to mention that there is a regulatory structure existing at present in the insurance industry. The structure is based on prescribed minimum qualifications, training and pre-licensing exam in the pre-licensing phase. In the post-licensing phase, all insurance intermediaries (individual agents, corporate agents and insurance brokers) are subject to a specified code of conduct and other market conduct-related circulars/guidelines. The onus of enforcing the regulatory prescriptions is, at

present, on insurance companies to a maximum extent. IRDA also monitors the implementation of the same through onsite inspections. Hence, it is not proper to mention that there is no regulatory structure at all.

d) On Page 20 at 'Disclosures. Outcome: Fairness', it may be specifically mentioned that there shall be transparency in the disclosures made. There is a distinction between a disclosure and transparency. A disclosure may not be a fair one. A transparent disclosure would be that fits with all fairness.

G Prabhakara
Member (Life)
IRDA

The following are Irda's comments made in November 2009:

The High-Level Coordination Committee on Financial Matters (HLCCFM) has set up a Committee on Investor Awareness Protection headed by Chairman, PFRDA with the following Members:

- Shri M S Sahoo, Whole time Member, SEBI
- Shri G Prabhakara, Whole time Member, IRDA
- Shri A Giridhar, Executive Director, IRDA
- Dr. Sujatha Prasad, GM, RBI
- Dr. K P Krishnan, JS, DEF, Ministry of Finance

The terms of reference (ToR) of the above Committee are as follows:

1. Reviewing and strengthening the present arrangements relating to investor awareness and protection
2. Role of regulators in investor awareness and protection
3. Need for a vertically integrated structure/organisation as the nodal agency for promoting financial education through pooling of resources
4. Importance of the issue in the context of financial

crisis with special reference to quality and effectiveness of communication during crisis

5. Recommend measures to enlarge financial literacy and financial awareness
6. Any other matter the committee may consider relevant.

The ToR was primarily related to investor awareness, protection, financial literacy and effectiveness of communication during crisis. The committee has held three meetings so far. The first meeting of the committee on 30th March, 2009 decided to discuss the two issues of financial literacy & education and role & regulation of investment advisors in the context of investor advice. The second meeting on 4th June, 2009 considered the status report on financial literacy and decided that:

1. The gap in financial literacy and advice shall be fulfilled by a national coordinated effort by regulators and other stakeholders.
2. There is a need for financial literacy mission under the paradigm of financial inclusion.
3. Plan for IFAs needs to be worked out for retail customers.
4. A national level body representing all the regulators needs to be set up for the above objectives.

However, the third meeting was presented with the "Consultation paper – Minimum common standards for financial intermediaries and Financial Education", which mainly focused on regulation of intermediaries and setting up another regulatory body for intermediaries. Out of the 39 recommendations made in the paper, hardly 9 are related to the ToR, i.e. Consumer awareness, protection and literacy and all others are pertaining to the regulation of intermediary and other issues. Thus, the report has considerably moved away from the primary objectives without the express approval of the Committee.

At this juncture, it is essential to recall that HLCCFM

had previously set up a Committee headed by Shri C S Rao¹, which held that:

1. With the expansion of financial services and broadening of financial market, there is theoretically a scope for promoting a cadre of financial advisors in the interests of investors.
2. The extant regulations in the insurance and capital market governing the role of intermediaries have a limited focus of ensuring a proper sale of products to investors, who would require them. The role may not be comprehensive as an investment advisory, but is currently meeting the limited needs at the present stage of development.
3. Sebi's initiatives would presently take care of the investor's interests and high networth individuals would always seek professional advice from wealth management professionals/banks etc., under mutual agreement.
4. The existing shelf of bank deposits and insurance policies do not as yet require the services of skilled and professional investment advisors.
5. It is possible to develop a regulatory model for creation and regulation of financial advisors taking the best practices available elsewhere, but there are severe constraints in implementing the regulatory structure.

The Committee, therefore, accordingly concluded that the development of a new regulatory framework for overall financial advisory particularly in the face of a serious administrative and regulatory problems and significant constraints in their oversights is clearly avoidable at the current stage of development. Considering the balance of advantage and ground realities, the Committee therefore decided that it would be appropriate to desist from recommending formulation of any new arrangement for creation of a new architecture of financial sector advisors or their regulation till a future date. It is more important to take suitable measures to develop overall financial awareness and literacy among the small investors in the meantime.

¹ Committee on Investment advice in Non securities financial markets, 2007, HLCCFM, Gol

The Committee, therefore, unanimously resolved to continue with the existing arrangements even as Sebi was looking at arrangements for protection of interests of small investors. It was decided to apprise the above conclusion to the Government of India, which had consulted the Committee as well as HLCCFCM. The present committee cannot claim to have examined the issue in any greater detail and hence those recommendations of the C.S Rao Committee are as valid today.

It is proposed to analyse the report in two parts, the first part looking at the arguments on which the paper has based its recommendations, and the second part analysing the recommendations made therein.

Part A

The basic premises the author of consultation paper relied upon for making recommendations are listed below:

(I) (i) The paper consciously equates the MF products with the insurance products for the purpose of distribution costs. The basic differences between the products ignored by the consultation paper are significant.

The insurance products are sold after due diligence on the health, income status, other risk factors on life and related contingencies of the consumer. The agent/broker has to do all this checking on behalf of the insurer before sale is affected. This may involve many visits to policyholder's residence, office, hospital, bank and other places.

Insurance products cover life and health risks and hence, distributor has a role in proper selection and prevention of adverse selection. This needs tremendous amount of hard work by the distributor.

Death and health being a taboo sociologically, insurance sales are the most difficult to drive while MF products are income oriented and are basically market driven.

Efforts involved in renewal of a life insurance policy are in no way comparable to the OTC sale of the MFs.

Agents/brokers also need to service the policies over the entire policy term while MFs do not have such necessity.

Absence of churn: Due to inherent nature of insurance products, churn of products and companies selected by the policyholder churn cannot be very high as all insurance products have longer term than other financial products.

(ii) Rural Network & Clientele:

We need to look at the objective of the regulation and focus of the industry also while working at the structure of distribution network. The parliament mandated IRDA not only to regulate the insurance industry, but also to develop it in an orderly fashion as per section 14 of IRDA Act, 1999. The Insurance Act, 1938 also mandates that insurers fulfil their social obligations by covering risks of rural and social population. IRDA has brought out regulations and the performance in last two years is tabulated below:

NEW BUSINESS PREMIUM

(Premiums in Rs cr)

FY	Rural		Urban	
	Policies	Premium	Policies	Premium
2007-08	12252210	12862.50	38594986	66560.47
% of Rural Business to Total NB	24.10	16.19		
2008-09	12795397	10951.45	38109474	58554.29
% of Rural Business to Total NB	25.14	15.76		

The unit holding pattern of Mutual fund industry as tabulated below shows that only 37.03% of the net assets are owned by individuals and remaining by NRIs/institutions. The ULIPs are totally oriented towards the individual policyholder and do not have bulk customers like FIs/institutions.

UNITHOLDING PATTERN OF MUTUAL FUNDS INDUSTRY ²				
CATEGORY	NET ASSETS (RS.CRORE)	% TO TOTAL NET ASSETS	NUMBER OF INVESTORS ACCOUNTS	% TO TOTAL INVESTORS ACCOUNTS
Corporates/Institutions/Others	2,36,233.35	56.34	5,75,938	1.21
Individuals	1,55,283.21	37.03	4,60,75,763	96.75
FIs	4,983.82	1.19	146	0.00
NRIs	22,821.28	5.44	9,71,430	2.04
TOTAL	4,19,321.66	100.00	4,76,23,277	100.00

Further, the penetration of insurance in rural area is much better than the capital market/Mutual fund industry mainly due to huge network of agents built up by LIC previously and by all private insurers in recent years. This type of marketing was possible only because of the specific suitability of the agents channel to the rural areas and product nature. No other channel we have heard of, could have achieved this amount of rural coverage. The incentive structure for this channel needs to be compared with that of the channels catering to the same clientele. Mutual fund distribution system with 50,000 intermediaries can in no way be suitable for this purpose. The recommendations which go towards dismantling this large rural network need to be viewed with a lot of circumspection.

Secondly, a very well trained independent financial advisor may be desirable but may not be able to reach the rural market which needs to be covered. A graduate with proper financial training will always look to city lifestyle and will no way provide the services to the rural population. Hence, at this stage of development, attacking the channel, which was acquitted itself quite well, is unjustified.

(II) The argument on which entire consultation paper bases its recommendations is presented in page 10 as follows:

“The Committee proposes the use of financial incentives in a manner that nudge participants into doing the right thing. The commission and reward system today makes the intermediary the agent of the financial products manufacturer, but his compensation comes from the customer. This gives rise to the inherent conflict in this relationship. A is the agent of B, but is paid by C. So A will sell to C, a product that B manufactures that gives him (A) the greatest remuneration. There is no other way for A to behave in a market economy – he is programmed to maximise his own utility rather than that of either B or C. Now, if instead of B, C, the customer, was to compensate A, the whole equation changes. It is now in A’s interest to keep C happy. Not just this one time, but over a lifetime of financial product buying, maintaining and selling.”

The argument can be broken down into following components

1. At present intermediary is the agent of manufacturer and not the customer.
2. Intermediary gets paid by the customer, through manufacturer
3. Intermediary alone maximizes his income and not the customer or the manufacturer
4. Hence intermediary shall be paid directly / exclusively by the customer

² Source: www.sebi.gov.in

With regard to insurance sector, the above formulation fails in following respects:

1. There are separate classes of intermediaries in insurance sector, brokers who are the agents of customers while agents represent insurers.
2. In insurance business, collection of substantial and crucial information necessary for underwriting, which is the job of insurer is outsourced to the intermediaries. Hence, it is natural that he gets paid for that part by the insurer. If the intermediary is limited to only advice, then the costs of marketing, underwriting, servicing, claims verification will get added to the management expenses. This changes accounting treatment only and not cost structure.
3. The question of informed choice by the customer is tackled in different means by the IRDA. In fact it is much more effective in insurance business and the sector regulation.

3.1 The Regulation 8(1) (d) under the IRDA (Licensing of Insurance Agents) Regulation, 2000 mandates disclosure of the commission to the prospect. Hence, the customer is empowered to choose the channel, the product of the company which is the cheapest. This was done in the year 2000 itself as soon as IRDA was formed.

3.2 The consultation paper ignores another major regulation brought in by IRDA on 1.1.2008 about the disclosures in ULIP products. It can be clearly seen that for 70.30% of new business underwritten in 2007-08 the disclosures were made as per Table A. The standard of disclosures is much tougher than it is for other sectors even now. The premium administration charges are specifically mandated to be disclosed and are being disclosed, unlike the previous mutual fund regime disclosures. The consumer is empowered by this measure to

select the cheapest product available from any of the 21 life insurers.

The argument ignores the fundamental nature of market economy, i.e, the competition. Commission has come down from 25.56% of first year premium in 2001-02 to 16.65% that of 2007-08. Thus the market competition, moderated by the regulators intervention has taken care of the intermediaries profit maximization motive.

(III) The consultation paper implies that in the insurance sector the intermediaries do not conform to IOSCO guidelines for being called regulated entities. The IOSCO has listed following norms for a regulated entity (page 6 of Consultation paper):

- a set of compliance exams
- a system of continuing education
- a process of registration
- a process of regulatory filings
- an on-going system of monitoring
- a system of compliance that the intermediary will follow
- well defined enforcement procedures
- punitive action

Insurance sector is guided by Insurance Core Principles (ICPs) which set the standards for intermediaries also. International Association of Insurance Supervisors (IAIS) in ICP 24 module describes the supervisory risks.

The consultation paper says that the “intermediaries which are selling financial products including the insurance products cannot be called regulated” by any global standards. This is far removed from factual position and ignores the present regulatory system in insurance sector. The paper has ignored the regulatory standards set up by IRDA for the intermediaries in insurance sector. The regulations made in the insurance sector conform to international standards as formulated by ICPs and have all the listed features.

(IV) The next argument the author of the consultation paper relies upon is that there is no fear of punitive action for the intermediaries. This also ignores the extant position in the insurance industry. For example, during the year 2008-09 the number of agents who lost their agencies for various reasons is 5,234.

As regards the Insurance Brokers Licenses, out of 294 licenses, 18 licenses have been either surrendered or cancelled. Further 8 licenses are under process for surrender during the year 2008-09. The monitoring of brokers' conduct is further strict whereby the brokers have to submit detailed documentations of their business transactions to the regulator at fixed intervals. Hence this premise on which the need for a separate regulator is built upon is unfounded and not factual.

(V) Another most important argument on which the consultation paper relies upon is that the lapsation rate is huge in insurance sector and the distributors are responsible for such lapsation. The paper gives lapsation rates ranging between 80 % and 4 %, with half of the 16 companies with more than 20 % lapsation ratio and just three less than 10 %. This particular statement picked up out of context and presented in an opportunistic fashion is totally biased and needs to be tempered with factual data. 80% lapsation cited is for one company viz., Aviva Life Ins. Co. whose market share of the premium was 0.9 % in 2007-08. In absolute numbers, the number lapsed was only 40,000 policies only. While LIC with 74% of total premium underwritten in 2007-08 had a lapsation rate of 6% only.

The data on the lapsation rate also reveals that the lapse for ULIP is 10.01% while that of the term insurance products is 18.95% for the years 2002-07.^[3]

It may also be noted that IRDA has brought in much higher transparency in the sale of ULIPs on 1.1.08 by mandating the disclosure of administration charges as well as the premium allocation charges (which includes commission) to the policy holder

at the time of sale of ULIP. Hence, the argument that the financial incentives available for sale of ULIP are driving their higher sales may not be really correct. Further the total loading on ULIP premiums is capped recently limiting them to 225 to 300 basis points based on tenor. Further, the lapsation rate has gradually come down during the years 02-03 to 06-07. This also negates the argument in the consultation paper as absolute amount of commission available in ULIP is much higher when compared to the absolute amount of commission available in term insurance products.

The lapsation rate can have numerous reasons (refer Annexure III - IRDA Journal, Aug 2008 page 23) which can include "absence of proper needs analysis / life cycle stage analysis, financial crisis of customers, nature of product, focus on first year commission, lack of customer contactability, lack of premium payment channels, Orphan policy / servicing issues, unintentional lapsation". Hence, the entire lapsation rate need not be blamed only on financial incentives available to the intermediaries.

(VI) The next argument which the author borrows is from the article in Economic Times [4] that the intermediaries are forcing the consumers to opt for the investment products like ULIP ignoring risk based term insurance products. This is another fallacy, which is a result of superficial understanding of the working of the insurance sector. The non linked business of the insurance has maintained trend growth rate throughout, irrespective of the phenomenal increase in ULIP products. Except for the year 2007-08, where there was slight dip in the sales of non-linked business, there was hardly any impact on the higher volumes of ULIPs growth on the non-linked business. The period of high growth in linked business products also coincides with the period of phenomenal growth of mutual fund industry. The years 2004-05 to 2007-08 is very high growth period of Mutual funds as was for the insurance sector. The data clearly shows that the higher demand for the investment products was met

³ Lapsation and its impact on Indian Life Insurance Industry (2002-07), IRDA pp. 43

⁴ Page no. 7 of the consultation paper

in equal fashion by both mutual fund products as well as linked insurance products. This is to say that ULIP products rode on the demand for investment income of the consumer. This clearly explains that the frequent accusation of mis-selling fuelling the growth of ULIPs is rather superficial and was not the result of any analytical research.

(VII) The consultation paper very conveniently picks up a statement on lapsation [5] and ignores the steep improvement seen in the lapsation rates after IRDA tightened the norms for ULIPs and disclosures. While lapsation in first year during 2004-05 was around 24%, it improved to around 13.43% during 2006-07 for all linked products [6]. Further the grievances data from Ombudsman (Table II & II-A), All Life Insurers (Table II-B) & LIC (Table II-C) show that, compared to the number of consumers, the complaints are very small in number and do not justify the hue and cry over mis-selling.

(VIII) The consultation paper also quotes from Economic Times paper [7] where it has accused that the average sum assured of Indian insured was kept at Rs.90000 is presumptive and does not take into account the huge number of policies taken for pension products, endowment products, multiple insurance covers taken by policyholders. It can be safely said that 90000 figure is a gross underestimation of average sum assured. An informed guess can put that figure anywhere between Rs. 1.40 lakhs to 2.00 lakhs. The data prescribed by life council puts the figure at Rs.1.38 lakhs of average sum assured.

(IX) The next argument the paper takes up is that of the front loading of the commission under Insurance Act. The argument presumes that every product has got loading of 40% premium paying period of 10-15 years and even extending upto 50 years. The average commission expenditure, it clearly shows that for regular products it varies between 15-17 % and the average worked out to 7.3% for the year 07-

08 for the entire industry. For the year 2008-09, the industry average commission expenditure for linked business is 12% and 3% for first year and renewal premium respectively, while for non-linked these are 15% and 5% respectively. This is not excessive by any stretch of imagination and is comparable to average expenditure on commission in many other sectors. Further, the report ignores the fact that the ceiling on commission for single premium products (comparable to MFs) is only 2% and these contracts constituted 20% (approx) of the total premium in 2007-08. Hence, the whole argument built on the premise that insurance intermediaries are paid 40% of the total premium to drive the sales collapses and it emerges that the average commission structure is almost comparable to that of the MF industry in fact better than that of MF industry.

The theme of the paper seems to be to bring down the presumed commission structure of the insurance products to drive the sales of other two sectors of MFs and equity products. The insurance penetration in India is only 4.60 during 2008-09 with average risk cover of not more than 2.5 lakhs. There is a need, as the paper argues for higher risk cover for the Indian population and it needs to be met by the insurance companies in a cost effective manner. The paper does not give any approach to achieve this objective of financial inclusion. The need of the hour is to make the consumers aware of the financial products available in the market to cover their present and future financial needs.

Hence the argument for level playing field between MFs/equity products and insurance products, if analysed based on facts and statistical data available will undermine the framework set up by the consultation paper. IRDA strongly recommends that the committee limit itself to financial literacy and investor awareness as it is mandated by HLCC.

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5 Page 7, para 2 of consultation paper

6 Lapsation and its impact on Indian life Insurance Industry (2002-07), IRDA P.P. 4

7 page 7 of consultation paper

Part B

The aim of the financial literacy and investor protection as brought out by the terms of reference of Govt. of India needed to be dealt in a thorough fashion and the strategies to set up a vertically integrated structure for promoting financial education through pooling of resources were to be recommended in the paper.

In the process, the draft consultation report should have considered the following issues to bring about the objectives of the investor awareness:

The unorganised sector is the most important source of employment for the rural and urban population in India. They constitute 90% of the total labour force and have the necessary financial wherewithal to invest in insurance and savings products. While at the lower end they need to cover themselves with life insurance, health insurance, and pension needs for the future, at the higher end they need to have necessary savings and investment instruments to take care of the needs of the family. Reaching out to them and educating them on the need of savings and insurance is a very difficult task which should have been dealt in more detail by the consultation paper. The self-employed, both in rural and urban areas cannot be reached in any fashion through the regular channels of financial literacy. The use of mass media in effective fashion can be one of the important strategies. The strategy to saturate this section of population did not figure in the consultation paper.

The report famously decides to confine itself to “HR department of willing large corporations”. There are a handful of large corporations which contribute a minuscule section of the total labour population. The smaller units including the SMEs contribute to the bulk of working population need to be addressed by different strategies.

The most difficult task in the financial literacy area will be reaching the illiterate population and the neo-literate with little understanding of the financial system. The agriculture labour, the daily wage labour, the street hawkers etc, definitely need to have necessary insurance, necessary savings for

their future and should have been focused upon as a vulnerable section for the report. The consultation paper presumably wants to use MFIs and NGOs for this purpose. However, it is experienced across the states that the MFI and NGOs cover very small proportion of the population and their cost structure is extremely unsustainable to take up any such literacy campaign. Their adverse cost structure is reflected in the rate of interest they charge on micro finance. Further, the focus of MFIs and NGOs can be different and riding on their main function for educating the masses may not be a suitable option in many cases.

While the report includes recommendation on the school curriculum and post 12th class literacy measures, it is felt that the paper could have devoted more space and time in bringing out necessary strategy of catching them young to achieve greater success and financial literacy campaign. The US and UK models have large financial literacy programmes for students and need to be studied in depth to work out a suitable model for India.

The report also recommends much laudable concept and utility based literacy for the purpose of financial literacy. However, the strategy given in the paper is designed to make the consumer expert in high school mathematics for the purpose of getting financially included. This is a tall order for substantial illiterate population. Even among the literate population, the strategy suggested seems to be quite impractical. The strategy suggested may work for school student as well as the literate urban masses but for the illiterate and neo-literate masses there is a need for different strategy which focuses more on need based financial literacy on the specific needs of the consumer categories. The specific knowledge about the insurance products in life, health and pension products need to be imparted to enable them to make an informed choice.

The mandate of IRDA, as for any other regulator in financial sector is to find the fine balance between the “duty to regulate, promote and ensure orderly growth of the insurance business and re-insurance business” and the “function of protection of the interests of the policyholders in various business and transactions

related issues arising in the sector.” As explained above the insurance regulations have mostly achieved the balance. Hence, as concluded by the CS Rao Committee unanimously, the balance of advantage

lies in not recommending any new arrangement for creation of new architecture for financial sector advisors and in nurturing the existing system which has helped in achieving the given mandate.

Committee's Comments

Irda has stated that the report has moved away considerably from the primary objectives without the express approval of the Committee. The Committee is of the firm view that its mandate was to review investor awareness and protection, and the recommendations are in line with the mandate.

Irda has further commented that the present Committee cannot claim to have examined the issue in any greater detail and hence the recommendations of an earlier Report (CS Rao Committee) are as valid today. (Irda has erroneously claimed that the earlier committee's conclusions were unanimous. PFRDA had given differing views). The Committee, with two members from Irda, did examine the issue in greater detail. The research took more than five months. In India, over 100 financial sector companies, including insurance companies (life and general), were surveyed, top professionals in the financial market, regulators and government officials were consulted. The research team surveyed the current regulatory moves in the US, the UK and Australia in detail and recorded the current best practices in 23 countries in the area of investor protection. This research goes significantly beyond what the earlier Committee undertook. Moreover, had the conclusions arrived at by the Rao Committee been acceptable to the HLCCFM and the Government, the present Committee would not have been constituted by the Government.

The Committee recognises that insurance and mutual fund products are different. It is only when investment products are presented as insurance products that there are issues of investor protection that need to be addressed. The Committee red flags the growing

cases of mis-selling and sharp sales practices of insurance products that are causing financial distress. Some consumer complaints have been appended to the report as examples of the kind of individual distress that is visible in the market place today. The Committee recognises that the rural market is difficult to reach. It questions the low current insurance penetration despite a commission structure of up to 40 per cent in the first year. If despite such high incentives the insurance sales force is unable to increase insurance penetration, is there a structural flaw in insurance products on offer in India? Also, given that the pure insurance product (that Irda says is so difficult to sell due to the “sociologically” difficult nature of death), term insurance, forms less than 10 per cent of the total product basket in terms of sales, could it be that the insurance sales force is mis-selling investment products in the name of insurance?

The Committee takes strong exception to Irda's contention that: “the theme of the paper seems to be to bring down the presumed commission structure of insurance products to drive the sales of other two sectors of MFs and equity products.” The Committee is a multi-regulatory and government-appointed body looking for a better regulated market, focusing on investors' well-being. The Committee firmly believes that the recommendations relating to common minimum standards of education, training and certification of financial advisors, uniform disclosure norms across products, no commissions embedded in product price and an apex-level coordinating institution for spreading financial education will go a long way in protecting the interests of investors.



ANNEXURE 6

Response of the National Federation of Insurance Field Workers

The following is a synopsis of the comments given by the National Federation of Insurance Field Workers on the consultation paper on 'minimum common standards for financial intermediaries and financial education' put in the public domain prior to the release of this report:

Insurance is a product that is sold, not bought. Therefore, it needs an agency force. The agency and development officer model, with commissions as remuneration, has worked very well in India. Agents work hard and put in much investment to establish a good business. They need to be remunerated for it. Due to the hard work it demands, insurance agency is not a sought after profession. Therefore, agents need to be paid commissions to take care of their business interests. The recommendations are applicable to unit-linked plans where there is market risk, but insurance is not at all an investment. It is a risk cover for protection and social security. It is only in Ulips that some sort of mis-selling is happening through exaggeration of stock market returns.

We wholeheartedly support efforts to increase financial literacy in India.



Abbreviations

AMCs	Asset management companies	LUCTF	Life Underwriter Training Council Fellow
ASIC	Australian Securities and Investment Commission	NCFM	NSE's Certification of Financial Markes
Amfi	Association of Mutual Funds in India	NFO	New fund offer
AUM	Assets under management	NPS	New Pension System
CFP	Certified Financial Planner	NSE	National Stock Exchange
CFPA	Consumer Finance Protection Agency	PAN	Permanent Account Number
CCIL	The Clearing Corporation of India Ltd	PBR	Principle-based regulation
EBI	Electronic benefit illustration	PFRDA	Pension Fund Regulatory and Development Authority
ETF	Exchange-traded fund	PMS	Portfolio management scheme
Finra	Financial Industry Regulatory Authority	RBI	Reserve Bank of India
FINMA	Swiss Financial Markets Authority	RBR	Rule-based regulation
FPA	Financial Planning Association, Australia	RDR	Retail Distribution Review
FPSB	Financial Planning Standards Board	SIP	Systematic investment plan
FSA	Financial Services Authority, UK	Sebi	Securities and Exchange Board of India
IAM	Independent asset manager	SEC	Securities Exchange Commission
IFA	Independent financial advisor	Sensex	Bombay Stock Exchange's 30-stock Sensitive Index
IPO	Initial public offering	SID	Scheme information document
IRA	Individual retirement account	SME	Small and medium enterprises
IOSCO	International Organization of Securities Commissions	SRO	Self-regulatory organisation
IRDA	Insurance Regulatory and Development Authority	TCF	Treating Consumers Fairly
KIM	Key information memorandum	Ulip	Unit-linked insurance plan
KYC	Know your customer		



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