CROATIA

Diagnostic Review of Consumer Protection and
Financial Literacy

Volume I

Key Findings and Recommendations

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### Abbreviations & Acronyms

<table>
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<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>APR</td>
<td>Annual percentage rate of change</td>
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<tr>
<td>ATM</td>
<td>Automatic teller machine</td>
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<td>AUM</td>
<td>Assets under management</td>
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<td>B2B</td>
<td>Business to business</td>
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<tr>
<td>B2C</td>
<td>Business to consumer</td>
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<tr>
<td>CEA</td>
<td>European Insurance and Reinsurance Federation</td>
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<tr>
<td>CISZP</td>
<td>Centralni Informacijski Sustav Zaštite Potrošača (Central Consumer Protection Information System)</td>
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<td>CIU</td>
<td>Collective Investment Undertaking</td>
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<td>DAB</td>
<td>Državna agencija za osiguranje štednih uloga i sanaciju banaka (State Agency for Deposit Insurance and Bank Rehabilitation)</td>
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<tr>
<td>DOLCETA</td>
<td>Development of On-Line Consumer Education Tools for Adults</td>
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<td>EC</td>
<td>European Commission</td>
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<td>EU</td>
<td>European Union</td>
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<tr>
<td>FINA</td>
<td>Financijska Agencija (Financial Agency)</td>
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<tr>
<td>GDP</td>
<td>Gross domestic product</td>
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<tr>
<td>GDPPC</td>
<td>Gross domestic product per capita</td>
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<td>HANFA</td>
<td>Hrvatska Agencija Za Nadzor Financijskih Usluga (Croatian Financial Services Supervisory Agency)</td>
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<tr>
<td>HNB</td>
<td>Hrvatska Narodna Banka (Croatian National Bank)</td>
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<tr>
<td>HRK</td>
<td>Croatian Kuna</td>
</tr>
<tr>
<td>HROK</td>
<td>Hrvatskog registra obveza po kreditima d.o.o. (Croatian Registry of Credit Obligations)</td>
</tr>
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<td>HRT</td>
<td>Hrvatska Radiotelevizija (Croatian Radiotelevision)</td>
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<tr>
<td>HUB</td>
<td>Hrvatska Udruga Banaka (Croatian Banking Association)</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>INA</td>
<td>Industrija Nafte, d.d.</td>
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<tr>
<td>IPO</td>
<td>Initial public offering</td>
</tr>
<tr>
<td>KYC</td>
<td>Know Your Customer</td>
</tr>
<tr>
<td>MiFID</td>
<td>Markets in Financial Instruments Directive</td>
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<tr>
<td>NGO</td>
<td>Non-government organization</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<tr>
<td>OG</td>
<td>Official Gazette</td>
</tr>
<tr>
<td>REGOS</td>
<td>Središnjeg Registra Osiguranika (Central Registry of Insured Persons)</td>
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SRI  Sustav Razmjene Informacija
       (Information Exchange System)
SRO  Self-regulatory organization
T-HT T-Hrvatski Telekom
UCITS Undertakings for Collective Investment in Transferable Securities
UK  United Kingdom
UNDP United Nations Development Programme
US  United States of America
ZSE Zagreb Stock Exchange

n.a.  Not Available

$1 = 5.10 HRK (average January 2010)
**Foreword**

Consumer protection and financial literacy lies at the heart of any financial sector that is efficient, competitive and fair. Three areas are important. Customers of financial institutions should have the right to receive information that is clear, complete, accurate and comprehensible before they decide to borrow or to invest. They should have access to recourse mechanisms that are efficient and cost-effective. They should also be able to obtain financial education that allows them to become financially literate so that they can make long-term financial plans and take informed decisions.

The issue is particularly important for the poor and other low-income households that are most likely to lack high levels of formal education and be vulnerable to abusive and unethical financial practices.

We are pleased to provide this pilot Diagnostic Review on Consumer Protection and Financial Literacy in Croatia and we would like to thank the Croatian authorities for their valuable cooperation and collaboration in the preparation of the Review. The Review not only looks at financial services in Croatia but also refines a set of good practices or benchmarks for reviewing consumer protection and financial literacy in any jurisdiction. It is expected that this work will prove helpful to the international community and those in emerging markets who seek to establish common ground for minimum good practices in financial consumer protection and financial literacy.
Acknowledgments

This review was prepared by a team led by Sue Rutledge (Senior Private Sector Development Specialist and Regional Consumer Protection and Financial Literacy Coordinator). The project team consisted of Nagavalli Annamalai (Lead Counsel), Rodney Lester (former Senior Advisor), Richard Symonds (former Senior Counsel), all from the World Bank, Nicola Jentzsch, Senior Research Fellow at the Technical University of Berlin, and Juan Carlos Izaguirre Araujo, Consultant of the World Bank. World Bank Group reviewers were Sanja Madzarevic-Sujster (Senior Economist, Zagreb Office) and Eric Haythorne (former Lead Counsel). Peer review comments were received from Lewis Mandell, Professor of Finance and Managerial Economics at the University of Buffalo. Thanks also to Matija Laco (Research Analyst, Zagreb Office) and Dubravka Jerman (Program Assistant, Zagreb Office) from the World Bank for their invaluable assistance in finalizing the Review.

The team would also like to express its appreciation to the Croatian authorities for their cooperation with the Bank team during the preparation of the Review. The team also thanks the numerous ministries, agencies and associations who generously contributed extensive detailed comments on the report.

The authors are grateful to all for their contributions.
Executive Summary

As financial markets develop and deepen, one of the key issues for a fair, open and efficient market is effective consumer protection and financial literacy. The EU takes the approach that an effective regime of financial consumer protection should allow consumers to have access to: (1) sufficient information to make informed decisions about their financial choices; (2) cost-effective recourse mechanisms to redress violations of financial service contracts; and (3) programs of consumer education and financial literacy that empower them to understand their financial rights and obligations.

The global financial crisis has also 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.

Protection of financial consumers is part of the objective of the EU in developing a single market for financial services. With 27 different types of national consumer protection frameworks within the EU, financial service providers are obliged to work with panoplies of national regulations for retail financial services. As a result, few cross-border financial services are sold within the EU. A study prepared for the European Commission (EC) found that 26 percent of European consumers purchased financial services from a national "distance" provider by telephone or through the internet in 2006. However only one percent purchased financial services on a cross-border basis. The need to strengthen financial consumer protection was also highlighted in the EU’s Green Paper on Retail Financial Services in the Single Market released in April 2007. In addition, in November 2007 the EC established a program to encourage financial literacy throughout all EU Member States.

Internationally financial literacy has also taken on increased importance. In its 2005 report Improving Financial Literacy: Analysis of Issues and Policies, the Organisation for Economic Co-operation and Development (OECD) summarized the worldwide programs that promote improved financial literacy. The report also presented recommendations for best practices, noting that financial literacy should not be used as a substitute for consumer disclosure and effective dispute resolution systems.

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. Financial institutions know their products very 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. A well-designed program to strengthen consumer protection and financial literacy can help reduce the imbalances of power and information between consumers and financial institutions.

This Review has found that the quality of consumer protection in financial services in Croatia has improved in recent years. In particular, the approval of the 2007 Consumer Protection Act incorporated many of the EU Directives related to financial consumer protection. In addition, the National Council on Consumer Protection was established in 2008 to advise the Government on its national strategy for consumer protection in the coming years.

However information for financial consumers could be improved. While the law requires that contracts provide detailed information for financial consumers on the terms and conditions of loans, the contracts are long and the terminology difficult to understand. It would be helpful
if financial institutions were required to prepare a "Key Facts Statement" summarizing in plain language all the key terms and conditions related to the financial product. The preparation of Key Facts Statements would also assist consumers in selecting among various service providers of financial services. The professional associations, such as the Croatian Banking Association (HUB), could take a leading role in developing a simple format for banking products and this may provide a useful base for developing standard simple Key Facts Statements for other financial products. The financial supervisory agencies may wish to test consumer understanding of the information provided to them, as is done by the Financial Services Authority of the United Kingdom and the Federal Reserve of the United States. The supervisory agencies may also wish to encourage financial institutions to make offers using examples of standard customers so that consumers could easily compare offers among providers of different services.

Sales practices should also be more consumer-friendly. The use of "tied" products should be discouraged—and volume sales incentive for financial intermediaries subject to special scrutiny, specifically, because they limit choice. Similar to the provisions required for the implementation of the Markets in Financial Instruments Directive (MiFID) in the securities markets, sellers of financial products should be required to ensure that the products are suitable for the customers who purchase them. Cooling-off periods should be established for all products that include a long-term savings component, that is, products that are particularly subject to high-pressure sales. Regarding the pensions sector, people giving advice on joining or switching a pension fund should be licensed and appropriately accredited. In addition, financial institutions should not be permitted to deny service to customers that are not willing to sign waivers giving these institutions the opportunity to share client information with any affiliates and third parties.

Collection practices should be less abusive. For loans that have "co-debtors" or co-signers, the law should not permit lenders to collect against the debtor and co-debtors at the same time.

The credit bureau could be improved. Consumers should be informed regarding any sharing of personal data by the financial institution with other parties. Retention periods for the credit bureau should be clarified. In addition, consideration should be given to providing access to the credit bureau for non-bank credit institutions. Also the credit bureau may wish to consider developing its own system of credit scoring, to be able to provide better services to the industry.

Consideration should also be given to strengthening the consumer protection associations and professional associations. One useful measure is to encourage the associations to develop codes of conduct—or consumer protection codes—that give customers a short summary of their rights (and obligations) in dealing with financial institutions.

Dispute resolution is an area of weakness in Croatia. Consumers can apply to any of nine different institutions and yet none is responsible for finding a solution to consumers' difficulties. HUB plans to use the mediation center run by the Croatian Employers' Association but it is not clear if this will be an effective solution. Consideration should be given to a comprehensive approach. Financial institutions should be obliged to establish a designated complaints department (or unit) within each institution. Codes of conduct could also provide guidance to financial institutions in dealing with customer complaints.

Consideration should be given to establishing an ombudsman for the financial sector. One approach would be to establish ombudsmen under the relevant professional associations. That said, ombudsmen established under professional associations generally lack the independence necessary to establish their credibility. Consideration should also be given to the appropriate governance structure to ensure a high level of transparency and accountability of the
ombudsman. Over time, it may be necessary to consider establishing an independent statutory ombudsman, as has been done in the United Kingdom and Ireland.

Whatever approach is taken, statistics on consumer complaints should be centralized and published. Further, these complaints should be analyzed to identify specific products and services that generate more complaints from consumers and to flag potential prudential problems. In 2006 the Ministry of Economy established the Central Consumer Protection Information System (CISZP), but it was only partially put in place and is not heavily used by financial consumers.

It would be helpful to establish Financial Consumer Complaints Center as a focal point where consumers can submit complaints regarding any type of financial service. The Center should be easily accessible by consumers, via toll-free telephone number, postal mail, email, or physical offices. The Center should also publish complaint statistics. Careful consideration should be given as to how to set up the Center. Initially, the Center would not resolve disputes but ensure that complaints are properly addressed by financial institutions and government authorities. Over time, consideration might be given to expanding the role of the Center to include making decisions on cases involving small sums of money.

Over the long-term, one of the best methods of ensuring high levels of consumer protection is to strengthen financial education and literacy. Any financial education and literacy program will need to cover three areas: (1) consumer awareness of the risks and rewards of various financial products, including possible financial scams; (2) consumer education in preparing personal and household budgets and making long-term financial decisions; and (3) surveys of financial literacy to understand which parts of the population may be particularly vulnerable to predatory lending, financial scams and weaknesses in budgeting and planning.

One weakness is the current institutional structure. Croatia has no national consumer protection agency that covers all sectors, including financial services. Nor does it assign consumer protection responsibility to the financial supervisory agencies. Financial consumer protection should be the responsibility of at least one specific government agency.

Consideration could be given to developing programs of financial education. This might include school programs, particularly at the primary level, where research has shown that encouraging the values of long-term savings and the importance of financial health can encourage children to act with financial responsibility as adults. HUB might provide teaching materials for teachers to assist them. However the most effective financial education is to adults at what are known as "teachable" moments. These include the times when consumers sign up to take a long-term loan, such as a mortgage, or they plan for their long-term retirement. Both financial institutions and NGOs should also play an important role in teaching consumers about personal and household finances. The issues are particularly important for low-income households, whose members often have weak formal education and insufficient financial literacy. However research shows that low-wealth households may be the most interested in education that allows them to start their own business, get bank loans and escape poverty.

A nation-wide baseline survey of financial literacy would provide useful information in designing programs in financial education and consumer awareness. As pioneered in the United Kingdom, financial literacy surveys can identify which part of the population is most vulnerable to financial abuse. The baseline survey should be segmented by age, gender, geographic area, household income, and formal education. After a period of three to five years, a follow-up survey could be done to evaluate the effectiveness of the programs of financial education and consumer awareness.
Introduction

The Diagnostic Review on Consumer Protection and Financial Literacy in Croatia is the fifth report in a World Bank-sponsored pilot program to assess consumer protection and financial literacy in developing and middle-income countries. The objectives of this Review are three-fold: (1) refining a set of good practices for assessing consumer protection in financial services, including financial literacy; (2) conducting a review of the existing rules and practices in Croatia compared to the good practices; and (3) providing recommendations on ways to improve financial consumer protection and financial literacy in Croatia. The Diagnostic Review was prepared at the request of the Ministry of Finance. The mission also met with representatives of the supervisory agency for the non-banking financial sector, namely Croatian Financial Services Supervisory Agency (HANFA), and the Ministry of Economy.

The Review was conducted using a set of draft international Good Practices as a reference point. Working with international regulators, the World Bank has drafted a set of international Good Practices on Consumer Protection and Financial Literacy. The Good Practices have been released as a Consultative Draft for international review and comment—and are expected to evolve following discussions among stakeholders. The Good Practices incorporate provisions of the EU Directives related to consumer protection and reports of European financial regulatory and supervisory agencies, as well as laws, regulations and business practice codes in the United States of America (US), Australia, Canada and other countries worldwide. The OECD has also released sets of good practices for financial education and awareness on pensions and insurance, and a set of draft good practices for credit products, supplementing the recommendations presented in its 2005 global review of financial education programs. As part of the process of further refining and developing the Good Practices, the Diagnostic Review for Romania was prepared using the Good Practices as a reference point.

For the Croatia Review, five segments of the financial sector were assessed and eight key issues were considered. The segments of the financial sector assessed in this Review were: banking, non-bank credit institutions, securities, insurance and private pensions. The eight key issues considered were: (1) consumer protection laws and institutions; (2) disclosure and sales

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1 Other reviews of consumer protection and financial literacy have been prepared (in chronological order) for the Czech Republic, Slovakia, Azerbaijan, Romania, the Russian Federation, Lithuania, Bulgaria and Latvia. The set of published reviews can be downloaded at http://www.worldbank.org/eca/consumerprotection..
2 The mission to Croatia was conducted April 14-23, 2008 and also met with officials from the National Council for Consumer Protection, the Zagreb Stock Exchange, the Banking Association, consumer NGOs and other members of the financial and legal community in Croatia. The Review was prepared with only limited input from the Croatian National Bank (HNB) due to the limited time availability of most of its staff in April 2008. A follow-up mission was conducted October 26-27, 2009 which discussed the draft Review with the Ministry of Finance, HNB and HANFA and updated the report.
3 The World Bank has released the document Good Practices for Consumer Protection and Financial Literacy in Europe and Central Asia: A Diagnostic Tool as a Consultative Draft. A copy can be downloaded at http://www.worldbank.org/eca/consumerprotection. The document summarizes the good practices and includes annotations noting which international experiences they have been used. The Consultative Draft has been published to stimulate discussion on what constitute good practices in consumer protection and financial literacy and obtain feedback and input from regulators and other stakeholders worldwide.
5 See OECD, Improving Financial Literacy: Analysis of Issues and Policies (2005), available at http://www.oecd.org/document/28/0,2340,en_2649_201185_35802524_1_1_1_1,00.html
practices; (3) customer account handling and maintenance; (4) privacy and data protection; (5) mechanisms for recourse in case of disputes; (6) guarantees and compensation schemes; (7) consumer empowerment (including programs for consumer education and financial literacy), and (8) competition issues in financial services. The assessment is not exhaustive and has not captured all prevailing services, products and practices of the financial sector, but has focused on the key areas related to consumer protection and financial literacy. The Review was conducted in April 2008 although some data has since been updated.

The recommendations in the Review incorporate provisions of the EU Directives and EC Recommendations but in some cases go further to reflect good practices used internationally. As described in the EU Consumer Policy Strategy for 2007-2013⁶ and the April 2007 Green Paper on Retail Financial Services in the Single Market⁷, European financial consumers would benefit from stronger legal and institutional protections than those currently in place. Both in Europe and globally, contemporary thinking on consumer protection is rapidly evolving. This Diagnostic Review takes into account the international discussion and the evolving good practices in financial consumer protection. Thus, the Review presents recommendations that are applicable to the Croatian financial sector but in some cases go beyond the existing requirements set by EU legislation.

It is hoped that the publication of the Diagnostic Review for Croatia will help further development of financial consumer protection both in Croatia and worldwide. In particular, it is anticipated that the application of the good practices in middle-income countries such as Croatia, will contribute to the international policy dialog on the key components of financial consumer protection and assist in the development of benchmarks that are widely accepted as generally applicable to consumer protection and financial literacy in any jurisdiction.

The Diagnostic Review for Croatia is presented in two volumes. Volume I notes the importance of consumer protection and financial literacy, provides statistics on the size and growth of the retail financial sector in Croatia, describes the EU and Croatian strategies on consumer protection and financial literacy, and sets out the key findings and recommendations of the Review. The Annex provides examples of consumer protection codes. Volume II provides: (1) a detailed analysis of the key consumer protection issues in five segments of the financial sector—banking, non-banking credit institutions, securities, insurance and private pensions; (2) an assessment of the Croatia consumer protection framework and practices compared to the template of good practices; (3) a description of the key EU Directives related to consumer protection in financial services; and (4) a brief survey of financial literacy programs worldwide.

**Importance of Consumer Protection and Financial Literacy**

Robust consumer protection in financial services and financial literacy are needed to: (1) ensure that financial markets are deep and serve the broad population, (2) provide access to financial services for low-income households and (3) ensure long-term stability in the financial system. Strong consumer protection and financial literacy are building blocks for financial markets. They help to build consumer trust in financial institutions and ensure that financial institutions reach out to serve the needs of the population, including low-income households that often lack access to basic financial services. Moreover as markets expand and provide innovative services to new entrants to the financial sector, high levels of consumer protection are needed to ensure that financial customers are treated fairly by financial institutions. Financial literacy is needed so that consumers can make informed decisions among complex

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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. 8 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). 9 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. 10 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—one 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 1: Household Debt

<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>
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<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>
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</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
easiest nor the most difficult market for households seeking to obtain consumer or mortgage loans.

Table 2: Access to Consumer and Mortgage Loans

<table>
<thead>
<tr>
<th>Physical access</th>
<th>Affordability</th>
<th>Eligibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Locations to submit loan applications (out of 5)</td>
<td>Minimum amount consumer loan (% of GDPPC)</td>
<td>Fees consumer loan (% of minimum loan amount)</td>
</tr>
<tr>
<td>Lithuania</td>
<td>4.25</td>
<td>6.31</td>
</tr>
<tr>
<td>Slovakia</td>
<td>3.64</td>
<td>10.26</td>
</tr>
<tr>
<td>Croatia</td>
<td><strong>3.43</strong></td>
<td><strong>3.90</strong></td>
</tr>
<tr>
<td>Poland</td>
<td>3.43</td>
<td>3.66</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>3.42</td>
<td>14.24</td>
</tr>
<tr>
<td>Hungary</td>
<td>3.29</td>
<td>4.77</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>3.13</td>
<td>10.22</td>
</tr>
<tr>
<td>Slovenia</td>
<td>2.13</td>
<td>1.13</td>
</tr>
<tr>
<td>Romania</td>
<td>2.00</td>
<td>6.10</td>
</tr>
</tbody>
</table>

Source: Finance for All? World Bank 2008
Note: GDPPC refers to gross domestic product per capita.

Since 2003, total financial investments by Croatian households have almost doubled. As seen in Table 3, the largest increases have been in mandatory pension funds which have increased around 370 percent and investment funds which have grown almost nine-fold since 2003. Household investments have been slowly decreasing as a proportion of household debt, falling from 1.7 times in 2003 to 1.5 times in 2007 and 1.4 in 2008.

Table 3: Household Financial Investments

<table>
<thead>
<tr>
<th>(Million HRK)</th>
<th>Dec-03</th>
<th>Dec-04</th>
<th>Dec-05</th>
<th>Dec-06</th>
<th>Dec-07</th>
<th>Dec-08</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank deposits</td>
<td>80,852</td>
<td>88,630</td>
<td>99,341</td>
<td>112,626</td>
<td>124,491</td>
<td>136,042</td>
</tr>
<tr>
<td>Housing bank deposits</td>
<td>3,265</td>
<td>4,728</td>
<td>5,515</td>
<td>5,804</td>
<td>6,038</td>
<td>6,298</td>
</tr>
<tr>
<td>Total deposits</td>
<td><strong>84,117</strong></td>
<td><strong>93,358</strong></td>
<td><strong>104,856</strong></td>
<td><strong>118,430</strong></td>
<td><strong>130,529</strong></td>
<td><strong>142,340</strong></td>
</tr>
<tr>
<td>Open-end investment funds</td>
<td>2,942</td>
<td>4,528</td>
<td>8,835</td>
<td>16,039</td>
<td>30,056</td>
<td>9,890</td>
</tr>
<tr>
<td>Close-end investment funds</td>
<td>977</td>
<td>1,120</td>
<td>1,537</td>
<td>2,443</td>
<td>3,470</td>
<td>1,898</td>
</tr>
<tr>
<td>Total investment funds</td>
<td><strong>3,919</strong></td>
<td><strong>5,648</strong></td>
<td><strong>10,372</strong></td>
<td><strong>18,482</strong></td>
<td><strong>33,526</strong></td>
<td><strong>11,788</strong></td>
</tr>
<tr>
<td>Mandatory pension funds</td>
<td>4,815</td>
<td>8,085</td>
<td>11,992</td>
<td>16,045</td>
<td>21,202</td>
<td>22,590</td>
</tr>
<tr>
<td>Open-end voluntary pension funds</td>
<td>32</td>
<td>99</td>
<td>211</td>
<td>416</td>
<td>716</td>
<td>800</td>
</tr>
<tr>
<td>Close-end voluntary pension funds</td>
<td>-</td>
<td>1</td>
<td>22</td>
<td>62</td>
<td>122</td>
<td>148</td>
</tr>
<tr>
<td>Total pension funds</td>
<td><strong>4,847</strong></td>
<td><strong>8,188</strong></td>
<td><strong>12,224</strong></td>
<td><strong>16,522</strong></td>
<td><strong>22,041</strong></td>
<td><strong>23,538</strong></td>
</tr>
<tr>
<td>Motor vehicle liability insurance</td>
<td>1,957</td>
<td>2,112</td>
<td>2,246</td>
<td>2,433</td>
<td>2,720</td>
<td>2,921</td>
</tr>
<tr>
<td>Life insurance</td>
<td>1,350</td>
<td>1,569</td>
<td>1,896</td>
<td>2,176</td>
<td>2,473</td>
<td>2,546</td>
</tr>
<tr>
<td>Personal accident insurance</td>
<td>448</td>
<td>458</td>
<td>470</td>
<td>499</td>
<td>525</td>
<td>547</td>
</tr>
<tr>
<td>Health insurance</td>
<td>105</td>
<td>127</td>
<td>187</td>
<td>224</td>
<td>253</td>
<td>281</td>
</tr>
<tr>
<td>Total insurance</td>
<td><strong>3,860</strong></td>
<td><strong>4,267</strong></td>
<td><strong>4,799</strong></td>
<td><strong>5,331</strong></td>
<td><strong>5,971</strong></td>
<td><strong>6,296</strong></td>
</tr>
</tbody>
</table>

Some of the increase in pension and investment funds was due to rapid rises in the prices of stocks traded on the Zagreb Stock Exchange. As seen in Table 4, the Zagreb Stock Exchange rose 61 percent in 2006 and 63 percent in 2007 fueled by IPOs for both INA (former state oil and gas company) and T-HT (former state telecommunications company.) The increases by the Zagreb Stock Exchange were among the largest within the new EU member states.

While statistics are not available, reports in the press suggest that some Croatian consumers have engaged in risky investment strategies. Such strategies have apparently included taking out bank loans in order to invest in publicly traded shares, or pensioners using limited retirement income for the same purpose.

Table 4: Selected Stock Exchange Indexes

<table>
<thead>
<tr>
<th>Index</th>
<th>Annual Return in %</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bratislava - SAX</td>
<td>25.6</td>
<td>0.6</td>
<td>7.2</td>
<td>-19.4</td>
<td></td>
</tr>
<tr>
<td>Budapest - BUX</td>
<td>41.0</td>
<td>19.5</td>
<td>5.6</td>
<td>-53.3</td>
<td></td>
</tr>
<tr>
<td>Ljubljana - SBI20</td>
<td>-5.7</td>
<td>37.9</td>
<td>78.1</td>
<td>-67.5</td>
<td></td>
</tr>
<tr>
<td>Prague – PK50</td>
<td>42.7</td>
<td>7.9</td>
<td>14.2</td>
<td>-52.5</td>
<td></td>
</tr>
<tr>
<td>Warsaw - WiG</td>
<td>33.7</td>
<td>41.6</td>
<td>10.4</td>
<td>-51.1</td>
<td></td>
</tr>
<tr>
<td>Zagreb - CROBEX</td>
<td>27.6</td>
<td>60.7</td>
<td>63.2</td>
<td>-67.1</td>
<td></td>
</tr>
</tbody>
</table>


The recent decline in share prices has highlighted the need for improved consumer awareness and financial literacy. During 2008, share prices on the Zagreb Stock Exchange declined by about 67 percent, one of the highest declines among similar emerging markets.

**Key Findings & Recommendations**

This Review has found that the quality of consumer protection in financial services in Croatia has improved in recent years. The transposition of the EU Directives into Croatian legislation has strengthened the financial sector laws and regulations related to consumer protection. The amendments of the Consumer Protection Act in 2007 incorporated many of the EU Directives related to financial consumer protection, including provisions on unfair contracts and distance marketing of financial services. The Capital Market Act, adopted in July 2008, replaced the 2002 Securities Market Act and aligned the Croatian legislation on capital markets with the acquis communautaire. The Consumer Credit Act issued in June 2009 (implementing the 2008 EU Directive on Consumer Credit) will further strengthen the consumer protection legal framework. The National Plan for Consumer Protection also established a clear strategy for further improvements in consumer protection, including in the financial sector. Furthermore, the creation of the National Council on Consumer Protection, which reports to the Government (rather than the Minister of Economy) is also a powerful step in strengthening consumer protection in Croatia.

Nevertheless more could—and should—be done to strengthen financial consumer protection and literacy in Croatia. This Review’s recommendations are grouped into three areas:

1) Improving information and disclosure for consumers, including sales practices and activities of the credit bureau;
2) Strengthening the system of resolving customer disputes regarding financial products; and
3) Strengthening consumer education and financial literacy.
Information & Disclosure for Consumers

The Credit Institutions Act and the Consumer Protection Act both require extensive information to be provided to financial consumers. Both acts stipulate, for example, that loan contracts should be as complete as possible and should include statements as to: (1) the amount of the loan granted; (2) the nominal annual interest rate and the effective interest rate (and conditions under which they are changed); (3) the costs charged at the time the contract is concluded; (4) the number and frequency or dates of installments; and (5) the total of all costs. Furthermore, advertisements for loans must also include a statement of the nominal annual interest rate, a statement of any other loan charges, and a statement of the effective interest rate.

The Consumer Credit Act of 2009 has helped clarify the calculation of APR. The new legislation implements the EU Directive on Consumer Credit and specifies a clear procedure for determining the effective interest rate on consumer loans. Previously the Credit Institutions Act and the Consumer Protection Act used different methodologies for this purpose. The Act entered into force in January 2010 and financial institutions have a year to achieve full compliance with the new legislation.

However the most common complaints relate to both insufficient transparency regarding financial services and weak understanding of financial services by consumers. For the Ministry of Finance, common complaints relate to the ability of banks to unilaterally raise interest rates on consumer loans without the consumer being aware of how the banks set the rates. Among non-bank credit institutions, concerns have been raised over the excessively high interest rates charged by non-bank credit institutions on households with patchy credit histories. To the HNB, consumers complained that, “we didn’t know what we signed.” Consumers also expressed discomfort that officers of credit institutions had not explained the risk to the consumer of signing a financial contract, particularly if the consumer was a co-signer, or “co-debtor” of another person’s credit.

Key Facts Statement

The professional associations should play a leading role in developing standardized formats of “Key Facts Statements”. While not required under the EU Directives, Key Facts Statements are readily being acknowledged as good practice worldwide and they are now common-place in numerous countries, including Australia, Ireland and the United Kingdom. To ensure that the Key Facts Statement is easy for financial institutions to implement, it would be best if the professional associations develop the format of the Key Facts Statement for each of their market segments. For example, in the case of bank loans, HUB should prepare a Key Facts Statement that would help to simplify terms and conditions of loan contracts and standardize their presentation, font size and terminology, particularly given that the current terminology is seen as unnecessarily complex. As the other professional associations become more active, they should also take the lead in developing Key Facts Statements in their markets, in cooperation with consumer associations. However if the professional associations prefer not to do so, the financial supervisory agencies should develop the formats for the Key Facts Statements.

The Key Facts Statement should give any potential retail consumer the basic information he or she needs to compare one financial product to another. In addition to ensuring that their contracts with retail consumers include all relevant terms and conditions, all types of financial institutions should provide consumers with a Key Facts Statements for their financial products. In
the case of credit contracts, the Key Facts Statement should indicate in addition to the APR: (1) the total amount of the credit; (2) the amounts of monthly payments; (3) the final maturity of the credit or investment; (4) the total amount of payments to be made; (5) all fees, including prepayment and overdue penalty fees, as well as any other charges that could be incurred; (6) any required deposits or advance payments; (7) if the interest rate is variable, the basis on which the variable calculation is to be made; and (8) any additional insurance (such as personal mortgage insurance) that is required to maintain the credit. If the credit is used to finance a durable good, such as a television or a washing machine, the consumer should be advised of the cash price of the product with and without financing charges so that he or she can determine the cost of financing, separate from the purchase price of the good. The disclosure to consumers should also indicate what mechanisms for recourse are available to the borrower or investor in the event of any dispute arising from the contract. In addition, if a privacy waiver is included in a sales document or insurance contract, the requirement for a privacy waiver should be disclosed in the Key Facts Statement. The Credit Institutions Act prescribes a list of basic information on credit and deposit products that credit institutions should disclose to consumers, such as the APR, the amount of loan, the number and frequency of payments to be made, all fees and charges that could be incurred, and required deposits. This information could be used by the banking industry to develop Key Fact Statements.

The Key Facts Statement should allow consumers to identify the key terms and conditions for financial services or products easily and quickly. Key Facts Statements should use a relatively large font size, contrasting backgrounds, be presented on a single page and be written in clear and plain language. The Key Facts Statement should indicate the need to consult the contract for a full description of the terms and conditions of the financial product. Although the Key Facts Statement is not a substitute for the legal contract, financial institutions should be obliged to ensure that any Key Facts Statement is not incorrect. A Key Facts Statement should be placed on the front page of all insurance policies sold to retail customers and included with all proposals to and applications from retail customers for insurance and pension products.

Special Risks Disclosure

Special risks should be disclosed to consumers in plain language. For mortgage loans and any other credits secured by real property (such as a house or apartment), the mandatory disclosure should note that in the case of default, the lender could seize the property. In addition, for loans denominated in a foreign currency (such as Japanese Yen, Swiss Francs or even Euros), the mandatory key facts disclosure should contain a warning that changes in exchange rates could increase the total amount of debt converted into domestic currency. It would also be useful to include an estimate of the current debt outstanding converted into local currency—or to provide representative examples of amount and costs of credit in foreign exchange and local currency for comparison.

Other consumer credits would also benefit from better disclosure. Credit card statements could be made clearer. A standard approach should be taken regarding consumer notification in the case of changes to interest rates, fees and other charges. For non-bank financial institutions that provide loan facilities, disclosure should be improved regarding all applicable fees, including penalty fees, if any, for the prepayment of a loan.

Penalties for failure to disclose required information to investors in securities and CIUs should be improved. Although the relevant laws and regulations provide for disclosure of relevant information during the sales process for securities and CIUs, the penalties for failing to comply are limited in scope and do not apply to natural persons. These penalties should be strengthened to deter violations.
Additional information should be disclosed to consumers in the insurance and pension sectors. As to insurance, commissions for life contracts with savings or investments components should be disclosed to consumers at their request. Regarding pensions, participants in mandatory pension funds should be advised at the outset if an intermediary or “spotter” will receive a commission or any other benefit as a result of the participant subsequently switching funds.15

The supervisory agencies may wish also to test consumer understanding of Key Facts Statements and standard contracts. Both the Financial Services Authority in the United Kingdom and the Federal Reserve Board in the United States test consumer understanding of standard formats of information provided to consumers.

Comparative Prices

The financial supervisory agencies should make it easy for consumers to compare prices and products being offered. Financial institutions worldwide present their products in non-standardized ways, making it difficult for any consumer to find the best financial product for his or her needs at the best price. HUB provides some comparisons of loan pricing and deposit rates offered by different banks but more could be done. The supervisory agencies could establish a standardized way of presenting offers, with a standard set of assumptions, and ask financial institutions to publish their offers for the standard products. For life insurance, the issue is particularly complex. HANFA should specify maximum interest crediting and bonus assumptions used for benefits illustration, based on current secure investment returns available (as is already the case for supplementary pension products). The cost comparisons should be published on the websites of the financial institutions. On the website of each supervisory agency, there could be a message saying that comparing the tariffs and charges for financial services and products provided by different financial institutions could help consumers save money.

Sales Practices

The sale of “tied” products should be more actively discouraged. In a survey of 25 EU Member States, the EC found that bank deposit accounts were as fully tied to residential mortgages and consumer loans in just three countries. Anecdotal information suggests that if Croatia were part of the same survey, consumers would also identify bundling of products such as the sale of life insurance as a requirement for obtaining a residential mortgage. Anti-competitive tying and bundling of products can result in decreased choice and lock-in of consumers. All banks should be required to establish separate service counters for bank deposit accounts and investment holdings. In addition, HNB could mandate in its regulations that no commercial bank may require a borrower to open a current account with the bank as a condition of receiving its financing. HNB has already conducted two surveys analyzing bundling practices of lenders when granting mortgage loans, it should continue analyzing bundling practices for other products. However the issue of tied products is not limited to banking. A high portion of mandatory motor insurance is sold through motor testing stations, some of which are licensed sole agents. This was probably an unintended result of the “polarization” requirements of the 2008 Insurance Law (prohibiting general agents). As a further measure, the Competition Authority and the financial supervisory agencies should monitor levels of competition throughout the financial services industry to ensure that no market player can leverage market power through bundling, tying or other exclusionary practices.

15 Investigations should also be undertaken of market friendly techniques being developed elsewhere to restrict non-productive switching. Frequent switching can reduce the long term value of a participant’s funds and add unnecessarily to the total costs of what is already a subsidized pension system.
Volume sales incentives for financial intermediaries should be subject to special scrutiny. In general, volume-based commissions or inducements for brokers or other financial intermediaries should be banned. Alternatively at the very least, any broker or agent who receives a volume-based commission should be obliged to disclose this fact to his or her customers.

Any seller of a complex financial product should be required to ensure that the product is suitable (and affordable) for the customer who purchases it. Those who distribute any loan or investment product should be obliged to know his or her customer sufficiently well to ensure that the product is suitable for the purchaser, based on his/her age, financial experience and savings goals. Following the implementation of the EU MiFID Directive, the Ordinance on Business Obligations of an Investment Firm when Providing Services to Clients establishes “Know Your Customer” (KYC) and suitability procedures for investment firms. However, this Ordinance does not apply to customers of collective investment funds. The same suitability rules should apply equally to investment funds. In the banking sector, different banks use different standards of affordability, as well as different ways of defining “disposable income”. It would be helpful if affordability tests were standardized for the banking sector. The issue of suitability is also important for pensions. HANFA should set a standard method of recording the information gathered and the advice given by sellers of individual supplementary pensions.

Improved training for sellers of financial services would also be helpful. Visits to banks indicated that tellers are not always able to answer basic questions about the terms of conditions of the bank products that they sell. Banks need to ensure that all staff members, but particularly sales staff, are sent for refresher courses on a regular basis. Training should also be provided for those who sell collective investment funds and private pensions (i.e. mandatory or voluntary funded individual accounts). They should be required to have at least the same level of qualifications as an investment advisor or specialized broker. Intermediaries selling long-term savings products should be required to satisfy examination requirements similar to those of investment advisors. HANFA should set and enforce severe sanctions for any breach of these training requirements. In addition, people giving advice on joining or switching to a pension fund should be licensed and appropriately accredited.

Cooling-off periods should be established for all financial products with long-term savings components. Following the EU Directive on Distance Marketing of Financial Services, the Consumer Protection Act amended in 2007 requires a cooling-off period for tele-marketing and doorstep selling of financial goods and services. Cooling-off periods should apply to all financial products with a long-term commitment. Financial products with long-term maturities are often subject to aggressive selling techniques, such as the use of "multi-level" distribution systems. A cooling-off period protects a consumer who has signed a long-term contract but, upon reflection (whether as a result of consultation with family members or others), no longer believes that the product is the most suitable for his or her needs. Cooling-off periods should apply to both loans and investments (such as insurance) where the commitment period is more than two or five years, respectively. Typically, the cooling-off period is either seven or fourteen days. In addition, cooling-off periods should also apply to the sale of any product that could be considered to be tied to another product. The essential point is that a customer who provides notice to his or her financial institution prior to the expiry of the cooling-off period of his or her desire not to proceed with the transaction, has the contract and transaction cancelled without penalty.

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16 In multi-level distribution systems, existing customers act as distribution agents selling the same type of financial products to their network of friends, family and business colleagues. Multi-level systems are known for their very high distribution expenses and high-pressure sales techniques. They are particularly common in the sale of insurance and pension products.

17 For a description of cooling-off periods in several EU member states see http://ec.europa.eu/consumers/cons_int/fina_serv/cons_directive/cons_cred1a_en.pdf
Consumer Credit Act prescribes cooling-off periods for most types of loans for retail customers. For loans that do not fall under the scope of the 2009 Consumer Credit Act, HNB is considering the inclusion of cooling-off provisions in the next revision of the Credit Institutions Act.

**Debt Collection Practices**

The law should not permit lenders to collect against the debtor and co-debtors at the same time. An estimated 75 percent of all household loans in Croatia are made using co-signers, known as "co-debtors." Under the Civil Obligations Act, if a borrower defaults, all obligations (including interest charges and penalty fees) are transferred to the co-debtor. This Act also allows creditors to place a lien on the salary of a co-debtor. To protect the customer, all financial institutions should be legally obliged in the first instance to exhaust all avenues of legal recourse against the borrower before taking any action against the co-debtor. In addition, creditors should be required to obtain a court order before attaching the salary of the co-debtor or garnishing his or her salary in a bank account. These restrictions should apply not just to banks but to all market participants in the financial sector.

**Sharing of Customer Information and Credit Bureau**

Sharing of customer personal information within financial conglomerates should be made more transparent and real choice should be given to the consumer. Under Croatian law, personal information about clients can only be shared within a financial group or with a third party if the client has given prior specific permission in writing. However, anecdotal information suggests that some banks require their customers to sign the waiver (accepting a bank’s information-sharing policy) before they are permitted to open a current account. While this requirement may be important for specific administrative and contractual matters (such as sharing information with a credit bureau), companies should not use this for obtaining consent on marketing (by sharing information within their company group). In addition, a law is required to ensure that any financial institution wishing to transfer any personal financial information of a customer to a third party must: (1) first notify the customer of this intention; (2) inform the customer that unless he or she gives written consent to the financial institution the transfer will not take place [or, at the very least, provide a reasonable period during which the customer is entitled to object]; and (3) comply with the wishes of the customer in these respects. If a privacy waiver is part of the required documentation for a financial product, the waiver should be a separate “opt-in” document requiring written acknowledgement and acceptance by the consumer.

The operation of the Croatian Credit Bureau (HROK) could also be strengthened. The Croatian Credit Bureau became operational only in 2006. Its efficient operation is already a substantial contributor to the database of information available to lenders. Over time, the work of HROK will increase competition and reduce prices for new retail consumers of financial services. However, care needs to be taken to control the use of personal information registered with HROK. According to the Act on Personal Data Protection, consumers have the right to know: (1) the purpose of processing their information, (2) the users of their personal data, and (3) whether providing the data is voluntary or mandatory for the consumer. These provisions are insufficient, however, when applied to any complex multinational financial group, such as those that dominate the banking and insurance sectors of Croatia. The subsidiary of a banking group may share personal data with the parent company such as a foreign bank, and then it is not transparent anymore to whom else the information is passed in the other country.

Consumers should be informed of the implications of third-party data sharing. This should hold for any individual whose personal information is subject to data processing, and it should apply especially to any potential co-borrower who is obliged to provide personal information and on which creditworthiness tests will be performed. This disclosure could be part of any loan
agreement or be included in a separate form. In addition, brochures that clearly explain data sharing and analysis might be helpful. When information is shared across borders, the consumer should be informed about this in detail and not with general statements. Consumers should have the right to prohibit information sharing within a group for marketing purposes.

**Access of non-bank credit institutions to the credit bureau should also be considered.** Only banks provide information and have access to the credit bureau. To be fully effective, however, HROK should also collect information about customer payment histories at non-bank credit institutions, such as consumer finance companies and leasing companies. Croatia has only one consumer finance company that is not owned by a bank. Planned changes in tax laws however will likely encourage the development of independent consumer finance companies. When this occurs, information on consumer payment histories should also be provided to HROK. For leasing, the Leasing Act prohibits the sharing of information about customer payments. It may be worthwhile however to consider amending this Act to allow the delivery of customer payment information to HROK. Similar provisions may also be needed regarding consumer finance companies.

**Retention periods for credit bureau information should be clarified.** The Act on Personal Data Protection includes no provision to permit the definitive removal of any information provided to HROK, be it positive or negative. The Personal Data Protection Authority should revise this Act to require that information be erased after a stipulated period of time. Retention periods differ from country to country, but credit information should not be kept longer than its expected predictive power. Common international practice is that positive information is retained for up to two years, while negative information for up to six. Whatever retention periods are selected, consumers should be advised of the time-limit for retention of credit information. At the time of signing a loan contract, the borrower (and all co-debtors) should be informed of the applicable retention periods. In addition, the Data Protection Authority could play a role in educating the public about credit information-sharing, scoring, effects of defaults and data retention periods. Similar work is being conducted in other jurisdictions, including the United Kingdom by the Information Commissioner and in the United States by the Federal Trade Commission, and they could serve as useful models.

**HROK could produce its own credit scores based on information submitted to the bureau.** With the exception of retail loans provided by commercial banks, Croatia does not have a sizeable consumer finance sector. However, throughout the emerging markets of Central and Eastern Europe, consumer finance companies are growing rapidly. They often provide access to credit for underserved populations and act as powerful competitors to commercial banks in providing loans to households. A competitive consumer finance sector needs to rely, however, on the ready availability of good credit information from credit registers—and reliable forms of credit scoring from an independent source such as a credit bureau. Efficient lenders need to be able to conduct stress tests on their portfolios and measure their value at risk in multiple economic scenarios. For consumer finance companies, success in risk management requires that credit decisions and pricing be based on comprehensive consumer credit scoring data and automated tools of analysis. In particular, competitive finance companies need to maintain risk databases that allow them to compare expected risk ratings on portfolios to the actual loss experienced, and then to identify the measures needed to refine the accuracy of credit risk evaluations. High quality credit information would thus allow consumer finance providers to

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18 See for example, PricewatershouseCoopers, *Consumer Finance Update*, Winter 2006 (available at [http://www.pwc.com/consumerfinance](http://www.pwc.com/consumerfinance)).

use risk-based pricing, thus reducing the interest charges at least for those borrowers with strong credit record of timely payments. This can increase access to finance for low-income borrowers. In addition, a reliable credit scoring system is needed if consumer receivables are to be securitized as an additional source of funding (and fee income) for financial institutions in Croatia.

The information in HROK could also be used to analyze the level of indebtedness of the population. Increasingly analysis of indebtedness is being treated as a “public good” that benefits all those who seek to understand household financial behavior fully. Credit bureaus hold detailed information on economic behavior, including repayment trends of different segments of the population. The financial supervisory agencies should consider accessing aggregate information from the credit bureau for their own analyses. Such is being conducted in the United States by the Federal Reserve\textsuperscript{20} and is being considered in Europe by the European Central Bank.

**Consumer Protection Codes**

The Code of Banking Practices should be strengthened and made into a Consumer Protection Code. In 2001, HUB developed a Code of Banking Practices, which has provided useful guidance for banks in Croatia. It is time, however, for the Code to be reviewed and revised. The Code should be based on broad principles, giving general guidance to banks in their operations. In their annual reports, banks should discuss the level of their compliance with the Code. During its onsite supervisory activities, HNB should review the accuracy of each bank’s compliance statement. The Code should also be widely publicized. While it is on the website of HUB, the existing Code is not well-known by consumer protection associations or members of the legal community. An example of a Consumer Protection Code is provided in the Annex 1.

The professional associations for securities, investment funds and pensions sectors should also be strengthened. HANFA should encourage the development of strong professional associations for each area. Following the strengthening of the associations, Consumer Protection Codes for all types of financial intermediaries should be prepared, adopted, publicized and widely disseminated. At the time of onsite supervision, HANFA should also review compliance with such Consumer Protection Codes.

**Dispute Resolution Mechanisms**

Of all issues related to consumer protection and financial literacy in Croatia, the greatest weakness is the mechanism for resolving disputes. Under the EU Consumer Policy Strategy for 2007-2013, consumers should have access to a dispute resolution system that is fair and effective. Most customer disputes regarding financial services concern small amounts of money of under the equivalent of €1,000. In any jurisdiction, when the time and effort spent to go to civil court exceeds the amount of a consumer’s claim, the consumer will drop the complaint rather than go through a legal process. This situation represents an issue of fairness. How can the power between an individual consumer and a financial institution be better balanced? How can the bargaining position of a retail customer vis-à-vis a financial institution be improved? The answers

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lie is an effective and inexpensive (for the consumer) system of dispute resolution outside of the court system.

In Croatia, consumers can submit complaints to a myriad of institutions before going to court. Nine different bodies are responsible for receiving complaints and taking at least some action. However, none is responsible for reviewing the full complaint and finding a solution that is fair to the consumer. The nine bodies are:

1) The designated internal unit within the financial institution (often the public relations department),
2) The internal audit department of the financial institution,
3) One of the two financial consumer protection NGOs,
4) One of four consumer counseling centers funded by the Ministry of Economy,
5) The State Inspectorate,
6) HNB (if the dispute is with a credit institution, such as a bank) or HANFA (for a non-bank financial institution),
7) The mediation (or conciliation) center of the applicable chamber or union,
8) The court of honor of the applicable chamber or union, or
9) The permanent arbitration court of the applicable chamber or union.

Each body looks at customer complaints from a narrow perspective. Take, for example, the case of a bank customer who goes to an ATM, requests HRK 3,000 and receives HRK 2,000 instead. The public relations department of a bank would see the issue of one of possible public embarrassment for the bank. The internal audit department would review the case to see if the bank followed the laws and regulations related to banking. The consumer protection NGOs might be more effective since they might be interested in using the press to embarrass the bank, but their role would be limited to advocacy of the rights of the consumer. The counseling centers would advise the customer of his/her rights under the law. The State Inspectorate would hand the case to HNB. HNB would forward the complaint to the bank and review the response from the bank. However even the HNB could not take action since its legislation does not allow it to get involved in any individual dispute between a bank and its customer.

Even mediation and arbitration are not likely to be satisfactory to the consumer. In theory at least, the customer and his or her bank might have more success agreeing voluntarily to refer their dispute to a mediation center. However, HUB has still to establish a mediation center. HUB has planned to set up a process to handle disputes through the Mediation Center run by the Employer’s Association. However, this center handled only two cases in 2007 and has a small and not specialized professional staff. The Court of Honor of the Employer’s Association might also be an option but the remit of courts of honor is merely to review whether the institution followed the code of conduct for the sector in question. Furthermore, even if the consumer wins the case, the most serious possible sanction of the court would simply be a public reprimand to the bank. Another option for a consumer would be the Conciliation Center within the Chamber of Economy. Provided both parties have previously agreed to have their dispute settled by binding arbitration, a further option of course would be the filing of a complaint with the Permanent Arbitration Court of the Chamber of Economy. Although it appears that the process of arbitration would be faster than that of a regular court, the cost involved can also be very expensive. Furthermore, the decision of the arbitration court will of course be binding on both parties, without the additional option for the unsuccessful party to appeal to the regular courts on the merits of the case. With such a complex system, few aggrieved consumers go through any dispute settlement process, with some simply approaching the press which is known for its poor financial literacy and high interest in sensationalism.

21 Under the new Payment System Act, the state budget would finance the costs of conciliation procedures related to payment services conducted by the Conciliation Center within the Chamber of Economy.
In spite of the complex system of submitting customer disputes, the agencies do receive some complaints. HNB received between 100 and 200 complaints about bank services in 2007. HANFA also received 40 complaints in the same year. The primary financial NGO, Potrošač, received a group of complaints which were primarily about the levels of fees and charges as opposed to disputes over improper treatment. Through the State Inspectorate, the Ministry of Economy received over 10,000 consumer complaints in 2007. Of this total, only 548 related to financial services.

Financial sector consumers have also submitted inquiries and complaints to the Ministry of Finance. The Ministry’s Directorate for Financial Services received 36 consumer communications related to financial services in 2007, 40 in 2008 and 34 in 2009. For example, consumers have complained about irregularities in transfers of payment to voluntary pension insurance funds by pension insurance companies. Consumers have also submitted requests to receive statements confirming payments to housing savings bank made several years ago, which is an inquiry rather than a complaint.

The current proposal for the banking sector is not likely to resolve the issues. HUB plans to use the Mediation Center run by the Croatian Employer’s Association. The plan is to allow HUB to approve a list of mediators affiliated with this Center and then recommend that any customer join his or her financial institution in voluntarily employing a mediator from this list to attempt at least to resolve the customer’s compliant. There are several weaknesses, however, with this approach. The Mediation Centre has only one mediator and that person specializes in labor relations rather than disputes regarding financial services. Also, as indicated above, the centre handled only two mediations in 2007. Furthermore, access to this Mediation Center is restricted to members of the Employer’s Association and banks have not been active members of the Union. In addition, there exists a lack of support for mediation from the Croatian legal profession. Local lawyers have been known to boycott the Mediation Center since they can only participate in one session and would not be able to seek income from any additional work. With an average of 19 months to resolve a dispute through the courts of first instance, one court case inevitably results in a larger total income for a litigation lawyer than does any single mediation hearing.

By contrast, the Insurance Bureau provides a mediation service for insurance-related disputes. While this mediation center has limited authority to compel actions by insurance companies, the extensive technical expertise of the Insurance Bureau has resulted in a more effective process and it is engendering a higher level of respect among insurance policy-holders.

Different countries take different approaches to dispute resolution institutions but some common criteria apply to all effective systems. Based on international good practices, any mediation or arbitration center should:

1) Be permanent and be publicly perceived as independent and competent;
2) Be accessible to consumers (low cost mechanism for consumers);
3) Have the means to sanction financial institutions, preferably through fines;
4) Have sufficient resources through fees collected from participating institutions and government budget;
5) Compile data on disputes and analyze them;
6) Publish statistics on numbers of complaint, types of complaints and their final resolution;
7) Cooperate and communicate frequently with the financial regulators, thus adding value to the financial consumer protection regime; and
8) Play a role in educating consumers by providing information to customers.

Financial institutions should strengthen their internal procedures to handle complaints from retail customers. The Credit Institutions Act requires that each credit institution nominate
at least one person to receive customer complaints. The same requirement should apply to insurance companies, securities firms and pension funds that deal with retail customers. All financial institutions should be required to establish a standardized internal procedure for receiving, dealing and resolving complaints, which includes an officer (or a unit) responsible for handling complaints. The process for submitting any complaint should be made clear to a customer at the time of the signing of his or her contract and then on an on-going basis. Each customer should also be advised of the stipulated timeframe for a written response from his or her financial institution to any complaint the customer may wish to make, as well as what action may be taken if the customer is not satisfied with the written response. The complaints officers in each financial institution should also be responsible for transmitting data (complaints received, complaints settled, complaints referred by type and contract) to the supervisory board of the financial institution and to the financial supervisory agency at least once per year.

**Codes of Conduct or Consumer Protection Codes should also provide guidance on how financial institutions should deal with complaints.** In particular, these Codes should cover requirements regarding: (1) written procedures for dealing with customer complaints; (2) acknowledgment by financial institutions of each complaint within a short time, such as five working days; (3) designation of a contact person (or department) to receive complaints; (4) periodical information to the customer of the status of his/her complaint, for example, every 20 working days; (5) notification of the completion of the investigation and the results thereof within a short period of time, say five days, following that completion; (6) treatment of verbal complaints with the same seriousness as written complaints; and (7) maintenance of records of complaints submitted. Additional detail is provided in Annex 1.

**An ombudsman for the financial sector will also likely be needed.** As part of modern Business to Consumer (B2C) dispute mechanisms, an institution is needed that is neutral, objective, easy to access, and inexpensive to the consumer. Elsewhere at least, the most effective institution has been that of an ombudsman for the financial sector, established either independently by statute or under the auspices of the industry.

**The approach of an independent statutory ombudsman has been the most effective in improving consumer protection and financial literacy in several countries.** This is the approach taken in the United Kingdom and Ireland as well as in Australia. In this model, the ombudsman is set out by law. The ombudsman covers all parts of the financial sector, including not just banks and consumer finance companies but also pay-day lenders, pawnshops and commercial companies (such as travel agents) that take funds from the public for prepayment of financial services. The decisions of the ombudsman are binding on the financial institution but not on the consumer. The statutory ombudsman is a permanent institution, with its own offices where consumer complaints can be submitted. The ombudsman publishes an annual report with statistics on complaints received, cases handled and cases resolved. The ombudsman is also responsible for helping members of the public become aware of their legal rights and obligations as financial consumers. The primary advantage of an independent statutory ombudsman is public perception. Since the ombudsman is financed from the government budget, he or she is not dependent on the financial industry that he or she oversees. Statutory authority also ensures that the ombudsman can take actions without the concurrence of the industry.

**However many EU member states prefer that complaints be referred to ombudsmen established by professional associations.** Of these, one of the most effective is that of the German banking ombudsman who, in effect, constitutes a service provided by the banking association. When a case arises, a retired judge or other legal expert is selected to review the case and make a decision. However the German ombudsman does have some independent authority. His or her awards of up to €5,000 are binding on the financial institution but leave the consumer with the option of appealing to the courts. However one weakness in most ombudsmen
established by the professional associations is the public perception that they are beholden to the industry.

Some measures can improve the transparency and accountability of ombudsmen set up by the professional associations. For example, the ombudsman should have the power to make decisions for what needs to be defined as “small and straightforward” cases. For other more complex cases, the ombudsman should establish a review board of senior retired legal experts with prior experience in settling complicated consumer cases regarding financial issues. Furthermore the decisions of the ombudsman (or the review board) should be binding on the financial institution up to a relatively modest maximum amount. In addition, care should be taken to ensure that the governance structure of the professional association ombudsman builds public and consumer confidence in its neutrality. The governing board should include consumer representatives as well as representatives of the industry. The ombudsman should also have transparent reporting responsibilities, including the publication of an annual report describing the activities of the ombudsman. One question will be whether there should be one ombudsman for the entire financial sector or for each part of the sector. A maximum of two is recommended: one for complaints involving banks and non-bank credit institutions and another for insurance, pensions and securities firms. The question will then be for complaints related to financial services provided by non-financial institutions, such as department stores and telecommunications companies. In the absence of a single financial sector ombudsman, the risk is that non-standard financial services providers are not covered by either ombudsman.

For Croatia, it may be best to start by having HUB establish an ombudsman using the same governance structure as the Insurance Bureau’s mediation service. The United Kingdom, Ireland and Australia began with professional association ombudsmen and then moved to a single independent statutory ombudsman. The experience of each professional association ombudsman proved worthwhile in building support for the concept of an independent statutory institution. If this course is adopted in Croatia, however, the Insurance Bureau’s Mediation Center should also assume responsibility for the pensions and securities sectors. Alternatively parallel ombudsmen could be established for securities and pensions.

The most efficient approach however would be to set up a single dispute resolution mechanism for the entire financial sector. Where separate arrangements are established for different parts of the financial sector, the risk is that the combined resource requirements of the different agencies far exceed what is needed for the office of a single financial ombudsman.

The EU members where the professional association model applies have also established government national consumer protection authorities covering all aspects of the economy. Croatia has established a Consumer Protection Department in the Ministry of Economy but it does not function as a fully fledged consumer protection authority. It may be helpful to look at the approaches taken by EU member states of similar size to Croatia, including Finland for example.

The Croatian authorities have already taken first steps to set up a system of monitoring financial consumer protection issues. As the supervisor for non-bank financial institutions—and as required under HANFA’s authorizing legislation, HANFA had already set up an internal special consumer protection unit. In 2009, the Ministry of Finance set up a Special Unit for Financial Literacy and Consumer Practices. The Unit has no executive powers but is responsible for monitoring consumer practices. When financial consumer complaints are submitted to the Ministry of Finance, they are forwarded to the Unit for further attention. The Unit for Financial Literacy and Consumer Practices has also started discussions with the Ministry of Education about developing a possible joint program for high school students. In addition, the Unit has initiated discussions with the professional associations (including for insurance and banking) and
chambers of commerce about possible financial education programs for consumers of financial services.

**The HNB is also considering creating a special Unit for Consumer Protection and Financial Education: this is to be commended.** In light of the possible conflicts of interest for supervisors reviewing both prudential supervision and consumer protection issues, the Unit would be placed outside of HNB’s Supervision Department and would report to a separate Executive Director. This approach would be very helpful. While prudential supervision and consumer protection may create conflicts within a single organization, several European supervisory agencies consider that the information gained from receiving consumer complaints provides an essential “early warning signal” for those conducting prudential supervision. Placing consumer protection in the same institution as prudential supervision is the approach taken by Ireland and the United Kingdom and most recently by Slovakia and the Czech Republic. The special Unit in HNB would not only receive consumer complaints but also develop programs of financial education for financial journalists, and would work with professional associations and the chambers of commerce.

**It would be helpful to establish Financial Consumer Complaints Center.** Financial consumers need a single location where they can submit complaints with regard to any type of financial service. They should not be obliged to figure out what kind of financial service they have purchased and which regulatory agency is responsible. Consumers should have a single focal point where they can submit complaints and be confident that their complaint will be addressed quickly, efficiently and fairly. In 2006 the Ministry of Economy established a central register of complaints known as the Central Consumer Protection Information System (CISZP). Nonetheless, the system was only partially put in place and is not heavily used by financial consumers.

**Experience in other countries shows that the majority of complaints are not disputes but inquiries.** Consumers’ complaints are often reflections of poor understanding of the terms of their contracts rather than an accusation of a violation of law. A central location that receives both complaints and inquiries can thus review each case and separate requests for financial education from disputes over the terms of a legal contract.

**The Financial Consumer Complaints Center should be easily accessible by consumers.** The Center should have a toll-free telephone number where consumers can call from any part of the country and receive clear understandable information about financial services. The Center should also be accessible by email and postal mail and should have offices, at least in Zagreb, where consumers can stop by and ask questions about financial services.

**The Complaints Center should also publish complaint statistics.** The Center should track the number of complaints, the type of complaints, what happened to the complaints, and common issues that arise. In its annual report, the Complaints Center should publish aggregate statistics so that government agencies, professional associations, consumer organizations and others can review the trends in consumer complaints and make recommendations on what should next be done. This might include revision to legislation, strengthening of financial institutions or simply programs of financial consumer awareness. Care should also be taken to ensure a standard reporting format so that the different supervisory agencies and interested NGOs can draw on the data for useful insights.

**Careful consideration should be given as to how to set up the Complaints Center.** The Center might be a public-private partnership, funded by a levy on financial institutions and supervised by a council of representatives from not only the financial professional associations, but also consumer organizations, the key government authorities such as HNB and HANFA, as well as the Ministry of Finance and Ministry of Economy. Initially the Complaints Center might cover just
one part of the financial sector, such as consumer loans, and later expand to cover all retail
financial services sold to households. Also the Complaints Center in its early stages would not
resolve disputes (as would an ombudsman) but would ensure that complaints are properly
addressed by the financial institution and the government authorities. Over time, consideration
might be given to expanding the role of the Complaints Center to also include making decisions
on cases involving small sums of money. It would be useful to conduct a study of similar
complaint centers elsewhere in Europe and identify the most suitable approach for Croatian
consumers.

Financial Education and Literacy

One issue for financial education and literacy in any jurisdiction is the prevailing
institutional structure. Most countries choose one of two institutional structures: (1) establishing a
national consumer protection agency which covers all sectors including financial
services or (2) assigning responsibility for consumer protection to the respective financial
supervisory agencies. Both approaches have their strengths and weaknesses. Countries using a
national consumer protection agency for all sectors often find that financial services are given
little attention and a specialized department with specialized and expert staff needs to be
established. Where countries assign consumer protection to the financial supervisory agencies,
the agencies find themselves in conflicts of interest between their mandates to ensure both sound
and stable financial systems and to protect the interest of financial consumers. Over time, one or
the other approach will need to be taken. Relying on a consumer protection department in one
ministry places too much burden on a government ministry whose focus should be on policy and
programs.

Whichever approach is selected, three key areas need to be considered. These are: (1)
consumer awareness of the risks and rewards of various financial products, including possible
financial scams; (2) consumer education in preparing personal and household budgets and making
long-term financial decisions; and (3) surveys of financial literacy to understand which parts of
the population may be particularly vulnerable to predatory lending, financial scams and
weaknesses in budgeting and planning.

Consumer Awareness

HANFA sees his role in consumer awareness and education as part of his legal mandate.
The Act on the Croatian Financial Services Supervisory Agency states that HANFA has a
governing principle of providing confidence among participants of the financial markets. In
addition, this Act mandates that HANFA develop “awareness of the benefits and risks that are
connected with various types of investments and financial activities”.

Under this mandate, HANFA has developed a consumer awareness program, consisting of
two elements: media campaign and website redesign. The battle phrase of this program is an
expression used in daily life: “You have the right to know” (“Imate Pravo ! Znati”). This
program received high attention from the media even before HANFA officially launched it.

The media campaign consists of a series of short TV spots and a group of TV programs
both dealing with basic issues in different financial segments. The TV spots present a popular
actor or actress talking about financial issues in a simple way during 25 seconds. At present, the
first couple of TV spots have been launched, one related to capital markets and the other to
pension funds. They are expected to be aired on national television throughout the year. HANFA
is also planning to run surveys every 3 months to assess the impact of the campaign on the
consumers. The second element of the media campaign is the production of TV studio programs
to be aired in HRT (Croatian Radiotelevision) once a week, between 4:50 and 5:00 pm. In these
programs, an expert will talk about different financial issues that are relevant for the market.

As part of the redesign of its website, HANFA has introduced a new Consumer Services
section. This section pops up to a new website (Edukativna Kampanja) dedicated to consumer
awareness issues (http://edukacija.hanfa.hr/). At present, the website contains 3 sections on: basic
questions about financial markets, the two existing TV spots, and four excel files providing tools
for individual financial planning. In the future, this website is expected to have 5 sub-sections:
capital markets, investment funds, pension funds, insurance and leasing. Each sub-section will
include a brief storyline describing the market and the entities, a series of information that the
consumers should ask for, sources the customers could look for advice, and list of frequently
asked questions.

Besides the consumer awareness campaign, HANFA has been conducting a series of
workshops and seminars, dealing with the recent changes in Croatian legislation and the
alignment with the EU Directives. These activities include training seminars for brokers,
investment advisors and other industry professionals (following the lines of previous trainings set
up together with the Zagreb Stock Exchange, for example), as well as educational workshops for
non-industry professionals, such as lawyers, notaries, judges, police, journalists and others.

**Financial Education**

**In the long-run, effective financial consumer protection relies on well-educated financial
consumers.** Consumers who are well-informed and financially-literate are able to make sound
financial decisions for themselves and their families. They are able to increase their financial
well-being and ensure economic security in times of financial crisis. Knowledgeable consumers
are also at the heart of transparent retail financial markets. They are able to protect themselves
from unscrupulous sellers of financial services and to make it difficult for sellers to use unfair or
deceptive practices. Consumers need to be able to understand the terms of their contracts with
financial institutions and to know their rights under the law. They also need to understand the
fundamental principles of finance and credit so that they can evaluate the expected rewards and
anticipated risks with every potential loan they might receive or investment in a financial service
of product they might make. Sustained financial health requires long-term financial planning and
the development of skills of financial analysis. Consumers who are literate in financial matters
are empowered consumers.

**The financial education program should be carefully prepared to ensure that it is effective.**
Academic research on the effectiveness of financial education in developed economies is mixed.
Recent research from the United States suggests that most financial education for high school
students has little impact. However interactive computer games involving stock market
investments have been proven to be highly effective in encouraging high school students to
consider ways of investing. Furthermore teaching children up to the age of 12 years helps them to
establish robust savings and spending habits—that financial health is as important as physical
health. To date, virtually all research on the effectiveness of financial education programs has
been conducted in developed economies. However in post-transitional economies, such as Croatia
where financial markets are not well-developed but general education standards are high,
financial education may be more effective than elsewhere.

**A national program of financial education should be established.** The public school system
should be primarily responsible for delivering a long-term program of financial education. As
noted in Table 5, the United Kingdom, Ireland and France as well as other countries, including
the United States, Canada and Australia, include financial education in the curricula of their
primary or secondary schools. One approach is to include financial education as part of other existing subjects, such as mathematics. High school classes in mathematics typically rely on physics and other sciences to show their applicability. The same classes could include examples that instead focus on finance, showing how mathematical theorems apply to financial models.

The National Council on Consumer Protection has decided to include financial education as part of its program. In preparing the National Consumer Protection Program for 2009-2012, the National Council plans to develop a national strategy for financial education. This is a useful approach since it combines the work of consumer protection (including for financial services) with a national program to strengthen financial education throughout the population.

HUB could provide financial training and teaching materials to primary and secondary school teachers. Educators need both toolkits and technical expertise on issues related to financial issues. HUB could work with the Ministry of Education and consumer associations to develop a training program. Also participating in the design of a curriculum might be the financial sector’s professional associations, consumer representative bodies (such as consumer NGOs), and representatives of teachers’ associations. HNB and the other financial supervisory agencies should provide expert technical advise to the Ministry of Education in developing textbooks and other teaching materials and establishing a program of “teaching the teachers.” The materials should also be made available to other ministries and agencies so that they can also distribute the teaching materials throughout their respective sectors.

Table 5: Financial Education Programs in Schools in Selected Countries

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<tbody>
<tr>
<td>Australia</td>
<td>n.a.</td>
<td>Voluntary</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Canada</td>
<td>6-18</td>
<td>Compulsory in some provinces</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>France</td>
<td>n.a.</td>
<td>Voluntary</td>
<td>No</td>
<td>No</td>
<td>n.a.</td>
</tr>
<tr>
<td>Ireland</td>
<td>12-18</td>
<td>Some elements compulsory</td>
<td>No</td>
<td>National Strategy Suggestions due 2008</td>
<td>Yes</td>
</tr>
<tr>
<td>Malaysia</td>
<td>7-17</td>
<td>Voluntary</td>
<td>No</td>
<td>No, but overseen by Fin. Ed. Committee</td>
<td>Yes</td>
</tr>
<tr>
<td>Netherlands</td>
<td>5-18</td>
<td>Yes for ages 5-12</td>
<td>No</td>
<td>Yes – part of CentiQ</td>
<td>Yes</td>
</tr>
<tr>
<td>New Zealand</td>
<td>11-18</td>
<td>n.a.</td>
<td>No</td>
<td>Under development</td>
<td>Yes</td>
</tr>
<tr>
<td>Singapore</td>
<td>n.a.</td>
<td>n.a.</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>UK England</td>
<td>5-18</td>
<td>Voluntary but expected by Government</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>UK Scotland</td>
<td>n.a.</td>
<td>Voluntary</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
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<tr>
<td>UK Northern Ireland</td>
<td>4-?</td>
<td>Compulsory for ages 4-14</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
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<tr>
<td>UK Wales</td>
<td>7-19</td>
<td>Compulsory for ages 7-16</td>
<td>No</td>
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<tr>
<td>US</td>
<td>n.a.</td>
<td>Compulsory in some states</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
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</table>


Financial education should also be provided for adults. In 2005-06 the EC funded the development of the DOLCETA program, which provides an online training tool for use by teachers of adult education. In addition, in 2006 the EC funded a study of financial education.
initiatives throughout the 27 EU Members, whose results were published in November 2007\textsuperscript{22}. The objective was to exchange best practice models for improving access to financial services for those suffering from poverty and social exclusion. Focus was placed on highly-indebted consumers.\textsuperscript{23} In 2008, a new DOLCETA module on support for primary and secondary school teachers and for educators of adults with literacy problems was developed for the 27 Member States. Other programs such as those of PattiChiari, developed by the Italian Banking Association, would also be helpful.

Financial education should be provided to adults at "teachable moments." Such moments include the point at which consumers make long-term financial decisions, such as taking on a home mortgage or other long-term loan. Another moment occurs when financial consumers plan their retirement and start to save through private pension funds or other long-term saving instruments.

Surveys of financial consumers in the US have found that the most effective form of financial education is through the media. In one survey, 71 percent of all consumers chose television, radio, magazines and newspapers as the most effective way to learn about personal finances. Information brochures and presentations at home were the next most effective methods of acquiring financial expertise.\textsuperscript{24}

Consideration should be given to Government support for programs that educate consumers and improve their financial literacy. HANFA has published two handbooks ("New Capital Market" and "Insurance Market") that provide basic information of the insurance and capital markets and explain recent changes in legislation in a style that is easy to read and understand by the general public. HNB is planning to develop program of permanent education of journalists that cover financial issues. Besides these efforts, HNB and the other financial supervisory agencies should play a key role in alerting consumers to illegal practices in financial services. The agencies should put in place a system of consumer alerts to highlight to the press and public any consumer protection issues in the financial sector. One useful approach would be to set up a “Consumer Affairs” page on the home page of their websites. The page could link to consumer and investor alerts, thus making it easy for consumers (and their advocates) to identify possible scams and schemes from unauthorized financial institutions—with regular distribution of press releases to the media.

Financial institutions should also play a role in educating their customers. The US Federal Reserve report noted that financial counseling prior to signing a mortgage helped to reduce payment delinquencies. In one survey of 40,000 mortgages conducted between 1993 and 1998, the effect of individual counseling was to reduce the delinquency rate by 34 percent compared to those who had received no counseling. Classroom training and home study also helped to reduce delinquencies by 26 and 21 percent respectively within the same period of time.

Additional reliance could also be placed on non-government organizations (NGOs) in financial consumer protection. In Italy and France, for example, non-government organizations are active in providing financial education to assist consumers in learning the basics regarding financial issues. The law provides scope for nongovernmental agencies to protect consumers’


\textsuperscript{23} A comprehensive survey of financial literacy programs worldwide is provided by the OECD’s 2005 report, Improving Financial Literacy: Analysis of Issues and Policies.

rights. However in the absence of a history of effective consumer protection associations in financial services, additional support may be needed to jump-start their activities. In Slovakia, for example, the national budget provides some funding for over 20 consumer advocacy organizations that assist financial consumers.

**Special consideration should be provided for low-income borrowers who often have weak financial literacy.** Recent research in the United States has found that, among other characteristics, subprime borrowers are less well-educated than prime borrowers. Sixty percent of US prime borrowers have had college education, while only 38 percent of subprime borrowers have received equivalent education. In another survey, 12 percent of subprime borrowers were unfamiliar with basic financial concepts such as the definition of "principal" and "interest." One-third also stated that they were not familiar with different types of mortgage products available.

**Low-income borrowers are particularly vulnerable to abusive lending practices.** Research in the US indicates that, in the residential mortgage market, predatory lending generally occurs in the "subprime" market where borrowers with weak access to credit use the collateral in their homes for debt consolidation or other consumer credit purposes. The research notes that predatory lending may also occur in the "prime" market but it is deterred by high levels of competition among lenders, the significant degree of homogenous loan terms and the prevailing high levels of financial information (and financial literacy) previously acquired by “prime” borrowers.\(^{25}\)

**Financial education targeted to vulnerable groups can, however, have a substantial impact on the financial health of their members.** Surveys in both the US and Poland have found that financial education for households with low income or low levels of formal education substantially increase their financial wealth. Using data from the US 2004 Health and Retirement Survey, one study found that classroom training for low-income participants increased their savings by 70 percent from a starting point of $2,000.\(^{26}\) For those with low education, the impact was even greater at 100 percent increase in wealth. Studies by the Microfinance Center of Poland have shown similar results.

### Financial Literacy Surveys

**A nation-wide survey of the levels of financial literacy in Croatia should be conducted.** An initial survey should be conducted as a baseline analysis with a follow-up survey three to five years later. The survey should use the methods that have been successfully applied in other EU Member States, such as the United Kingdom. The survey should be comprehensive and segmented. It should be large enough to cover all key groups in Croatia, segmented by geographic area, socio-economic level, gender, family status, household income, level of formal education, profession, and ethnic origin. Special consideration should also be given as to how to reach low-income groups, who are often the most difficult from which to collect data. The survey might include not just questions on the levels of current financial literacy but also questions on how consumers spend their budgets and plan their financial futures. Taken together, such measures of financial literacy and consumer behavior constitutes “financial capability” and provide useful information for policy-makers. Other less structured surveys would also be useful.

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One informal approach would be to use a financial IQ quiz to test consumers understanding of retail financial services. The quiz could be administered through a consumer survey.

**Not many countries have conducted nation-wide literacy surveys.** To date, such surveys have only been conducted in the United Kingdom, France, Hungary, the United States, Australia, India, and Ireland (ongoing.) (See Volume II for a summary description of the surveys.) Other surveys have been conducted by private sector organizations in many countries but none have provided nation-wide results that can be used to determine government policy in financial education. Croatia would thus provide leadership to other emerging market countries in financial literacy.

**The results of the survey of financial literacy should be used to refine the national programs of consumer awareness and financial education.** The survey may take two to three years before it is completed and the findings are analyzed. In the meantime, the programs of consumer awareness and financial education should be established, at least on a pilot basis. Once the survey has been completed and published, the programs of consumer awareness and financial education should be modified to target the issues raised by the survey. The follow-up survey can be used to determine if the programs are effective—and what further modifications may be needed.

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Annex 1: Consumer Protection Codes

Banks, Insurance Companies and Securities Firms

Know your Customer

Before providing a product or service to a customer, a bank must gather, record and retain sufficient information from the customer to enable it to provide a recommendation or a product or service appropriate to that customer. The level of information gathered should be appropriate to the nature and complexity of the product or service being sought by the customer, but must be to a level that allows the bank to provide a professional service.

Suitability

A bank must ensure that, having regard to the facts disclosed by the customer and other relevant facts about that customer of which the bank is aware:

1. any product or service offered to a customer is suitable to that customer;
2. where it offers a selection of product options to the customer, the product options contained in the selection represent the most suitable from the range available to the bank; or
3. where it recommends a product to a customer, the recommended product is the most suitable product for that customer.

Cooling Off

A rule should be put in place requiring banks to provide a cooling-off period for contracts such as mortgages and loans, and to inform customers of their rights. The customer must have the right to withdraw from the arrangement without having to incur expenses other than the transaction processing fee agreed upfront.

Linked Sales

Where a bank requires, as a condition of granting a loan, that a borrower puts a payment protection insurance policy in place (or other similar policy), the bank may not insist that the insurance policy from any particular insurer be used. Customers should be free to shop around for insurance products.

Preservation of Rights

A bank should not, in any communication or agreement with a customer (except where permitted by applicable legislation), exclude or restrict, or seek to exclude or restrict:

1. any legal liability or duty of care to a customer which it has under applicable law or under the regulations;
2. any other duty to act with skill, care and diligence which is owed to a customer in connection with the provision of financial services to that customer; or
3. any liability owed to a customer for failure to exercise the degree of skill, care and diligence that may reasonably be expected from it in the provision of a financial service.

Guarantees

An advertisement must not describe a deposit, or the interest rate payable on a deposit, as guaranteed or partially guaranteed unless:
1. there is a legally enforceable agreement with a third party who undertakes to meet, to whatever extent is stated in the advertisement, the customer’s claim under the guarantee; and
2. where it is the case, the advertisement states that the guarantee is from a connected party of the bank.

Notifications to Customers

Unless agreed in writing with the customer a bank must, at least annually, issue a statement over every account operated by it, setting out:
• All transactions over the account during the period covered by the statement; and  
• Details of the interest rate(s) applied to the account during the period covered by the statement.

Current account and credit card account statements should normally be issued monthly. Credit card statements must set out the minimum payments required and the total interest costs that will accrue, if the cardholder makes only the requested minimum payment. Mortgage account statements should clearly indicate the amount paid, the outstanding amount and the allocation of payment to the principal and interest and, if applicable, tax accruals. Customers should be notified of changes in the interest rates paid or charged on their accounts in advance where possible, and as soon as practicable otherwise. Customers should be notified of changes in non-interest charges at least 30 days in advance of the effective date.

Customer Records

A regulated entity must maintain up-to-date customer records containing at least the following:
1. a copy of all documents required for customer identification and profile;  
2. the customer’s contact details;  
3. all information and documents prepared in compliance with this Code;  
4. details of products and services provided to the customer;  
5. all correspondence with the customer and details of any other information provided to the customer in relation to the product or service;  
6. all documents or applications completed or signed by the customer;  
7. copies of all original documents submitted by the customer in support of an application for the provision of a service or product; and  
8. all other relevant information concerning the customer.

Details of individual transactions should be retained for six years after the date of the transaction. All other records required, as noted above, should be retained for six years from the date the relationship ends. Customer records need not be required to be kept in a single location but must be complete and readily accessible.

Debt Recovery

The customer must be protected against abusive debt collection practices by the bank or third-party debt collectors. The type of debt that can be collected, the person who can collect the debts and the manner in which debt can be collected must be indicated to the customer at the time the transaction is entered into. The right of debt collectors to contact anyone else about a customer’s debt must be indicated and the type of information they may seek must also be provided. Debt collectors should be prohibited from using false statements during debt collection, using unfair practices, or giving false credit information to others (for example to a credit bureau).
**Non-Bank Credit Institutions**

Each non-bank credit institution should develop its own consumer protection code that details its institution's practices as they relate to the good business conduct principles of quality, openness, knowledge and complaint handling.

**Quality**
- Seek sufficient relevant information from customers to ensure that only suitable products and services are sold to them
- Provide consumers with clear and accessible information and educational material where possible that uses visualization and applied examples

**Openness**
- Make the consumer protection code available to customers where financial transactions are conducted
- Identify a senior officer responsible for ensuring the code is implemented and followed
- Do not mislead customers as to the real or perceived advantages or disadvantages of any product or service
- Do not engage in bait-and-switch techniques, where the consumer is induced to believe that no interest rates are associated with credits
- Make full disclosure of all relevant information both before and after a loan is granted, including all charges, in plain language
- Advise consumers on fees of closing accounts and switching providers, in plain language
- Make independent assessment such as credit scoring and other ratings available to customers
- Disclose all information to be shared with third parties and provide the consumer with a real choice of selecting the information sharing the consumer finds adequate

**Knowledge**
- Educate customers so that they can make informed decisions about the opportunities, risks and responsibilities related to all products and services
- Develop educational and information material together with consumer associations
- Include in all information and educational material the rights and responsibilities of consumers
- Explain to the consumer the system of bank executioners and the penalty in case of default, using examples to explain
- Educate employees about acceptable procedures of conduct in client relations

**Complaint Handling**
- Correct errors and handle complaints speedily, efficiently and fairly
- Ensure a complaint resolution procedure is in place
- Provide customers with the information they need to use the complaint resolution procedure
- Identify a senior officer responsible for resolution of complaints
- Inform the customer how long it will take to respond
- If the complaint is not resolved to the customer’s satisfaction, provide the customer with the reason for the decision and advise the customer on additional options for resolving the complaint
Annex 2: Key Laws & Institutions for Financial Consumer Protection in Croatia

Legal Framework

General Laws and Regulations

1) Consumer Protection Act (OG 125/2007)
2) Consumer Credit Act (OG 75/2009)
4) Civil Obligations Act (OG 35/2005)
5) State Inspectorate Act (OG 129/2005)
6) Competition Act (OG 122/2003)
7) Associations Act (OG 88/2001)
8) Law on Mediation (OG 163/2003)
9) Law on Arbitration (OG 88/2001)
10) Execution Act (OG 57/1996 and amendments)

Regulatory Agencies

1) Croatian National Bank Act (OG 75/2008)
2) Act on the Croatian Financial Services Supervisory Agency (OG 140/2005)

Banking

1) Credit Institutions Act (OG 117/2008)
2) Law on Deposit Insurance (OG 177/2004 as last amended by OG 119/2008)
3) Payment System Act (OG 133/2009)
4) Decision on the Effective Interest Rate of Credit Institutions and Credit Unions and on Service Contracts with Consumers (OG 41/2009)

Non-Bank Credit Institutions

1) Leasing Act (OG 135/2006)
2) Ordinance on the Manner of Calculating the Real Annual Interest Rate for Finance Lease Agreements (OG 135/2006)
3) Ordinance on the Method of Calculating the Total Fee of Operating Lease Agreements (OG 135/2006)

Securities

2) Investment Funds Act (OG 150/2005)
4) Ordinance on Requirements for Professional Training and Examination of Professional Knowledge Required for Obtaining License to Conduct Activities of a Broker, Investment Advisor, Certified Pension Fund Manager and Certified Pension Insurance Company Manager (OG 5/2009)
5) Ordinance on Organizational Requirements for Providing Investment Services and Conducting Investment Activities and Ancillary Services (OG 5/2009)
6) Ordinance on Business Obligations of an Investment Firm when Providing Services to Clients (OG 5/2009)
9) Ordinance amending the Ordinance on the Promotion of Investment Funds with a Public Offering (OG 109/2006)
10) Ordinance on Regulating the Procedure, Costs and Time Limits for the Winding up of Investment Funds (OG 103/2007)
Insurance
2) Ordinance on the Form, Content and Manner of Keeping the Register of Insurance Agents and Insurance Brokers (OG 58/2006)
3) Ordinance on the Requirements for Professional Training and examination of Technical Knowledge Needed to Obtain an Authorization to carry On Insurance Representation or Insurance Brokerage Business (OG 45/2006 and 76/2006)
5) Act on Compulsory Insurance within the Transport Sector (OG 151/2005)
6) Code of Insurance and Reinsurance Business Ethics (Croatian Chamber of Economy)

Pension Funds
1) Mandatory and Voluntary Pension Funds Law (OG 49/1999)
2) Ordinance on Informative Prospectuses of Voluntary Pension Funds (OG 113/2003)
3) Ordinance on Informative Prospectuses of Pension Funds (OG 26/2002)
4) Ordinance on the Manner of Allocating Insured Persons to Mandatory Pension Funds and Informing Them of the Allocation (OG 118/2001)
5) Ordinance on the Transferring the Mandatory Pension Fund Member's account (OG 115/2001)
7) Ordinance on the Requirements for Professional Training and Examinations of Technical Knowledge Needed to Obtain an Authorization or License to Conduct Activities of a Broker, Investment Advisor or Authorized Pension fund Manager (OG 26/2008 and OG 97/2006)

Institutional Arrangement

The National Consumer Protection Council was established in February 2008 to advise the Government on the national consumer protection strategy and program. The Council consists of 22 agencies representing the HNB, HANFA, other ministries and agencies, the Chamber of Economy, the Chamber of Trades and Crafts, and NGOs active in consumer protection.

Croatia does not have a separate consumer protection agency. The Consumer Protection Department of the Ministry of Economy, Labor and Entrepreneurship prepares the national plan and strategy on consumer protection for all fields, including financial services. In 2006, the Ministry established the Central Consumer Protection Information System (CISZP), as a central register of complaints related to consumer services and programs. The Ministry also funds four regional Consumer Counseling Centers run by non-government organizations.

The State Inspectorate enforces the Consumer Protection Act in cooperation with the responsible agencies and ministries (and starting from 2010 it will also enforce the Consumer Credit Act). However the State Inspectorate does not have expertise in financial sector issues. As part of its mandate to ensure financial stability, HNB has indirect responsibility for protection of consumers using credit products. The HNB supervises banks and with the enactment of the 2008 Credit Institutions Act, also licenses electronic money institutions. The non-bank financial supervisory agency, HANFA, supervises securities, collective investment funds, insurance, private pensions and leasing companies, and has explicit responsibility for investor education. The State Agency for Deposit Insurance and Bank Rehabilitation (DAB) is responsible for the bank deposit insurance program.
The Zagreb Stock Exchange is the primary venue for stock trading in Croatia. The Central Depository and Clearing Company is the clearing and settlement institution for the Stock Exchange. It is also the share registry for all of the dematerialized shares traded on the exchange and holds the accounts for all retail investors. The Central Registry of Insured Persons (REGOS) maintains records for all contributions to mandatory pension funds.

The Personal Data Protection Agency is charged with administering the Personal Data Protection Act, including information held by the Credit Bureau (HROK).

Mediation services are provided by the Chamber of Economy (Conciliation Center), the Chamber of Trades and Crafts (Mediation Center), and the Employers’ Association (Mediation Center). In addition, both chambers maintain their respective Courts of Honor. For insurance, the Insurance Bureau has implemented two recourse mechanisms consisting of an Ombudsman with powers equivalent to a Court of Honor, and a mediation centre regarding insurance disputes. All operate under the 2003 Mediation Law. In addition, arbitration is available under the Permanent Arbitration Court (of the Chamber of the Economy) which has legal authority to issue binding decisions with the same force and effect as the decisions of a court, provided that the parties to the dispute have previously signed an agreement by which their disputes would be resolved by binding arbitration.

The Croatian Banking Association (HUB) is active in consumer protection issues. There are two professional associations for securities market participants: the Investment Fund Management Companies Association and the Association for Financial Market Operations and Intermediation, both of which collaborate actively with HANFA. A separate association covers pension funds.

In total, 26 non-government organizations (NGOs) operate in Croatia, of which two are focused on financial services. Potrošač is the largest and best-known of the financial NGOs. Another NGO, Zivot u Plusu provides personal financial counseling services.

Croatia is also in the process of revising its legislation to follow the EU Directives. Table 6 provides a summary of the EU Directives relevant for financial consumer protection and the status of their implementation in Croatia.
Table 6: EU Directives on Financial Consumer Protection and Applicable Croatian Laws

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<tr>
<th>CELEX Reference</th>
<th>EU Directive</th>
<th>Supervisory Agency</th>
<th>Croatian Law</th>
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* Together with the competent authorities