

Development of Universal Banking and Legal Mechanisms for Financial Consumer Protection: A Lesson on Financial Consumer Protection Failure During US Subprime Financial Crisis 2008 *

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Abstract

This research focuses on the study and analysis of the development and structure of commercial banking business in the form of universal banking in the United States during the period before the economic crisis or subprime financial crisis 2008, and the failure of the consumer protection mechanism that was supposed to protect the benefit of those who used the services of such commercial banks.

Both the failure of consumer protection mechanism and the universal banking finally led to the tragic crisis (subprime financial crisis in 2008). The universal banking itself and the then unsound behavior of commercial banks were considered significant causes for financial services or products in the form of predatory lending transactions taking advantage from their own customers who lacked adequate financial knowledge.

Another cause was the governance problem. There was a situation of quite a number of financial supervising organizations scattering during the period and thus created the unity of governance. In some cases, there existed within the organizations the role conflict between bank stability (soundness) and consumer protection, the problem of relaxation on practice from authorities' criteria (financial deregulation) which led to regulation arbitrage and in turn destroyed the level playing field between the commercial banking industry and other financial business as well as the efficiency of customer protection.

This research also found that in Thailand, the current format and development of commercial banking business in the form of universal banking and the mechanism of customer protection are forming a shape that is similar to that of the subprime financial crisis in 2008. As such, to avoid this phenomenon from happening again in Thailand, improvement of consumer protection in all

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above three aspects namely, commercial banks or operating companies, laws governing bodies and consumers is inevitable. Building better understanding and knowledge of financial services to consumers (financial literacy) will be the effective tool for protecting consumers that will create consumer as well as market confidence in the universal banking business and the high competitive financial business for Thailand.

1. Preamble

In 2008, the world's most tragic financial crisis happened to the United States, which is known as the "Subprime Financial Crisis", which had significant adverse impact on the financial system of United States and other countries all over the world. This crisis was related to or associated with the banking business in the form of Universal Banking and the consumer protection mechanism for customers who used financial services in the United States. In the past, commercial banks in the United States were the center of comprehensive financial services or so called Universal Banking, which provided functions like a large shopping mall with various products for the customers. At present, commercial banks in the United States have two roles, namely, a commercial bank that engages in loan transaction with business sector and the public, and an investment bank¹ that provides services related to securities and investment in securities for itself. From 1933, the Glass-Steagall Act of 1933 required a complete separation of these two business types. However, in 1999, there

was a change in the globalization trend that made the said law become outdated. Therefore, the congress of the United States enacted a new legislation, i.e. The Gramm-Leach Bliley Act 1999, to repeal the separation condition of the two businesses. As such, investment banks formed part of commercial banks, such as Citibank, Chase Bank, JPMorgan, and etc. Thereafter, other commercial banks began to take a role of providing services in relation to securities business and the sale and purchase of securities, which became an important part of the financial system of the United States.

Many academic papers in USA provide an interesting analysis works² which describes the financial crisis of the United States during the period in question. The main reason is commercial banks which could be considered as 'large complex financial institution' (LCFI) or commercial banks that provided several and comprehensive financial services or "Universal Banking" and provided various financial products, for instance, savings or mortgage loans, syndicate lending, securities underwriting, issuance of derivatives, such as Asset Back

¹ The investment banking is a form of commercial banking business in the new era which becomes more important and plays significant role in earning profits or revenue of the financial institution. The investment banking takes significant part in developing the capital market in both Primary Market and Secondary Market, financial system and economic system of a country and the world. In this regard, the investment banking is a business that relates to the development of the capital market, the issuance of shares to raise funds from the public, mergers and acquisitions, the trading of securities or financial instruments, the role as financial advisor in issuance and offer of securities, underwriter, debt instrument arranger, custodian, trustee, securitization and fund management.

² For example, Arthur E. Wilmarth Jr., *The Dark Side of Universal Banking: Financial Conglomerate and the Origins of the Subprime Financial Crisis*, The George Washington University Law School Public Law and Legal Theory Working Papers No. 468, 2009, in addition, the work of Matthew Richardson, Roy C. Smith and Ingo Walter in "Large Banks and the Volcker Rules" that explains that Universal Banks in the United States has aspects of Large, Complex Financial Institutions, LCFI which is the cause of the subprime financial crisis and then expand to the global financial system (systemic risk) which is a result from a massive expansion of business after the financial deregulation of the United States, the trend of globalization of financial system and the permit to engage in various commercial banking business [Matthew Richardson, Roy C. Smith and Ingo Walter, *Large Banks and the Volcker Rule" in the Regulating Wall Street The Dodd-Frank Act and the new Architecture of Global Financial* edited by Viral V. Acharya/Thomas F. Cooley/Matthew Richardson/Ingo Walter, New York University Stern School of Business, John Wiley & Son, Inc., 2009]

Securities, Collateralized Debt Obligation, as well as, trading in securities and derivatives over the counter (OTC) and being in Financial Conglomerate.

Preliminarily, the problem that is important and has a direct impact on the financial crisis of the United States during the relevant period is the failure of the consumer protection mechanism for the customers who use financial services in the United States. According to the report of the “The National Commission on The Causes of the Financial and Economic Crisis in The United States”³, as appointed by the President Barack Obama, it clearly indicates that, in addition to the above mentioned causes, the other important cause is the problem in the consumer protection mechanism for the customers who use financial services of the United States. For example, there are many laws governing the consumer protection in financial services both at federal and state levels and there are several and dispersed bodies supervising the consumer protection in financial services, such as The Federal Reserve, The Office of Currency Controller, The Federal Deposit Insurance Corporation, the supervising bodies at state level, including The Federal Trade Commission or FTC, which have preliminary responsibility and power to supervise and control the fair trade and consumer protection in financial services that result in an inefficient consumer protection mechanism in financial services, as well as, the expansion of the scope of business of commercial banks in the form of Universal

Banking. After the enactment of the Gramm – Leach Bliley Act, there were more financial deregulations by the government and the competent bodies. Thus, commercial banks in form of Universal Banking started to compete more, develop various financial products, such as savings, loans, electronic banking or innovation in financial assets that are more complex and interesting, in order to persuade the customers to make investments or use financial services of such commercial banks. However, commercial banks engaged in providing services to their customers too excessively that they did not disclose or provide facts and information of the financial products to the customers fully and sufficiently, and they offered the financial products in such a way that is considered to be an unfair and deceptive practice to the customers.

The offering of financial products by commercial banks in the form of Universal Banking in the United States that was taking advantage and being unfair was seen frequently, due to various factors including the constant growth of the economy in respect of real estate value (housing boom) and the demand of the consumers, especially those who have income or repayment capacity that is too low to own a house or real estate either for the purpose of living or investment. Therefore, commercial banks played a significant role in supporting such activities in the form of lending or electronic banking. They were not being careful in considering the customers’ actual ability to make payment, they did not disclose necessary

³ *The Financial Crisis Inquiry Report, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, Authorized Edition, January 2011*

and important information of the loan, and they acted unfairly as commercial banks, for example, abusive lending practice to customers in several ways, such as disclosing material parts of the lending agreement that are complex and difficult to understand, changing the fees or interest rates that are burdensome to the consumers with retroactive effect without prior consent of the consumers, specifying the default events in the agreement in too many circumstance or too broad, increasing the lending credit automatically with prior consent of the consumers which resulted in an excessive expenses afterward. In addition, the regulatory bodies in respect of the consumer protection mechanism at that time did not pay much attention to these behaviors of commercial banks and the supervision was too poor and inadequate that immensely affected the consumers in financial services as the consumers were unable to cope with the expenses or costs from using such financial services which eventually led to default of payment and seizure of many real estates and houses and later created a crisis in real estate and the economy of the United States.

In Thailand, the government has continuously supported the commercial banking business in the form of Universal Banking as seen in the financial master plan I since 2003, which focuses on the improvement of the stability of the financial institutions by the way of mergers and financial conglomeration. The financial institution should adjust themselves to conform with various financial circumstances, particularly the entry into the Asian Economic Community (AEC) regime in the future.

However, the development and structure of the Universal Banking of the United States

before 2008 form a significant part in the failure of the consumer protection mechanism in financial services and the Subprime Financial Crisis 2008. The Bank of Thailand, as the main governmental body supervising the commercial banks, has become aware of the importance of those problems in order to find protection of such problems not to happen to Thailand, although such crisis rarely impacted Thailand's commercial banking system and financial system. In this regard, the Bank of Thailand has set up a center of the protection of financial services customers to accept petitions from consumers when they have problem with financial services, including to provide knowledge in connection with several financial services so that the consumers have basic knowledge in using financial services. In addition, the Bank of Thailand, as the governmental body supervising commercial banks, has considered the particular aspect of the commercial banks which is in the form of Universal Banking and being "The Significant Important Financial Institutions" (SIFI) and the connection between the business and other related external factors both within and outside the country, such as the real economy, the economic system, cross-border or international transaction, the importance and impact which might occur from the business that affects the financial institution system, the whole financial system and economic system (systematic risk) in order to adjust and improve the supervision of commercial banks that engage in Universal Banking and the protection of financial services customers to be appropriate with the business environment that has substantially changed.

Nevertheless, from the preliminary considerations, it is found that the development of the structure of Universal Bank and the failure of the consumer protection mechanism which led to the Subprime Financial Crisis of the United States has consistency and create similar problems in the commercial banking business in the form of Universal Banking and the current consumer protection mechanism in Thailand. However, according to the current legal mechanism in relation to the protection of financial services customers in the context of both general and special law, together with the policy and law enforcement by the relevant competent bodies, it has not yet improved to be efficient enough to prevent the problems, and it is significant in creating the economic crisis as happened in the United States. An example can be seen from the statistics of the petitions from the financial services customers and the provision of advice by the center of financial services consumer protection of the Bank of Thailand which keep increasing consecutively. Therefore, in this research, it is necessary to study and analyze the development and structure of the commercial banking business in the form of Universal Banking, the failure of consumer protection mechanism in financial services and the Subprime Financial Crisis in the United States. The commercial banking business in the form of Universal Banking and the current consumer protection mechanism in financial services in Thailand must be compared with the development of structure of Universal Banking and the failure of consumer protection mechanism during the Subprime Financial Crisis 2008, including the solutions of the United States to solve the problems in order to

synthesize the appropriate form of Universal Banking, as well as, the improvement of law regarding the consumer protection mechanism for financial services customers to be more appropriate so that it could efficiently protect consumers and prevent Thailand from having the problems that occurred to the United States.

2. Research method

The research shall be divided into 2 methods, namely:

1. Documentary Research – focus on the analysis of laws relating commercial banking, development of commercial banking business in the form of Universal Banking, international basic concept of the consumer protection law in financial services, measure of relevant bodies in supervising the consumer protection in financial services, the Subprime Financial Crisis of the United States, including notifications, rules, policies, orders, circulate letters and other relevant documents, such as articles, writings, researches, studies in Thailand and the United States.

2. Field Research – in-depth interview with officers at the management and practice level of the commercial banks by focusing on the 4 large commercial banks with high volume of transactions and interview with relevant state officers, such as officers at the management of policy and practice level of the Bank of Thailand, the Securities and Exchange Commission and the Office of the Consumer Protection Board.

3. Findings of the research

The development and the structure of investment banking in the form of universal

banking in the United States took place and continued for a long time, under the legal limitations imposed by the National Banking Act 1864 and the McFadden Act 1927. Commercial banking and the banking industry have not been developed or expanded as they should have been. Nonetheless, the development and growth of the economy, commerce and monetary system in Europe and in the United States provides a larger role for commercial banks. Commercial banks have expanded their business scope from traditional banking business, which is considered to be the core of a commercial bank, into non-traditional banking business, in order to become the financial center and to support the growth and development of the national economy, until the Great Depression happened in 1933, when commercial banking was considered to have contributed to such economic crisis, such that the government at that time passed a very important legislation called “The Glass-Steagall Act 1933”, to limit the business scope of commercial banks that is considered to involve excessively high risk, in order to prevent any impact on the status and stability/security of commercial banks, confidence of depositors, and the national economy.

Subsequently, from 1980 onward, the development and globalization of the global financial system, financial liberalization, technology and communication development, higher competition in the commercial banking industry and other financial businesses both domestically and internationally, all have influenced commercial banks to expand their scope of business, in order to seek more revenue and profits from both traditional banking and non-traditional banking businesses, securities

business, insurance-related business, and circumvent the legal limitations of the Glass-Steagall Act 1933 and the McFadden Act 1927, through a significant number of mergers of commercial banks and other financial businesses and the birth of financial conglomerate, such as Citicorp Group. In addition, the government policies at that time realized the significance and the role of commercial banks for the development of the national economy. As a result, deregulation was announced, which led to the legislation of the Riegle-Neal Interstate Banking Act 1994 and the Gramm-Leache Bliley Act 1999 to remove the legal limitations and allow the commercial banking industry to grow and expand the scope of business into large Universal Banking since then.

However, when another significant economic crisis or the ‘Subprime Financial Crisis’ took place in 2008, there were many questions on the cause of this crisis. Conclusions were drawn that the cause of this crisis partly involves excessively high risk transactions by commercial banks, especially proprietary trading transactions, which undermines the stability and soundness of commercial banks, investment banking activities which contributed to the development of financial products that are complex and difficult to understand (such as collateralized debt obligation or CDO), conflict of interest in the business and, more importantly, the provision of loans for the purchase of home and real property and other financial services in the form of predatory lending transactions or unfair, deceptive, abusive practice (UDAP), which contributed to the failure or inefficiency of the mechanism to protect customers of financial services and also contributed to the Subprime

Financial Crisis. The current government under President Barack Obama managed to resolved these issues by passing one or the most significant legislation in the U.S. banking industry, called the Dodd-Frank Act 2010, with the intention to limit the scope of high-risk business activities of commercial banks (so called the ‘Volcker Rule’), improve the mechanism to protect customers of financial services by organizing a special government agency called The Consumer Financial Protection Bureau (or CFPB), and revise the criteria of loans for the purchase of home or real property which are considered to be a predatory lending transaction.

Especially, with respect to the failure of the mechanism to protect consumers of financial services during that time, the research found that, in addition to the manner in which commercial banks offered credit and financial services in the form of predatory lending which is unfair and hurt consumers, there are issues with the ambiguous supervision of the regulatory agencies responsible for the protection of consumers of financial services during the period before the crisis, consumer protection laws that are scattered around several regulatory bodies who regulate commercial banks, such as FED, OCC, SEC, FDIC, OTS, FTC, without a central agency with the principle responsibility of protecting financial services consumers. This led to a conflict in the regulatory policies between the stability and soundness of commercial banks and the protection of consumers. In addition, regulatory agencies who regulate commercial banks issued policies intended for deregulation, did not enforce the relevant laws strictly and

effectively to stop activities of commercial banks that are considered to be a predatory lending transaction, and did not enforce the law to create a level playing field between national banks, state banks and other financial businesses that led to the issue of preemption law and regulatory arbitrage. At the same time, there was an issue of financial understandings of the financial services consumers, especially those who are the general public with limited access to important and necessary information, which rendered them unable to understand the essence of complex financial products or services, various related risks and expenses, which rendered them unable to properly pay debts (i.e., asymmetric information).

From the research, it found that in Thailand’s current context the development of banking business operation in type of the universal banking was similar to and in consistence with such development in the United States, especially before the period of Subprime Financial Crisis in 2008. At that time, the banking industry was continuously expanded. The banking business form was in both traditional banking business and non-traditional banking business. The financial liberalization policy and the Financial Master Plan were to develop the commercial banking operation to be the universal banking and financial conglomerate, financial globalization, and opening for Asian Economic Community (AEC), leading to high competitive environment of the commercial banking system and other financial business with both under supervision and not under supervision of the authority. The banking business

form which was changed from profit earning from interest income base to become fee income base. Importantly, under the high competitive environment, it affected the behavior of commercial banking operations to earn more profit with the form of offering new financial product or service which was more complicated, or with modern marketing method in order to persuade or induce the customers to use the financial product or services. Then, the behavior presenting the financial services in the type of predatory lending or unfair treatment did not show the full basic right of the consumers. Besides the similar situations between the experience from USA Subprime Financial Crisis and the current situation in Thailand, the research found that there were 4 similarities and consistency of problems and the legal enforcement of the regulatory organizations relating to the consumer financial protection in Thailand and during USA Subprime Financial Crisis.

[1] Concept and Policy on Supervision

The main concept and policy on supervision of regulatory organizations under the special laws providing the poser were determined as a clear important mission that it shall regulate the business operation of the business operators to be secured, safe and fair through the prudential regulations. Thus, the important concept and policy on supervision of banking business operation, especially of the Bank of Thailand, which was an important mission to enforce the law, was prioritized on maintaining the stability and security of the commercial banks and financial system of the country such as capital or liquidity maintenance, risk management

including credit risk, liquidity risk, operational risk, and management under good governance standard. The role or mission of consumer financial protection was also important as the following priority. This could reduce the role of commercial banking business supervision and consumer protection or some conflicts may be occur between the protection of commercial bank's benefit under aggressive competition situation of the financial system and consumer financial protection.

[2] Redundancy of Supervisory Role and Duty

At present, the role of commercial banks was more and more important. The commercial banks had expanded their various scope of business operation by covering the business under the supervision of other regulatory organizations such as securities business, insurance business, and other financial support business. The complication and redundancy of the legal provision relating to the consumer financial protection were the consequence because the regulatory organizations had their own concept of supervision relating to the consumer financial protection. This could be seen in many criteria established by the regulatory organizations. For example, the Bank of Thailand provided the criteria for consumer protection in advertisement or promotion of financial products, while the Securities and Exchange Commission provided the same criteria with slightly different details. Therefore, this may cause the redundancy and difference of the regulations or roles and duty in supervision, including the unfair competition in the financial

market of commercial banks, securities company, or other financial institutions that were not commercial banks (non-bank)⁴, or which was called 'level playing field'. The difference and redundancy of the authority's regulations, concept of organizational approach through various and unclear regulatory organizations should be changed to the concept of regulation according to the characteristic of activities through one regulatory organization (Functional Approach) in order to efficiently and seriously focus on the consumer financial protection.

[3] Problems of Law Enforcement in Practice

The problems of law enforcement in practice of the regulatory organizations were also shown in the survey of compliance with laws and regulations relating to information disclosure relating to financial products in order to protect the financial banking consumers of 6 large commercial banks with 20 branches in Bangkok business areas during May-June 2013. The survey found that to offer the financial product unfairly by taking advantage with the consumers (predatory lending) such as non-disclosure of important and necessary information relating to real risk or cost of financial product to the customers, offering the financial products by inducing high benefits or return without considering actual cost and expense. This showed that although the regulatory organizations had issued the regulations relating

to the consumer financial protection, it still found the problems on law enforcement in practice that happened with branches of the commercial banks, where was the important units that were direct contacting and involving with customers.

[4] The issue with Universal Banking and the problem of financial consumer protections mechanism in Thailand under the context of domestic and international level

Currently, there is a tendency for financial liberalization in the global financial system, financial conglomerate under the context of domestic and international level e.g the Asian Economic Community [AEC] and the economy of East Asia, APEC will significantly increase the competition of commercial banks and financial institutions. Cross-border or international businesses will take place. The development of technology to introduce financial services will become more complex. More financial conglomerate and Universal Banking with respect to commercial banks inside and outside the country will happen. Financial business group and alliance group will be formed, in order to satisfy the demand for financial services both domestically and internationally. Therefore, the mechanism to protect financial services consumers will become more important. Under these circumstances, the following issues with the protection of financial services consumers will arise, which show that responsible

⁴ The financial institutions that are non-bank in this sense means financial institutions operating credit card and personal loan business under the supervision of the Bank of Thailand. The research relating to the supervision of credit card and personal loan business of non-bank in Thailand of Pakorn Wichayanan and his group proposed that the non-bank business supervision should be in the consistent and congruous direction as supervision of other financial institutions in order to prevent the economic crisis problem that may occur as in USA in the Subprime Financial Crisis (Pakorn Wichayanan and his group, *Credit Card and Personal Loan Business of Non-Bank in Thailand*, Thailand Development Research Institute (TDRI), 1st Publishing, 2008)

agencies in Thailand have not taken into consideration or provide measures to clearly address these issues.

a) Customer information management

Commercial banks introduce financial products or services for the benefit of customers. At the same time, commercial banks also carry on activities or transactions for their own benefit or the benefit of relevant bank officials or any other actions which are not appropriate in relation to information of the customers. This is very dangerous, because it may undermine the foundation of trust or confidence under the fiduciary relationship that consumers place on commercial banks and bank officials. The law related to fiduciary duty clearly provides that the person who is trusted shall refrain from taking any action that give rise to a conflict of interest or a conflict of benefits in the future, and shall act carefully to protect the maximum benefit of the consumers, especially important and general information of consumers, for which there is a duty of confidentiality. Nonetheless, under certain circumstances, there is a necessity for today's business for commercial banks or bank officers to disclose information to others or use such information. However, the important thing is consent from consumers or those who place trust needs to be obtained, or a disclosure of a conflict of interest is made before taking any action (i.e., consent/disclosure base).

Nonetheless, under the current financial business situation where there are financial conglomerates under the increasingly competitive environment, a financial conglomerate which consists of commercial banks, securities firm, law firm, companies in the alliance group, etc.

results in collaboration to exchange and introduce customers to each other (i.e., collaboration with affiliated companies). A customer of a bank that makes a deposit may be introduced to securities services of the securities firm in the financial group or the alliance group, for a referral fee. Therefore, the data base of information of the customers may be exchanged between companies in the financial group and alliance group.

b) Unlawful use of insider information (i.e., insider dealing transaction)

The role of commercial banks, companies in the financial business and other associated groups in relation to the introduction of financial products or financial services to consumers gives rise to an opportunity to learn a consumer's information which is both general and important, which can be used for their own benefit of benefits of others. This results in damage to consumers and take advantage of others in the financial market.

c) Conflict of interest with respect to the role of commercial banks and other companies in the financial group or alliance group

Currently, under the financial business environment, conglomeration of financial business groups or alliance groups, especially in relation to the provision of financial services and introduction of various financial products of commercial banks (i.e., Universal Banking) in the form of a business or a provision of services is based on the fiduciary relationship that can be called "multi-functional business". This causes several important issues to follow, which is a conflict of interest, with the following 3 characteristics.

- Personal Conflict – a conflict

between the interest of the customer and the commercial bank including bank officers. (This case can be referred to as a “Conflict of Interest”)

- Client Conflict – a conflict between interest of customer. This conflict is created because commercial banks and bank officers provide services or conduct transactions for 2 or more customers at the same time. Action with respect to one customer could be detrimental to another customer. In this situation, commercial banks and bank officers may not be able to fully act for the benefit of all customers at the same time as the person who receives trust. (This situation is called a “Conflict of Interest and Duty”)
- d) The issue with an abuse of dominant bargaining position

From the perspective of a financial theory, an unequal bargaining position takes place in the following situations⁵:

- Unequal information, which is the result of possession of asymmetric information
- Inability to access resources for material information, due to various limitations such as social or economic status.
- Inability to process material information, which could be the result of the lack of experience or knowledge (i.e., vulnerabilities).

Given the current status of the financial business of the Thai capital market, the status of retail customers or the general public means a low level of understanding of business transactions. The investment knowledge and expertise is also different. Therefore, commercial banks, securities firm and other companies in the financial business group and alliance group with expertise are in the position to gain trust (i.e., fiduciary relationship) from customers. Therefore, any action of commercial banks and companies within the group may be an abuse of dominant bargaining position. For instance;

- The condition requiring a transaction to be conducted with the securities firm or companies within the financial business group or alliance group. In this regard, commercial banks may introduce their customers to the securities firm or other companies within the group and require services from the said companies. Refusal to use such services may impact the services that the commercial bank offers to the customer.
- The condition requiring the use of services of commercial banks with high cost or fees.

e) The issue with non-arm's length transactions

In the financial business environment where there is an increasing number of financial conglomerates, there is a parent company which acts as a commercial bank or a holding company, subsidiaries and affiliates within the same financial business group, in order to create the power to compete with the competitors, through

⁵ John R. Boatright *Ethics in Finance*, Wiley Blackwell, Second Edition, October 2007 page 35-37

the introduction of comprehensive and various financial services, new technology, and to satisfy the demand of customers both domestically and internationally, as well as the formation of alliance with other financial business groups. Therefore, there may be an issue with assistance and collaboration to exchange information with one another, which could be considered to be inappropriate or unfair to the customers or business competitors (i.e., arm length's transactions), and monopolize and undermine the competition in the financial market (i.e., anti-competition / monopoly transaction). This is detrimental to the customers and the stability of that financial business group, which affects the confidence and trust in the capital market, financial market and the economy in general. For instance:

- The fixing of costs for services between companies within the financial business group and alliance group, which is different or not normal, when compared to the case of general customers.
- The fixing of compensation for fee for referral and collaboration between companies within the financial business group and alliance group, which is high and provides excessive benefits, when compared to the case of general customers.

Besides the similarity of problems on law enactment of the relevant supervising organizations of Thailand and the United States during the Subprime Financial Crisis in 2008, this research also found other additional problems relating the inefficiently legal mechanism for customer protection of Thailand. Although

such problem did not happen in or was a cause of the Subprime Financial Crisis in 2008, the following problems have been occurring in Thailand, which needed to be solved at the same time in order to enhance the efficiency of the mechanism of the customer protection.

[1] General Law

Problems on implementation and interpretation of juristic acts and contracts and tort law

Such legal relationship on the duty of providing financial services or financial products trading of the commercial banks to consumers was under the supervision of the general principles of law such as relationship of the law of obligations, legal completeness of juristic acts and contracts, and other relevant laws as deemed necessary, as well as, shall not violate the mentioned relationship. However, this shall be in accordance with the principles of sanctity of contract and the freedom of contract. Such principles were as legal binding which was enacted between commercial banks providing financial services and consumers.

However, the legal relationship between commercial banks and consumers who use the financial services was diversified with complicated procedures and methods, which was difficult to be all accepted as agreements or contracts. Some kinds of contracts may consist of various legal relationships such as contract of deposit acceptance together with investment management services for the consumer's benefit, including financial advisory service, loan agreement and contract for assurance acceptance, and contract of providing electronic transaction services. Therefore, the consumer may not clearly understand the detailed

significance or conditions, rights and duty, and requirements for financial services. Therefore, the freedom of contract or the principle of sanctity of contract may not be used efficiently. The general principles of law was not used in the agreement for using financial services or financial products of consumers, which was based on equality and bona fide to each other in order to set it up as a defense of each other. Especially, for the issue of using the principles of juristic acts and contracts law and tort law for proving damage occurring from the action of commercial banks under the offense of default or breach of contract, the burden of such proof would be at the consumer as a plaintiff, who needed to attest the action clearly, which was very difficult in practice. In addition, in case the general principle of law on was based by the agreement in the contracts entered between commercial banks and consumers, and the court had judged according that, it would be unfair for the consumers and society in overall.

Caveat Emptor

Caveat Emptor or Let the Buyer Beware was Latin meaning the buyer must bear his/her own risk from property buying. It is the principle relating to property buying and the buyer has no right to claim for any damage from the seller, occurring from the defect of such property, unless the need-to-know fact is covered by

the seller or by dishonesty or deception.

The mentioned principle provided the important reason that the seller was not liable for any damage because during buying process, the buyer knows or should know that the property to be sold was defect, but the buyer still bought it. This showed that the buyer accepted the defected property. Therefore, the buyer could not claim the seller for being liable for the defect after buying. The court has applied this general principle of law in order to refuse the liability of the seller.⁶ If this principle was considered with the action of juristic acts and contracts in the current business, trading, and investment situation, especially in the financial services or financial products of commercial banks in both money market and equity market, many actions relating juristic acts and contracts were executed. The characteristics of the abovementioned juristic acts and contracts were very different from general sales of property since the property to be sold was highly complicated financial products. There were many financial risks, including the risk from no investment return when it is due, called ‘Credit Risk’, or the risk from inability to receive the investment return according to the expected amount because of market fluctuation, called “Market Risk”, including other risks in the financial market system.

⁶ However, such defect shall occur before or at least during the period of making the purchase agreement. If the defect has already existed, but it is unable to clearly be seen when the seller delivered the property to the buyer, the buyer cannot refer to this Section for not being liable for the damage. Refer to the Judgment of the Supreme Court no.5581/2533, stating that “the buyer bought a canned fish with tomato source from the seller. It found out that the canned was in rust with some defect, resulting from the production process of the seller, causing the deterioration of the appropriateness towards the intended benefit according to the contract. The seller shall be liable for such defect, although the buyer has accepted the product without any objection. However, on the delivery period, such defect could not be seen (Associate Professor Dr.Champee Sothipan, *Explanation of Sale and Exchange Law*, Winyuchon Publisher No.2, January 2003, Page 199-200)

As for the sale of financial products to the consumers who are general people, not sophisticated investor or skillful in risk analysis, or do not have any bargaining power or power to access into material information, called 'Unsophisticated Investor', this kind of investors should be specially protected by the government or law in order to protect the benefit of a number of public investors, resulting to the confidence of overall financial market system and economic system. Thus, the principle of Let the Buyer Be Aware or *Caveat Emptor* could not be used for refusing any liability of the seller or issuer or wide presentation of financial products. In this regard, the role of commercial banks as a mediator was very important for keeping the benefit of the consumers and general people by providing correct information or performing the duty to be in consistent with customer's trust (Fiduciary Duty), which was good and efficient to the financial market system.

Standard Contract/ Adhesion Contract in Paternalism and Position Bargaining Power

To conduct the juristic acts and contracts has related to the daily life of people, either relating to consumer products that everyone shall involve or relating to public services. The problem in the current situation of conducting juristic acts and contracts was whether such person could determine his/her own obligation, whether the juristic acts and contracts were specific for each counterparty, the price of goods or service was fixed and could not be changed, and whether the bargaining ability of the counterparty was existed, whether the sanctity of contract and the freedom of contract under the private of autonomy were existed, and how

to determine the scope of relationship, rights and duty, and liability of the counterparty freely according to the intension of the counterparty. These issues were very important and may cause the inequality and unfairness among counterparty, including advantage and disadvantage, and the remedy of damage occurring from the fault of a person who was authorized to determine the scope of relationship of the juristic acts and contracts, which was call Standard Contract or Adhesion Contract.

At present, to enter into the juristic acts and contracts, especially in the financial business area, investment in financial market and equity market is increasingly in the form of standard contract or adhesion contract. Whereas, the scope of relationship, rights, duty, and liability among counterparty was specified by the commercial banks that provided the financial services or significantly presented the financial products. The customers giving a trust or confidence to the commercial banks had not determined or did not understand the said scope. Therefore, when there was a damage occurring with the customers resulting from the performance of the commercial banks, the commercial banks and their officers could decline the liability based on the exemption of the liability or the scope of liability relationship according to the said standard contract.

Agreement exempted the liability under the contract

Under the principle of the freedom of the contact, the counterparty shall be able to freely determine the scope of relationship, rights and duty, and liability as long as the contract is complete as specified by law and in compliance with the regulation of the society, which is not

contrary to public order and good morals, as well as, shall be able to prior determine the exemption of any liability among the counterparty when the damage occurs.

The aforesaid agreement shall not be enforced in case it was an advance exemption of the liability of the counterparty that occurs from his/her serious fraud or gross negligence.⁷ According to Latin Maxims of *nulla pactio ne effidi potest ut dolus praestetur*, it said that the advance agreement shall be void. However, under the current circumstance of the financial service or financial product providing of the commercial banks, if such agreement is determined, the liability occurring from a person's performance can be declined. Although the refusal of liability occurring from serious fraud or gross negligence is negative, in the real situation, the commercial banks and their officers could refuse the liability with the reason that they did not behave or perform any deceptive action or serious negligence that caused any damage. At the same time, the customer could not clearly and sufficiently prove the fraud and gross negligence of the commercial banks and relevant officers, and the scope of carefulness. This caused the damage to the consumers who were not fully remedied.

[2] Special Law

As for the current role of legal mechanism of the special laws in financial consumer protection in Thailand as aforementioned, in the writer's opinion, the problems required to be considered were a problem on insufficient provision of law or standard law for consumer protection in

financial service, a problem on redundancy of the provision of law, and a problem on unclarity of the provision of law.

All special laws relating to the consumer protection for using the financial services were mostly laws with concepts or objectives that the government would intervene in the operating mechanism of the private sectors in business operation, especially in the financial business and banking business, which played a major role and significantly affected the people and economic system of the country. Therefore, it was a public law focusing on economy that the government had supervised in the business operations in order to be secured and safe, and to be real benefit to the public. The special laws for supervision, therefore, were established and they were categorized by type of organization or business entrepreneur (Organizational Approach). For example, the operators of commercial banking business were supervised by the Bank of Thailand; the operators of securities business were supervised by The Office of The Securities and Exchange Commission; the operators of insurance business were supervised by the Office of Insurance Commission, or the Office of the Consumer Protection Board. The special laws, empowering the governmental organizations to have a supervisory power, including the Consumer Protection Act, the Financial Institution Business Act, the Securities and Exchange Act, the Insurance Commission Act, or other relevant laws, had provided the basic principle for supervising the business operator to conduct the business firmly and fairly. Therefore, the special

⁷ Section 373 of the Civil and Commercial Code, "An agreement made in advance exonerating a debtor from his own fraud or gross negligence is void."

laws were as the Prudential Regulation, prescribing the supervising organizations to issue the criteria in order to establish the strength and security of the operating organization, including providing good and efficient risk management or conduct of business. This may relate to the protection of consumers who using the financial services by focusing on the completeness and sufficiency of the disclosure of material information when the commercial banks presented the financial products and services. Thus, under the special laws, currently there is no fundamental law and standard law relating to the consumer financial protection. However, those special laws have determined the supervisory organizations to have the secondary responsibility in the customer protection by issuing criteria, regulations, requirement or policy statement, which were considered as a soft law without serious enforcement. These laws were enforced to the business operations under their supervision in the part of customer protection in financial services. As a result, criteria or provisions relating to the customer protection were decentralized and may be redundant which were difficult to be enforced or to apply in practice.

At present, those special laws have still provided unclear provision such as the Unfair Contracts Terms Act B.E. 2540, having a gap to interpret the fairness or appropriate reason without any guideline or example or clear practice. As a result, the business operators have referred their own reason and enable to refuse any liability to the consumers. This caused the inefficient and unclear mechanism of consumer financial protection. In some special laws such as the Credit Information Business Act B.E. 2545,

stipulating in Section 20 that before the Credit Information Company can disclose the credit information of the customer to other parties, the Company shall obtain the consent from the customer at every time, unless the owner of information gives the consent in other ways. This requirement has opened for the commercial banks to provide the general consent of the customer in advance, stating in the financial service agreement which was a standard contract or adhesion contract. This was difficult for the consumers to understand clearing and it was unfair for them if the said credit information was used by other persons without his/her acknowledgement on the purpose of information usage, and later the damage occurred to them. This did not really certified any fundamental rights to acknowledge the said information or to give the specific consent of the consumers.

Additionally, all mentioned special laws were still lack of concepts, measures, or standards necessary to the protection of the consumer's benefit in the financial services such as the concept of fiduciary relationship, basic measures for customer protection, which included 1) preventive measures on problems of predatory lending transactions that was efficient and clearly defined the penalty, 2) information disclosure in a loan agreement in type of "Adjustable-Rate Mortgage, ARMs", 3) periodic information disclosure and the civil liability of commercial banks in non-disclosure of material information of the Regulation Z of the US Truth in Lending Act, 4) rights to correct the billing error under the US Fair Credit Billing Act, 5) information disclosure of conditions in deposit agreement before opening the account under the Truth in Saving Act, 6) consumer

information disclosure of commercial banks to the National Credit Bureau Co.,Ltd. (NCB) and from NCB to other parties according to the Credit Information Act B.E.2545, which was specific, not general, and in accordance with need-to-know basis in the credit report under the US Fair Credit Reporting Act, and 7) guideline or measures on efficient debt collection under the US Fair Debt Collection Practice, including remedy measures.

4. Risk factors leading to the failure of legal mechanism of the consumer protection in Thailand financial services

The followings were the risk factors on the mechanism of the consumer protection in Thailand financial services, which were facing problems leading to the subprime financial crisis in 2008 and needed to be improved and correct.

(1) Signal for Economic Situation and Local Consumer Lending Rate

The significantly economic signal or indicator that should be considered for improving the mechanism of the consumer financial protection was a continuously increased rate and non-performing loan rate (NPL) of Thailand financial services in personal loan or consumer loan. These rates showed two views, which were 1) behavior of consumers that was more luxurious with less understanding in the mentioned financial products or services, and 2) problems on business operations or presentation of products or services that may insufficiently certify the fundamental rights of the consumers in the

financial services. The report of the Bank of Thailand (BOT) revealed that NPL outstanding of financial system in the 1st quarter of 2013, only in the part of consumer loans, was 60,204 million baht or 2.03% of total loans, increasing from the previous quarter which was 3,621 million baht. BOT also pointed that the demand for loans to households in the 2nd quarter was still slightly increased from the 1st quarter. The significant factor was from influencing interest rate of commercial banks. However, BOT has still supervised the standard of consumer loan of commercial banks to be in the proper rate.⁸ Nevertheless, according to NPL figure during the past 5-6 years, 23% of consumer loans used to be in the loan portfolio of commercial banks was increased to 33%, or its average growth at 16% per year. An analyst from TMB Analytics opined that it was an extreme competition in providing consumer loan, causing the most violent NPL problem since the occurrence of Subprime Financial Crisis in 2008.⁹ Together with the opinion of the Office of the National Economic and Social Development Board (NESDB), it showed that the outstanding balance of personal consumer loans was increased continuously. As of March 2013, the outstanding balance was 2,960,097 million baht, which increased by 20% from the previous year in the same period. The default of debt repayment for personal loan under the supervision was increased by 38.9% in the 1st quarter of 2013, which was 8,553 million baht, while NPL of personal consumer loan was increased by 17.7%, which was 60,204 million baht or

⁸ Report of the Result from Senior Loan Officer Survey in the 2nd quarter of 2013, the Bank of Thailand (www.bot.or.th)

⁹ Information from Manager Daily Newspaper on 22nd May 2013 (www.manager.co.th)

23.5% of total NPLs.¹⁰ Although the NPL figure was not high when comparing to total loans in the financial system. To let the problem continuously occurred may encounter the same problem as the Subprime Financial Crisis in the United States.

(2) Statistics of Claims from Consumers in Financial Services of Financial Consumer Protection Center (FCC)

According to FCC's information of complaints and consultations in 2012, BOT pointed out the overall figure of performance in 2012 which it found that all 3,785 consumer complaints were related to financial services at 3,621 cases (95.7%), 2,832 loan-related cases (78%), 686 cases of deposit and bills (19%), and 103 cases of other issues (3%). The top five complaints from the consumers were debt restructuring, soft loan problem, improper debt collection, behavior of commercial banks' officers, and fee calculation or interest rate and loan rate. In the part of loans, the complaints were related to retail loans which were 942 cases (33%) of housing loans, 854 cases (30%) of credit card loans, 392 cases (14%) of personal loans and 309 cases (14%) of other loans. The complaints can be categorized by problems of each retail loans. Moreover, 686 complaints relating to deposit and investment mostly involved in fee calculation and 177 cases (26%) of the presentation of cross-selling products such as cross-selling products of deposit attached to insurance, or loans attached to insurance. The commercial banks did not

provide sufficient information to consumers and made them misleading that it was a kind of deposit or likely forced them to buy insurance, or the bank's officer proposed special conditions if the customer buys the insurance with the company recommended by the commercial banks.¹¹ Thus, it has reflected the current problems relating to the consumer financial protection in type of consumer loans. If this problem was not solved promptly, it would be spread out.

(3) Problems on Consumer's Understanding in Financial Services

The key researches of the Fiscal Policy Office of Ministry of Finance in 2011, regarding the Role of Microfinance in Promoting Financial Access pointed out that the sampling group of 3,011 respondents of the questionnaire in 10 provinces had low financial understanding, which was 74% of all respondents. There were only 11% of all respondents that had high level of financial understanding.¹² According to key researches of Angkana Prayulsin and her group, regarding Understanding of Depositors and Policy Holders and Significance to Development of Financial Consumer Protection System in September 2009, the survey on understanding level of financial service users was conducted. The result showed that most of respondents had less financial understanding, without any awareness of regulations relating to the change of financial supervision and financial service protection. Most of consumers who had a problem in financial service did not make any claim.¹³ In addition,

¹⁰ Circumstance in Thai society in the 1st quarter of 2013, Social Situation and Outlook, the National Economic and Social Development Board (NESDB), 10th year, 2nd May 2013 (www.nesdb.go.th)

¹¹ Information from Financial Consumer Protection Center (FCC), the Bank of Thailand (www.bot.or.th)

¹² Final Report of Project Re: The Role of Microfinance in Promoting Financial Access, September 2011

the report on the project of studying the financial service demand (public version) of CSN & Associates Co.,Ltd. in 2003 showed that in overall most of people may understand the basic financial services such as deposit acceptance or type of loans. Meanwhile, as for the complicated financial services or products such as depositing areas or investment, most of people did not clearly understand about relevant risks or expenses.¹⁴

Therefore, the said research reflected the level of financial understanding of consumers in financial services from the past to the present which was still in the same problem. Especially, the understanding of retail consumers, who were general people, in the fundamental rights of consumers relating to financial products or services, which was the important mechanism of consumer protection, may be affected.

(4) Development of Commercial Banking Business Operations in type of Universal Banking in Thailand

What to happen in the future for the banking industry in Thailand would be a development of form and structure of banking business under higher competitive circumstances in the future. When Thailand opens for financial freedom and enters into Asian Economic Community (AEC) or Asian-Pacific Economic Cooperation (APEC) or East Asian Countries, which influenced on the development of business form in order to support the demand of consumers

in local area, overseas, and global monetary system, as well as, to seek for various sources of income of each commercial bank in order to make profit and to enhance the consistency and stability of the commercial banks. Therefore, the higher competitive situation in both local and overseas areas would push the pressure to the commercial banks to speedily adjust their strategies again after the adjustment in Thailand economic crisis in 1997. Besides its variety, the form of commercial banking business operation could respond to the demand of customers, covering every occupation. In addition, the form of business operation in type of Universal Banking could be developed. As aforesaid, the policy of the authority or supervisory organization was required to be established in order to develop Thailand as a financial center, at least, among Asian countries. The forms of consolidated business or finding business alliance in the same financial business and in other servicing business were increased in order to find out the opportunity or channel for his/her own business operations. Therefore, if the legal mechanism or the role of authority or supervisory organization was not strong enough or had no improvement of the form of banking business operation of the commercial banks in type of the proper Universal Banking in Thailand, it was an important risk factor causing the failure of legal mechanism of consumer financial protection and building the consumer confidence at the same time.

¹³ Final Report of Project Re: Understanding of Depositors and Policy Holders and Significance to Development of Financial Consumer Protection System, by Angkana Prayulsin and her group, September 2009

¹⁴ Final Report of Project Re: Demand on Financial Services (Public Version) presented to the Bank of Thailand by CSN & Associates Co.,Ltd., 2003

(5) Lessons and Experiences from the United States of America (USA) during the Subprime Financial Crisis in 2008

Under the analysis comparing to the mechanism of consumer financial protection of Thailand and USA during the said Subprime Financial Crisis, it clearly showed the mechanism of consumer protection in Thailand's financial services, including consideration on the content of provision of law, supervision of regulatory organizations, and especially enactment of law and problems occurring in the commercial banking operations. When presenting the financial products or services to the customers, it was in line with the situation occurring in the United States during the period before the Subprime Financial Crisis in 2008. In such situation in the view of overseas academics, although the cause factors from the failure of the mechanism for consumer financial protection may not be the main cause of the economic crisis, the mentioned factor was the primary cause. If there was no such factor, the Subprime Financial Crisis, that was most violent in the history of USA, may not happen. Although, the contexts of business operations of commercial banks, consumer behavior, and the mechanism for supervision of regulatory organization were considered carefully in order to prevent the mentioned problems not to make any impact and to become the economic crisis, it was not a guarantee that the current mechanism for customer protection in financial services could solve the problems incurring in Thailand, including problems from political policy or Thailand's social and economic situation that may occur in the future. Therefore, to improve the mechanism of consumer protection law

in financial services by using the lesson from the United States was the best way of Thailand.

After the occurrence of USA Subprime Financial Crisis in 2008, the international organizations relating to the supervision of monetary system, such as G20 finance minister, the governors of the central banks, the Financial Stability Board (FSB) under the Bank for International Settlements (BIS), World Banks, IOSCO and OECD, have established the relevant working groups in order to analyze and present the countermeasures for consumer financial protection, and to issue the recommendations. Those recommendations were the most important conceptual framework in developing measures or mechanism for consumer financial protection to be more efficient in Thailand.

5. Recommendation

From the United States' experiences or lessons and countermeasures, including other problems, specially related to current legal mechanism in Thailand's consumer financial protection, which have not yet been mentioned, it was necessary to improve the mechanism of consumer financial protection within the conceptual framework of consumer financial protection theory as follow:

Basic Rights for Consumer Protection and Concept of Criteria/ Supervisory Measure

The significant principles of consumer protection, that the United Nation and in the ruling period of John F. Kennedy, the President of the United States, have pointed out 4 consumer rights: right to choose, right to be informed, right to be heard, and right to remedy. UN has determined the following principles and conceptual framework for these rights in order

each country shall clearly provide the consumer protection laws or measures.¹⁵

1) To enhance and protect the consumer's financial damage

2) To have an accessibility to material information relating to goods and service in order to be able to make a decision as to customer's really intension

3) To study or to educate the consumers relating to goods and services which affect the customer's decision making

4) To provide the efficient process that the customer could obtain the remedy

5) To provide the right and liberty for the customers and other organization in order to protect the consumers who claim or express their opinion on goods and services

In this regard, the government of each country shall provide the sufficient infrastructure for developing and supervising the consumer protection policy. The special control shall be made in order to ensure that the consumer protection measures are established for the benefit of the consumers, and public people who have low income. Meanwhile, the business operators should be aware of the compliance with regulations and measures on consumer protection. The measures or guidelines relating to consumer protection proposed by UN were as follow:

- To provide an efficient mechanism in order the consumer can obtain maximum benefit from the standard services, fair business practice,

information presentation about services and good and efficient protection in order to prevent any damage that may occur¹⁶

- To provide a mechanism or measure that controls or supervises limits or actions of taking advantage or being unfair to customers (Abusive Business Practice) which may cause any damage to the consumers, including measures or methods for efficiently enforcing those measures¹⁷

- To provide a mechanism for consumer protection from the requirement in one-sided standard contract which is important to the consumer's right and conditions in loan agreements that difficult to understand¹⁸

- To provide a mechanism for supervision of sale practice in goods and service by using fair principle and providing necessary information and measures for customer's freely making decision with measures to ensure that such information is correct¹⁹

- To provide a legal mechanism or administrative measure in order to remedy the consumers properly, in both formal and informal method with low cost and accessibility, as well as, to promote business operators to provide the countermeasures for civil dispute resolution with fairness, and to provide voluntary consultation²⁰

- To provide a mechanism for developing and encouraging concrete knowledge or education or clear project, including other

¹⁵ Department of Economic and Social Affairs, United Nations Guidelines for Consumer Protection (as expanded in 1999) New York 2003

¹⁶ ¶ 15 United Nations Guidelines for Consumer Protection

¹⁷ ¶ 17 United Nations Guidelines for Consumer Protection

¹⁸ ¶ 21 United Nations Guidelines for Consumer Protection

¹⁹ ¶ 22 United Nations Guidelines for Consumer Protection

²⁰ ¶ 32 United Nations Guidelines for Consumer Protection

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necessary and beneficial information, and rights of consumers²¹

Iain Ramsay, a famous law professor relating to consumer protection, said that the reasons for the government intervening the mechanism of private sector in order to protect the consumers was to prevent the market failure problem, including the social reason or ethical goals, which referred to distributive justice, increasing community values, inequality of bargaining power, and the concept of Paternalism.²² This was in consistence with Professor Peter Cartwright who pointed out that in general the regulations or supervisory measures in the view of economics was to prevent the systemic risk or problems on asymmetric information occurring in financial system, which leads to the problem on market failure. But, the problem on systemic risk has to compare or closely relate to the market confidence and consumer confidence, which were an important part for reducing systemic risk of the mentioned system. Moreover, the objective or view of society also had an important role as determination of form of regulation or supervisory measure such as distribution of fairness to occur in the society. The supervision policy, therefore, shall be determined with reason from comparative analysis about advantage and disadvantage between economics result and social result

(cost & benefit analysis, CBA)²³

As for the supervisory criteria or measures for general consumer protection, Iain Ramsay had proposed the supervisory tools or methods such as information disclosure, determination of standard of business conducts, request for approval from regulators (screening/licensing), pricing controls, and other mechanism that was not other criteria such as beneficiary group or private organization in consumer protection and Self Regulatory Organizations (SROs).²⁴ However, the researches in many countries found that supervisory criteria or measures for consumer financial protection focused on information disclosure of goods and services necessary to the consumers or how to disclose such information to the consumers as much as possible in order to prevent the problem on asymmetric information. However, this problem was difficult to be solved and it was only in ideology. The research of H. Hadfield, R. Howse and M. Trebicock pointed out that to establish the said policy or measures in order to solve the asymmetric information problem was insufficient, but it should focus on roles and duty of consumers on making understanding in such information by themselves.²⁵ In addition, WC Whiteford said that to implement the supervisory policy or measure in order the commercial banks or business operators shall provide the necessary information relating

²¹ ፩ 35 United Nations Guidelines for Consumer Protection

²² See Iain Ramsay, *Consumer Protection Text and Materials*, Weidenfeld and Nicolson London, 1989 page 33-58

²³ Peter Cartwright, *Banks Consumers and Regulation*, page 237-239 และสรุปผลการอภิปรายของ Peter Cartwright, *Consumer Financial Protection: Putting the Law in Context*, in Consumer Financial Protection edited by Peter Cartwright, International Banking Finance and Economic Law Series, Kluwer Law International, First Edition, 1999

²⁴ See Iain Ramsay, *Consumer Protection Text and Materials*, page 59-92

²⁵ Refer to details from Hadfield, R. Howse and M. Trebicock, *Information-Based principles for Rethinking Consumer Protection Policy*, Journal of Consumer Policy, 1998

to goods or services as much as possible. This meant to increase information or quantity of information may not an appropriate approach for consumer financial protection because such disclosure was a benefit for only specific group of consumers who had a good basic understanding.²⁶ Therefore, the most efficient policy and measure for customer financial protection, proposed by Peter Cartwright, focused on consumer financial literacy, methods or ability of consumer to understand information²⁷. Additionally, Peter Cartwright gave the interesting opinion about the supervisory criteria or measures for customer financial protection under pre-approval regulation in the business operation relating to financial product understanding in order to examine whether such operator had complied with the expected regulation or not. However, the problem on the mechanism for consumer protection was the minimum standard of the business operators was established for serving the pre-approval regulation in the initial period only and may not obstruct the operators to access in the market. This well supported the competition in financial system and provided the alternatives to financial consumers with lowest cost.²⁸ Therefore, the proper measure that should be and be efficient was the banking code which was the establishment of practice standard and relationship between business operators and consumers in offering

financial products or services. This also was an advantage for consumers as it was the legal requirement that the consumers could use its benefit of enactment other than official laws or criteria which was come into effect at present.²⁹

The consumer rights protection through the legal process such as juristic acts and contracts law was costly and spent a long period in legal proceedings. The mechanism for protecting the consumer's basic rights shall be any mechanism or measures that the financial consumer could enact the mentioned basic rights efficiently. Thus, the properly supervisory measures of the regulatory organization were very important to such process such as the establishment of minimum standard of performing commercial banking business, when violating against law or the said minimum standard (Enforcement Action) and causing damages and remedy to the consumers. Moreover, the proper supervision included the role of regulatory organization in general explanation or interpretation in order to protect the consumer's right such as to establish a guideline or principle of unfair terms in consumer contracts, to provide the consumer's right in order to dispute the requirement in the financial service contract, to promote the Alternatives Dispute Resolution (ADR).³⁰ In addition, Professor Iain Ramsay had proposed the supervisory guideline for lending

²⁶ Refer to details from WC Whiteford, *The Functions of Disclosure Regulation in Consumer Transactions*, Wisconsin Law Review, 1973

²⁷ Peter Cartwright, *Banks Consumers and Regulation*, page 240 and refer to details from Sophie Ahiswede focusing on knowledge and understanding in risks or financial product characteristics were the best consumer protection. (Sophie Ahiswede, *Consumer Protection in Financial Service*, Deutsche Bank Research, May 24,2011 information from internet)

²⁸ MH Bernstein, *Regulating Business by Independent Commission*, Princeton University Press, 1955 នៃលោក Peter Cartwright, *Banks Consumers and Regulation*, page 242

²⁹ Peter Cartwright, *Banks Consumers and Regulation*, page 242-243

³⁰ Ibid. page 244-245

business operation of commercial banks (Credit Practices) such as necessary information disclosure or reduction of creditor cost, supervision of conditions and terms in the financial service contracts such as cooling-off period or determination of interest rate, other important expenses or conditions³¹

Fiduciary Relationship

The relationship between commercial banks and customer (Banker-Customer Relationship) happened when the customer agreed to use the financial services of the commercial banks. Then, the commercial banks became a fiduciary or in fiduciary relationship. There were 3 legal relationships as fiduciary when the customer used financial services, which were trustee-beneficiary relationship/property theory, principle-agent relationship/contract theory, and reliance relationship/reliance theory. These legal relationships were certified by a number of judgments of the Court of Justice in the Common Law. For example, the case of Lloyds Bank vs. Bundy 1975³² showed that the commercial banking operation was in fiduciary relationship and based on the expectation that was required

to take action for the highest benefit of the consumers. For the important case of Woods vs Martin Banks 1959³³, the court had provided the significant principle when the commercial banks provided the suggestions to the customers as a consultant of financial product investment. This made the commercial banks to be in fiduciary relationship that was required to provide the suggestions for the most beneficial and careful to the customers.³⁴

There were three duties of the commercial banks as the fiduciary: a duty to avoid any conflict of interest (no conflict rule), a duty of not taking benefit wrongfully (no profit rule), and a duty to be careful for the utmost benefit of consumers (fiduciary discretion). However, as for the commercial banking operation in type of the universal banking in Thailand at present and in the future, what to be analyzed for an important problem relating to various financial services of the commercial banks was a problem on customer information management and unfair practice, especially the problem on conflict of interest. These problems were mentioned in the overseas academics and the experience during the Subprime

³¹ Iain Ramsay, *Consumer Protection Text and Materials*, Page 309-368

³² Besides the judgment of the court in the case of Lloyds Bank vs. Bundy 1975, the judgment of the court which was criteria for determining the fiduciary relationship was the judgment of the case of Keech vs. Sandford (1726)³². In this case, the defendant, who was a trustee, entered into the leasing agreement with the leaser on behalf of fiduciary who was a child. Before the leasing agreement was due, the trustee request the leaser to renew the agreement, but the leaser declined under the reason that the counterparty was a child. To force the child to comply with the agreement was not doable. Therefore, the trustee entered into the leasing agreement with the leaser on the child's behalf. The court judged that the trustee could not enter into the said agreement since to enter into the agreement was a result from his duty as a trustee of the previous leasing agreement, although the trustee tried to follow the agreement on the fiduciary behalf. In this case, Lord King gave a reason that this principle should be interpreted strictly that the trustee should not enter into the leasing agreement because the result was clearly shown if the trustee did so." As for the judgment in the case of *the Bristol and West Building Society vs. Mothew (1996)* "Fiduciary referred to a person who did a transaction for other person or on other's behalf under the fiduciary situation. The key responsibility of the fiduciary was to be honest. The fiduciary shall act in good faith, that meant he shall not try to benefit from the duty improperly and shall not bring himself into the situation that may cause the conflict of interest between his benefit and the fiduciary's benefit without any consent."

³³ Woods vs Martin Banks (1959) 1 QB 55

³⁴ Refer to the details from E.P Ellinger, E.Lomnika, R.J.A Hooley, *Ellinger's Modern Banking Law*, Oxford University Press, Fourth Edition, 2006 *or* Ross Cranston, *Principles of Banking Law*, Oxford University Press, Second Edition, 2002

Financial Crisis of the United States, as well as, the behavior of the commercial banks was separated because of the conflict of interest problem. In this regard, the commercial banks breached the fiduciary duty and the consumers were not fully protected. These problems in the overseas academic and the experience during the Subprime Financial Crisis in USA, including in Thailand, had no clear conclusion or countermeasure, but under Thailand's circumstance, this issue should be considered for finding the appropriate approach of Thailand in order to enhance the mechanism of customer financial protection to be complete and efficient.

Principle of Customer Financial Protection under the Guideline of Regulatory Organization and World's Financial System

Stephen Lumpkin, the Chief Executive Officer of the Organization for Economic Co-operation and Development (OECD), mentioned that under the current world's financial system, there were two issues: to present the financial innovation and to protect the benefit of consumer. These issues related to the accessibility of financial services of every group, class, and type of consumers who must be able to access in the services, including the suitability of the consumer in using the financial services. However, the development of the new

form of financial products and services of the commercial banks and business operators was more complicated. In the financial system of several countries, the accessibility was not a problem, but the suitability instead because the financial products and services were difficult to understand for personal consumers. Therefore, the proper measure or method was to provide knowledge and educate the consumers (financial literacy), while the commercial banks or business operators should provide a good internal control in order to prevent any damage that may occur to the consumers, including disclosure of necessary information to the consumers, determination of severe and clear penalty when the commercial banks or business operators did wrong acts or took an advantage or did unfair practice to the consumers.³⁵

However, after the economic crisis in USA or Subprime Financial Crisis in 2008, and the result spreading to the financial system of countries throughout the world, the international organizations relating to financial supervision such as G20 Finance Ministers, the governors of the central banks, Financial Stability Board (FSB) under the Bank for International Settlements (BIS) World Bank, IOSCO and OECD, had set up the relevant working group in order to analyze and present the solution

³⁵ Stephen Lumpkin interestingly summarized that the good and efficient customer or consumer protection was to use the supervisory regulations, laws, or measures in order to make fairness, transparency, and to prevent the conflict of interest that may occur. The fairness proposed by Stephen Lumpkin was

1) Control of information asymmetric meant the consumer should obtain the information about the financial product completely, correctly, and accessibly in order to be able to make a decision, including no undisclosed information or fraud or insider trading for his own benefit.
2) Control of "Agency Problem" which related to the problem on Fiduciary Responsibilities and Contractual Obligations
3) Accessibility to financial services that must no conditions or walls for the consumers to access into the financial services
4) Unbiased treatment or no discrimination to the consumers

(Stephen Lumpkin, *Consumer Protection and Financial Innovation: A Few Basic Propositions*, OECD Journal Financial Market Trends: Volume 2010/Issue 1)

guideline, called Task Force on Financial Consumer Protection of the OECD Committee on Financial Markets (CMF), and to issue the recommendation in order to present in the meeting to give the certification to the international organizations and G20 Finance Ministers Meeting, held on October 14-15 2011, called *G20 High-Level Principles on Financial Consumer Protection, October 2011*. Such recommendation was the most important conceptual framework relating to customer financial protection which was an important guideline on the measure or mechanism for consumer financial protection.

Improvement of the mechanism to protect financial services consumers should be considered from 3 aspects at the same time; that is, from the perspectives of commercial banks or business operators, laws and regulatory bodies and consumers, as follows:

1) The aspect of commercial banks or business operators

- Improvement should be made to the business model which should be appropriate for the business of commercial banks in the form of Universal Banking under the model of the United States, which puts an emphasis on the structure and model of commercial banks as financial conglomerate, in order to separate the risk from the risky businesses, has good risk management whether it is a reputation risk or operational risk which directly relates to the consumer protection mechanism and affect the confidence and stability of commercial banks. At the same time, agencies that regulate commercial banks could implement provide supervision in the form of consolidated supervision and the systemic risk effectively for

the benefit of commercial banks, consumers and the economy in general.

- To apply the concept of accommodation to the basic rights of customers, standards of practice for those who have a fiduciary duty (i.e., fiduciary duty/standard), the scope of management that is appropriate and sufficient for the management of information of customers and unfair action in the context of the grouping of financial businesses in the ASEAN economic community and the East Asia Community, other laws or supervision manuals or other relevant standards for consumer protection that are imposed by the government, a regulatory agency or an association of private entrepreneurs, in order to create an organization culture through a policy, an internal control system, a system to accept complaints from customers, code of conduct, code of ethics and operational manual.

2) The aspect of the law and regulatory agencies

- The law

An improvement should be made to legal provisions that protect financial services customers, which should cover preventive measures and remedy measures. Preventive measures should cover an improvement to general law, which all relevant parties, whether commercial banks, business operators, regulatory agencies or law enforcement personnel should adopt the concept of the accommodation of the basic rights of customers, the idea of fiduciary duty and standard, the principle of good faith and the principle of an abuse of right. The law should be interpreted beyond the legal interpretation under the principle of contracts, for fair protection of customers. At the same time, a specials

legislation for the protection of financial services customers should be passed, especially the parent law and the standard law, which shall be the special law applicable to financial products or services that are important and affect retail customers, such as personal or retail loans, home loans, credit cards, etc. Such law consists of the following principles.

1. Equity and fair treatment
2. Disclosure of important and necessary information
3. Customer confidentiality
4. The filing of complaints or remedy for customers
5. Penalty

In this regard, the said law should provide the authority to regulatory agencies that are related to the protection of financial services customers to issue regulations or rules applicable to activities of commercial banks and other financial businesses to create a level playing field, in the context of both Thailand and the grouping of financial businesses in the ASEAN economic community and the East Asia Community. Existing law and regulations related to consumer protection of agencies that regulate commercial banks could be used as a supplement, in order to issue new regulations or rules as the child law or subordinated laws. With respect to preventive measures, there should also include a policy or a master plan to provide financial knowledge to customers on the national level (i.e., financial literacy master plan) by regulatory agencies who are related to the protection of financial services customers, to create financial knowledge and understanding and the realization of the basic rights and obligations of consumers who consume financial

services or products.

Moreover, with respect to remedy measures, there should be 2 important principles, which are an out-of-court settlement, which is part of a clear disclosure of information related to the basic rights of customers with respect to a claim or demand for compensation from commercial banks or business operators, and the filing of complaints with an internal department of a commercial bank or complaint centers of regulatory agencies who are related to the protection of financial services customers that are organized with the power to investigate the facts both centrally and regionally. The second principle is a settlement of dispute in the court. The law on the consumer protection procedure should be improved to expand the scope and cause of action of the dispute that can be brought before the court. This should include a dispute from a breach of fiduciary duty by commercial banks or business operator, good faith or an abuse of right, and any action that is not consistent with the basic rights of consumers. The court should take into consideration the said principles as part of the inquiry system in order to facilitate justice even more.

- Regulatory agencies

A special governmental agency should be created, with the status equal to a division in the Office of the Consumer Protection Board or the OCPB, in order to supervise and monitor the protection of financial services customers only. In this regard, the law should provide the scope of the authority and the main objectives for the protection of financial services customers. There should be a policy for the supervision of the protection of financial services customers both in the context of both Thailand and

the grouping of financial businesses in the ASEAN economic community and the East Asia Community. The administration will be carried out by a sub-committee for the protection of financial services customers, which consists of the sub-committee chairman who is appointed by the Prime Minister with the recommendations from the Minister of Finance and sub-committee members who are representatives of regulatory agencies, commercial banks associations or international commercial bank associations, consumer protection association or foundation, and relevant independent scholars. The administration will be carried out through the director of the financial services consumer protection division, with the power to give instructions to relevant officers under supervision. Furthermore, this special governmental agency should also be responsible for 5 types of work, which are policy and regulation, research, investigation and punishment, the promotion of financial literacy, and the filing of complaints. This special governmental agency must co-operate, collaborate and exchange information with the private sector, the government and other regulatory agencies both in Thailand and outside of Thailand.

3) The aspect of consumers

The role of organizations related to commercial banks' business activities, whether the Thai Banking Association or the Association or International Banks, should be promoted, which should be allowed to participate in the protection of financial services consumers through, policies or a mission, standards for basic rights of consumers, standards of fiduciary

duty of commercial banks, and standards for penalty or warnings applicable to commercial banks who violate the basic rights of consumers or other relevant laws. In addition, collaboration of associations or foundations of financial services consumers should be promoted and should be part of an independent public institution for consumer protection under Section 60 of the Constitution.

In any event, in addition to the recommendations to improve the legal mechanism for consumer protection as described above, the most important recommendation which should be implemented urgently and continuously is the basic financial knowledge and basic financial understanding of consumers or the general public (i.e., financial literacy). Financial literacy is the most effective consumer protection mechanism, which acts as a shield to sustainably protect the benefits of customers, which will play an important role in the development of the confidence of consumers and the financial market in the future. These are the roles and obligations of all relevant parties, including the public and private sectors, commercial banks and non-banks, regulatory agencies, associations of business operators, and private foundation and organizations, who need to create financial understandings through measures appropriately, concretely and systematically that will apply to all types of consumers. This will be important for the development of a consumer protection mechanism that is effective and can prevent issues for Thailand, such as the economic crisis in the United States in 2008 or the Subprime Financial Crisis.

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