

BOX 4

**Market Conduct Supervision:
Upholding Trust in the Financial System**

Introduction

Recent financial debacles and crises, even in several advanced and well-regulated economies over the past couple of decades, have highlighted the criticality of upholding the trust and confidence of public, especially financial consumers, on financial institutions, financial authorities and the financial system as a whole. Hence, financial authorities around the world have been compelled to reinforce and reshape the scope and approaches to the financial system oversight function with an increased focus on widening financial inclusion and strengthening the financial consumer protection provided to the financial consumers by Financial Service Providers (FSPs). In this context, strengthening the financial consumer protection framework through effective regulations, supervision, and consumer empowerment is becoming one of the priorities of financial authorities worldwide. For example, as per the 2022 Global State of Financial Inclusion and Consumer Protection Survey conducted by the World Bank, out of 113 responded jurisdictions, 109 jurisdictions have regulations on financial consumer protection.

Market Conduct Supervision

Market Conduct Supervision (MCS) is one of the pillars of financial consumer protection and is used by regulators in achieving the overarching goal of market integrity and trust among depositors, borrowers, investors, stakeholders, and the public, contributing to financial system stability and economic growth. A comprehensive or full scope MCS involves a continuous review of FSPs' products, services, systems and procedures, and practices with prompt corrective and enforcement actions. Despite some similarities in its goals, approach process, MCS is different from prudential supervision of financial institutions in terms of its concepts and focus areas and tries to provide fair outcomes for both financial consumers and FSPs.

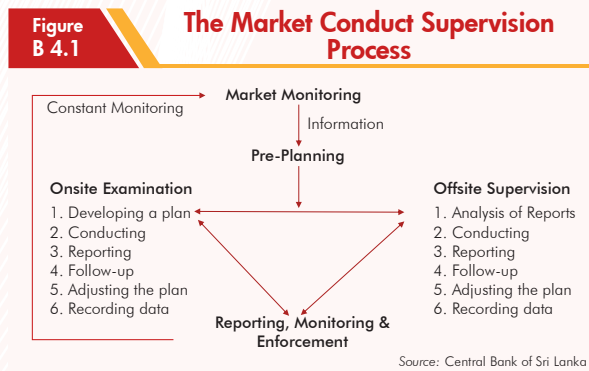
MCS Approaches

As MCS is designed and implemented under different operating environments and structures, two main approaches can be adapted to suit the regulatory objectives, resources, and skill levels as well as the development of the industry and economy as a whole. In a compliance-based approach, supervisors focus on non-compliance with

laws and regulations of FSPs and take appropriate enforcement actions to ensure full compliance. In the risk-based approach, supervisors focus on risk analysis and mitigations. Accordingly, the risk-based approach of MCS is more forward looking and the supervisory activities are fine tuned according to the risk levels identified prior and during the supervisory cycle.

Main Supervisory Tools

MCS encompasses a range of supervisory tools such as media watch and product reviews, thematic reviews, mystery shopping and calls, self-assessments by FSPs and direct engagement with FSP leadership focusing on market conduct risks and controls to emerging issues, validating specific practices, and gauging control adequacy. These tools collectively facilitate supervisors to have an effective MCS.



The Market Conduct Supervision of the Central Bank

Pursuing the development of global financial consumer protection regulations, the Central Bank established the Financial Consumer Relations Department (FCRD) in 2020 and issued the Regulations on Financial Consumer Protection, No. 01 of 2023, under Section 10(c) of the then Monetary Law Act in August 2023, covering all financial institutions under its purview. The Regulations, which will be fully effective from August 2024, integrate and strengthen the existing customer protection frameworks issued under different statutes and empower the Central Bank to supervise the market conduct of FSPs regulated by it.

With the empowerment by the Regulations, the Central Bank has arranged to commence its MCS under a risk-based approach while giving due consideration to the reported non-compliances and malpractices of FSPs. As a precursor to MCS, FCRD conducted a thematic review on the complaint handling mechanism of FSPs. The assessment helped set the background for the MCS process while providing an opportunity for FSPs to improve their internal redress mechanism.

Conclusion and Way Forward

As countries navigate through increased risk and complexities of modern financial products and services, upholding public confidence in the financial system is a key element in achieving financial inclusiveness and system stability. A robust MCS as the main mechanism in regulating financial consumer protection always fosters fair treatment for financial consumers and responsible market conduct of FSPs. This will pave the way for increased public trust in the overall financial system.

In this regard, the Central Bank is developing the necessary mechanisms, competencies, and procedures for conducting MCS of FSPs in terms of the Regulations No. 01 of 2023. As of 2023, the Central Bank has developed a

market conduct supervisory manual integrating its supervisory approach, tools, and process with required details and is expected to commence the first full scope MCS during second half of 2024. Going forward, the Central Bank expects to have greater co-operation from market conduct supervisors in other countries and international networks such as Alliance for Financial Inclusion (AFI) and the International Financial Consumer Protection Organisation (FinCoNet) to gain necessary experience and expertise for effective implementation of MCS contributing to a more resilient and stable financial system upholding the trust and confidence of the financial consumers.

References

1. An Introduction to Developing a Risk-Based Approach to Financial Consumer Protection Supervision (2022) - World Bank
2. Establishing a Financial Consumer Protection Supervision Department (2021) – World Bank
3. Financial Consumer Protection and New Forms of Data Processing Beyond Credit Reporting (2018) – World Bank
4. Good Practices for Financial Consumer Protection (2017) – World Bank
5. Market Conduct Supervision in Small Countries: The Case of Armenia (2013) – World Bank
6. Market Conduct Supervision of Financial Services Providers A Risk-Based Supervision Framework (2016) - Alliance for Financial Inclusion
7. Market Conduct Supervision – A Toolkit (2023) - Alliance for Financial Inclusion
8. The Global State of Financial Inclusion and Consumer Protection (2022) - World Bank