financial products—and develop household budgets sufficient to cover their needs, including savings for retirement.

The global financial crisis has highlighted the importance of consumer protection and financial literacy for financial stability. The stability of financial markets may be undermined where consumers assume more debt than they can afford or are misinformed about their financial options or obligations. Particularly in the developed markets of the United States and Western Europe where consumer lending plays a large role, weak financial consumer protection has been identified as one of key contributors to the 2008-09 instability of financial markets.

At its heart, the need for consumer protection arises from an imbalance of power, information and resources between consumers and their financial service providers, placing consumers at a disadvantage. Consumer protection aims to address this market failure. Financial institutions know their products well but individual retail consumers may find it difficult or costly to obtain sufficient information on their financial purchases. Information may also be too technical or complex for the average consumer to understand and assess. Personal insurance, such as auto or life insurance, are often cited as examples of the imbalances. The complex contracts prepared by insurers—and the risk allocation between the consumer and the financial institution—are often beyond the capacity of most consumers to understand. The same may be true for consumers who take on mortgage loans denominated in foreign currencies, as seen throughout Eastern Europe. A well-designed consumer protection framework can help reduce the imbalances of power and information between consumers and financial institutions.

The focus of consumer protection is on the relationship and interaction between a retail customer and a financial institution (or its agent or other intermediary). Distinguishing between unsophisticated retail and highly sophisticated professional customers is important when designing successful consumer protection provisions. Transactions with well-informed financial and corporate institutions are not subject to many of the problems that can potentially harm retail consumers.

**EU and Croatian Strategies regarding Consumer Protection & Financial Literacy**

The EU Consumer Policy strategy 2007-2013 aims to strengthen consumer protection and financial literacy. The strategy has three objectives to: (1) empower consumers by ensuring

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9 The Review uses the definition of retail market employed by the European Commission in its Consumer Policy strategy 2007-2013. That definition is that the retail market covers economic transactions made between economic operators and final consumers (consumers operating outside their professional life). This is sometimes called the business-to-consumer (or B2C) market. Thus the definition does not include businesses--however small--in their role as purchasers of financial services.

that they have real choices, accurate information, market transparency, and the confidence that comes from effective protection and solid rights; (2) enhance consumers' welfare regarding price, choice, quality, diversity, affordability and safety of products; and (3) protect consumers as a group from the serious risks and threats that cannot be withstood on an individual basis. Key steps for the implementation of the strategy involve development of benchmarks for national consumer policies, including a consumer protection policy for the financial sector, and collection of service quality data and complaint statistics. The EU takes the approach that an effective regime of financial consumer protection covers three areas. Consumers should have access to: (1) sufficient information to make informed decisions in the purchase of financial services, (2) cost-effective recourse mechanisms to redress violations of the financial service contract, and (3) programs of financial education.

In addition, the EU is engaged in an extensive program to further strengthen consumer protection in financial services. Table 6 provides a listing of the key EU Directives related to financial consumer protection and their transposition into Croatian laws. In 2008, the European Parliament approved the revised Consumer Credit Directive, which requires a substantially increased level of disclosure of the terms and conditions of consumer credits. (Transposition of the Directive is required before 2010. Croatia has prepared draft legislation to incorporate the revisions.) However as the European Commission has pointed out, most consumer protection directives require only "minimum harmonization." As a result, EU Member States have often expanded the laws and regulations related to consumer protection. To provide a common framework, the Commission has proposed a new Consumer Rights Directive that would supersede existing Directives on Unfair Contract Terms, Distance Selling, and Doorstep Selling. (Another Directive—on Sale of Consumer Goods and Guarantees—would also be included but this does not relate to financial services.)

Financial education is also being emphasized in the program under development in the EU. In November 2007, the European Commission (EC) released its survey of over 150 financial education programs conducted in the 27 Member States. An October 2008 report of the European Parliament identified measures to be taken to improve financial education throughout the EU. In its Communication on Financial Education the Commission noted it would conduct a comprehensive review in 2010 to evaluate the effectiveness of existing programs of financial education among Member States. In addition, in its April 2009 meeting, the Expert Group on Financial Education suggested that the EC recommend that all member states develop national strategies on financial education. The Expert Group noted that the financial crisis of 2008-09 had highlighted the importance of high levels of financial literacy for all households.

Croatia is in the process of harmonizing its legislation with the EU Directives. Under the Stabilization and Association Agreement signed in Luxembourg in October 2001 (and in force as of February 2005), the Republic of Croatia agreed to adjust its national legislation to the acquis communautaire. The Agreement further specifies that under Article 74, (consumer protection), Croatia and the European Community will cooperate to harmonize Croatia’s consumer protection standards with those of the EU, including implementation in market practice. In 2007, Croatia updated the Consumer Protection Act to follow EU Directives, particularly on distance marketing.

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11 See http://ec.europa.eu/consumers/rights/cons_acquis_en.htm
of financial services. In July 2008, the Croatian Parliament adopted the Capital Market Act, which implemented the EU Directives related to capital markets.

The Croatian National Strategy on Consumer Protection established a clear strategy for further improvements in consumer protection, including in financial services. The Consumer Protection Department under the Ministry of Economy, Labor and Entrepreneurship is in charge of elaborating the National Strategy on Consumer Protection. The Department also carries out the activities of the National Consumer Protection Council, institution established in February 2008 to advise the Government on the national consumer protection strategy and the national programs for consumer protection. The Council is established for a four-year period and consists of 22 representatives of ministries, state bodies responsible for consumer protection, the Chamber of Economy, the Chamber of Trades and Crafts, NGOs active in consumer protection and independent experts in consumer protection. The creation of the National Council on Consumer Protection, which reports to the Government (rather than the Minister of Economy) is a good step for strengthening consumer protection in Croatia. The fifth session of the Council was held in April 2009 and its main activities included drafting of the Report on Implementation of the National Consumer Protection Program for 2007-2008, and establishing the working group in charge of preparing the draft proposal of the National Consumer Protection Program for 2009-2012. In preparing the National Consumer Protection Program for 2009-2012, the National Council plans to develop a national strategy for financial education.

**Background on Croatian Household Finances**

Over the last five years, the doubling of consumer credit throughout Europe has highlighted the need for strong consumer protection and financial literacy. Concerns have been raised as to whether consumers fully understand and recognize the risks they assume with higher debt service obligations. Where long-term loans, such as residential mortgages, are priced based on variable interest rates or where obligations must be repaid in foreign currency, households take on risks that they may not be accustomed to managing.

Since 2003, household debt in Croatia has been rapidly increasing. As seen in Table 1, by year-end 2006 household debt had risen to represent 35 percent of GDP and 96 percent of gross disposable income. By the end of 2008, loans to households had grown to 53 percent of all bank lending.

<table>
<thead>
<tr>
<th></th>
<th>Dec-03</th>
<th>Dec-04</th>
<th>Dec-05</th>
<th>Dec-06</th>
<th>Jun-07</th>
<th>Dec-08</th>
</tr>
</thead>
<tbody>
<tr>
<td>Household Debt (Billion HRK)</td>
<td>57.3</td>
<td>68.4</td>
<td>82.2</td>
<td>100.9</td>
<td>111.0</td>
<td>135</td>
</tr>
<tr>
<td>as % of GDP</td>
<td>25.2</td>
<td>27.9</td>
<td>31.1</td>
<td>35.2</td>
<td>35.3</td>
<td>39.5</td>
</tr>
<tr>
<td>as % of gross disposable income</td>
<td>63.5</td>
<td>68.5</td>
<td>81.7</td>
<td>96.2</td>
<td>103.5</td>
<td>n.a.</td>
</tr>
<tr>
<td>annual growth (%)</td>
<td>27.9</td>
<td>19.2</td>
<td>20.2</td>
<td>22.6</td>
<td>22.4</td>
<td>12.6</td>
</tr>
<tr>
<td>Household loans as % of total bank loans</td>
<td>48.3</td>
<td>50.7</td>
<td>50.7</td>
<td>50.3</td>
<td>50.5</td>
<td>52.6</td>
</tr>
</tbody>
</table>


The extent of access of Croatian households to credit lies, however, within the range found in the new EU Member States. Research indicates that broad and deep access to financial services is a key factor in the long-term development of an economy (World Bank, Finance for All?). As seen in Table 2, on questions of physical access to credit institutions, affordability and eligibility, when measured against Eastern European EU Member States, Croatia is neither the