RUSSIAN FEDERATION

Diagnostic Review of Consumer Protection in Financial Services

Volume I
Key Findings and Recommendations

[July 2009]
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Russian Federation

Diagnostic Review of Consumer Protection in Financial Services

Volume I – Key Findings and Recommendations

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<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>ADR</td>
<td>Alternative dispute resolution</td>
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<tr>
<td>AMC</td>
<td>Asset management company</td>
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<td>APR</td>
<td>Annual Percentage Rate of Charge</td>
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<td>ARB</td>
<td>Association of Russian Banks</td>
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<td>ARBR</td>
<td>Association of Regional Banks of Russia</td>
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<td>ARIA</td>
<td>All Russian Insurance Association</td>
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<tr>
<td>ATM</td>
<td>Automatic teller machine</td>
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<tr>
<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>CBR</td>
<td>Central Bank of the Russian Federation</td>
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<tr>
<td>CCCH</td>
<td>Central Catalogue of Credit Histories</td>
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<tr>
<td>CEE</td>
<td>Central and Eastern Europe</td>
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<tr>
<td>CIU</td>
<td>Collective investment undertaking</td>
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<tr>
<td>COE</td>
<td>Council of Europe</td>
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<tr>
<td>CPS</td>
<td>Federal Service for the Oversight of Consumer Protection and Welfare</td>
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<tr>
<td>DOLCETA</td>
<td>Development of On-Line Consumer Education Tools for Adults</td>
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<tr>
<td>EC</td>
<td>European Commission</td>
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<tr>
<td>ETS</td>
<td>European Treaty Series</td>
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<td>EU</td>
<td>European Union</td>
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<tr>
<td>FAQ</td>
<td>Frequently Asked Questions</td>
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<tr>
<td>FAS</td>
<td>Federal Antimonopoly Service</td>
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<tr>
<td>FCAC</td>
<td>Financial Consumer Agency of Canada</td>
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<td>FFMS</td>
<td>Federal Financial Markets Service</td>
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<tr>
<td>FINCA</td>
<td>Foundation for International Community Assistance</td>
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<tr>
<td>FSB</td>
<td>Federal Security Service</td>
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<tr>
<td>FSIS</td>
<td>Federal Service for Insurance Supervision</td>
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<tr>
<td>FSS</td>
<td>Federal Service for the Supervision of Mass Media, Communications and Protection of Cultural Heritage</td>
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<tr>
<td>FSTEC</td>
<td>Federal Service for Technical and Export Control</td>
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<tr>
<td>G-8</td>
<td>Group of Eight Countries (Canada, France, Germany, Italy, Japan, United Kingdom, United States, Russian Federation)</td>
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<tr>
<td>GDP</td>
<td>Gross domestic product</td>
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<tr>
<td>ID</td>
<td>Identity document</td>
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<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
</tr>
<tr>
<td>KonfOP</td>
<td>Interrepublican Confederation of Consumer Societies</td>
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<tr>
<td>KYC</td>
<td>Know your customer</td>
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<tr>
<td>LIBOR</td>
<td>London Inter-bank Offered Rate</td>
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<td>MICEX</td>
<td>Moscow Interbank Currency Exchange</td>
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<td>MOF</td>
<td>Ministry of Finance</td>
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<tr>
<td>MOUs</td>
<td>Memoranda of Understanding</td>
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<td>MTPL</td>
<td>Motor third party liability</td>
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<td>NAFI</td>
<td>National Agency for Financial Studies</td>
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<tr>
<td>NAUET</td>
<td>National Association of Electronic Commerce Participants</td>
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<tr>
<td>NAUFOR</td>
<td>National Association of Stock Market Participants</td>
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<td>NFA</td>
<td>National Securities Market Association</td>
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<tr>
<td>NGO</td>
<td>Non-governmental organization</td>
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<tr>
<td>NLU</td>
<td>National League of Management Companies</td>
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Acknowledgments

This review was prepared by a team led by Sue Rutledge, Regional Corporate Governance /Consumer Protection Coordinator and Senior Private Sector Development Specialist, World Bank. The project team consisted of Rodney Lester (Senior Advisor), Richard Symonds (Senior Counsel), Eric Haythorne (Former Lead Counsel), and Kirill Vasiliev (Senior Education Specialist) all from the World Bank. Also part of the team was Nicola Jentzsch, Senior Research Fellow at the Technical University of Berlin, and Juan Carlos Izaguirre Araujo, Consultant of the World Bank. Research assistance was provided by Guljahan Kurbanova of the World Bank. The report was translated by Inna Davidova. Special thanks are to Ljudmilla Poznanskaya (Private Sector Development Specialist), Andrei Markov (Senior Human Development Specialist) and Klaus Rohland (Country Director).

The team expresses its appreciation to the Russian authorities for their cooperation during the preparation of the Review. Detailed comments on an early draft of the report were provided by the Ministry of Finance, the Consumer Protection Service, the Federal Financial Markets Service, the Federal Service for Insurance Supervision, KonfOP, the Association of Regional Banks of Russia, the Association of Russian Banks and the National Association of Non-State Pension Funds. The project team would like to gratefully thank all those who so generously contributed to the final report.

Peer review comments were received from Tomáš Prouza, former Deputy Minister of Finance of the Czech Republic, and Lewis Mandell, Kermit O. Hanson Professor of Finance and Business Economics at the University of Washington. The authors are grateful to all for their contributions.
Consumer protection in financial services 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 sufficient financial education to understand the terms and conditions and other information provided to them as financial consumers.

We are pleased to provide this pilot Diagnostic Review of Consumer Protection in Financial Services in the Russian Federation and thank the Russian authorities for their valuable cooperation and collaboration in its preparation. The Review not only looks at financial services in Russia but also refines a set of good practices or benchmarks for use in reviewing consumer protection in financial services 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 consumer protection in financial services.
Executive Summary

As financial markets develop and deepen, one of the key issues for a fair, open, efficient and healthy market is effective consumer protection and financial literacy. The rapid growth of household lending over the last decade has been accompanied by an increase in the number of households that had difficulty in understanding the risks and obligations that they assumed—or the full range of choices available. Complex financial services are often offered to consumers, including those with weak credit histories. The securitization of such household credit highlights the importance of consumer protection and financial literacy (as well as risk management) in minimizing systematic risk of the financial sector.

At its heart, consumer protection is needed to address imbalances of power, information and resources between consumers and financial institutions, which place consumers at a disadvantage. Financial institutions are very familiar with the terms and conditions of their financial services, but retail consumers may find it difficult or costly to obtain sufficient information on their financial purchases, or to assess complex financial services even when relevant information is disclosed. The overarching aim of any program to strengthen consumer protection is to redress the imbalances of power, information and resources, by giving individuals clear and complete information that would allow them to make informed decisions, and by prohibiting financial institutions from engaging in unfair or deceptive practices. Consumer protection also helps build demand for good governance, by strengthening transparency in the delivery of financial services and accountability of financial firms. In addition, consumer protection helps financial firms face the risks that arise when dealing with retail customers, especially those related to mis-selling of financial services.

Rapid expansion of household credit has highlighted the need for strong consumer protection and financial capability in the Russian Federation. The Russian household credit market has registered an average annual growth rate of 84 percent between 2003 and 2008, one of the highest growth rates in Central and Eastern Europe. Such rapid increases carry some increased risk. Past-due loans have risen from 1.3 percent of total household loans in 2005 to 4.1 percent in 2008. However in relative terms, the Russian household credit market remains small, representing only 9.2 percent of the national GDP.

A nationwide financial literacy survey conducted in June 2008 found that the Russian population had low levels of financial literacy and lacked awareness of their rights as financial consumers. Half the respondents of the survey considered their level of financial literacy as unsatisfactory. About 25 percent of respondents could not provide more than one correct answer to six simple questions on basic issues needed to manage household finances. Furthermore, over 60 percent of households were unaware of the banks’ obligations to disclose the effective annual interest rate of a loan, and only 11 percent of the participants provided a correct answer regarding the absence of government protection from personal losses in investment funds.

The survey also showed that Russian consumers distrust financial institutions but are interested in learning more of consumer protection issues and receiving financial training. Consumers lack trust on financial entities, mostly commercial banks but also insurance companies. They also have little confidence in the existing systems of solving problems and do not feel they can resolve disputes over financial transactions. At the same time, consumers are interested in learning how to protect themselves when dealing with financial institutions and how
to identify and avoid financial fraudulent schemes. They are also interested in pension planning and in learning how to avoid over-indebtedness, as well as knowing more of consumer credit and mortgage credit. Households prefer that financial training be provided by government regulators, including financial regulators, followed by independent financial consultants and NGOs.

The Diagnostic Review found that the basic legal framework for consumer protection in financial services is largely in place. In order to improve consumer confidence in financial institutions, the Review proposes strengthening consumer protection in five key areas: regulatory and supervisory structure related to financial consumer protection, disclosure of information of financial services for consumers, prohibition of unfair business practices, dispute resolution mechanisms and financial education programs.

The current regulatory and supervisory framework for consumer protection in financial services is complex and needs strengthening. The Federal Service for the Oversight of Consumer Protection and Welfare (CPS) has responsibility for enforcing the key legislation—the Law on Protection of Consumer Rights. Most banking and credit lending services come under the Consumer Protection Law but the Consumer Protection Law does not cover all retail financial services. The Law thus does not cover securities, investment funds, or pension funds. Neither is it clear if the Law covers insurance. At the same time, the financial supervisory agencies, the Central Bank (CBR), Federal Financial Markets Service (FFMS), and the Federal Service for Insurance Supervision (FSIS), supervise the activities of financial institutions. The legal authority of the FFMS and FSIS includes protection of retail investors and policy-holders but that of the CBR does not explicitly cover protection of retail borrowers, leaving consumer protection of retail consumers of banking services to the CPS. A further issue is that while the financial supervisory agencies are highly qualified in financial issues, the CPS lacks sufficient expertise and institutional capability to adequately monitor consumer protection in financial services. Responsibility for monitoring advertising in the financial markets, including advertising targeted at consumers, lies with yet another agency, the Federal Antimonopoly Service.

Three options are available to improve this framework: (1) the CPS could maintain authority for consumer protection in banking services but the CPS’ institutional capacity should be strengthened and co-ordination with the financial supervisory agencies improved; (2) the CBR could receive expanded authority for consumer protection in banking and credit lending services while the FFMS and the FSIS maintain their existing consumer protection responsibilities; or (3) a new specialized financial consumer protection agency could be established. The Review recommends that the first option—strengthening the capacity of the CPS regarding financial services—be implemented but notes that this will require substantial improvements in co-ordination among the supervisory agencies. A clear mechanism for measuring the effectiveness of the CPS in protecting the rights of financial consumers should also be put in place.

All institutions providing financial services should be registered and licensed by one of the financial supervisory agencies. Several types of financial institutions are not currently regulated or supervised, which creates opportunities for abuses against financial consumers. Financial intermediaries play an important role in improving financial sector’s efficiency. However, at a minimum, it would be helpful if a special law were to authorize the CBR to maintain a public register credit and debt collection agencies. The law should also set forth a legal framework (and related procedures) for regulation of debt collection, guiding principles and minimum requirements for debt collection companies, including that the owners be free of criminal records. Insurance intermediaries should also be registered in a public register. There should also be a system of qualification and certification of all intermediaries. Furthermore, all types of credit cooperatives should be licensed and supervised by a government authority, all types of financial
pyramid schemes should be handled by the Federal Financial Market Service, and all non-credit payment service providers should be under the supervision of a financial supervisory agency.

**Requirements of disclosure of information to consumers should be improved.** A Key Facts Statement that summarizes in plain language—and a standard and comparable format—the key terms and conditions of a financial service would be useful. It may also be helpful to conduct a survey of financial consumers to see how they understand the terminology in the disclosure provided to them. Financial supervisory agencies should also ensure that useful comparative information is made available to consumers. In addition, there should be specific disclosure requirements for non-state pension funds, insurance companies, consumer credit providers, credit reporting institutions and non-credit payment services.

**Unfair and abusive sales and collection practices should be prohibited.** Cooling-off periods should be set for all financial services addressed to consumers, with exception of securities and investment funds. Financial institutions should be prohibited from granting unsolicited credit to consumers, and discouraged from engaging in practices of tying and bundling financial services. Regarding self-regulation, professional associations should develop codes of business practices, which should focus on minimum procedures to ensure fair and transparent relations with retail customers.

**A minimum level of competency should be set for those who sell financial services to retail customers.** As a starting point, regulations (or legislation) should introduce the concept of those who work with the public and sell financial services to consumers. Specialized training should also be provided to those who deal with retail customers. The training should be consistent with the complexity of the product and the nature of the intermediary—a travel agent selling short term travel insurance does not need the same training as a financial planner.

**Currently there is no centralized mechanism that deals with customer complaints on financial services.** Financial consumers submit complaints to any of six different types of institutions, but only one of them (the consumer protection service) could act as an advocate of a consumer in a court of law. As a first step to improve dispute resolution mechanisms for consumers, all financial institutions should be required to establish a specific procedure to deal with consumer complaints. In addition, a centralized service should be implemented in order to collect, redirect, follow up, and publish statistics on, complaints related to financial services. This service could also be authorized to make decisions on complaints related to small amounts of money.

**A financial sector ombudsman (or Commission on Protecting Financial Consumer Rights) may help to resolve disputes between consumers and financial institutions.** A two-stage strategy may be the best approach. As a first step, a professional ombudsman should be established for each part of the financial sector. The implementation of this type of ombudsman can be done quickly and would not require government funding. For the long-term, financial sector ombudsman—or perhaps Commission on Protecting Financial Consumer Rights—covering all financial services and established by law would be the most effective way of resolving consumer disputes in financial services. This would also help to build public confidence in the financial sector.

**Consideration should also be given to the alternative of strengthening the existing system of mediation and arbitration and the system of consumer advocacy organizations.** A mediation law has been drafted to facilitate the use of mediation as an alternative to litigation and several organizations have been establishing arbitration courts to deal with cases of retail consumers.
Each of the professional associations for the financial sector should consider establishing arbitration courts for their areas, if they do already have an arbitration court in place. One weakness of arbitration courts is that they do not force the financial institution into a final discussion resolving a customer complaint. However they play a useful role in mediating consumer disputes. In addition, a system of consumer advocacy organizations would be helpful to serve low-income as well as heavily-indebted households, particularly in the regions.

**In the long-run, one of the most effective forms of consumer protection is ensuring high levels of financial literacy.** Financial education is needed throughout the country, not just in the major urban areas but also in small villages where the range of available financial services may be limited.

**The number of financial education initiatives from private institutions and non-government organizations is growing in Russia.** The majority of grass-root initiatives focuses on investment advice and rarely covers other range of topics, such as personal budget planning, managing personal debt, pension planning and insurance. Furthermore private institutions initiatives primarily address the affluent segments of the population and provide orientation and counseling for individual investors. In addition, several informal extracurricular financial education initiatives have emerged, such as competitions, elective classes and summer schools.

**The public sector should also be involved in financial education for consumers.** The current provision of general financial education programs for consumers is inadequate and the public sector intervention would help to ensure that middle- and low-income population groups are not kept underserved and unprotected. In addition, public sector is needed to assess the quality of the different initiatives and differentiate between commercial and educational purposes.

**A national policy of financial literacy and education, as well as an effective national taskforce, should be established in order to improve coordination of efforts.** Education for consumers of financial services is being discussed as a part of the general financial literacy policy. In this context, the Ministry of Finance along with several government bodies is developing their own financial education policies and setting up coordination mechanisms. A comprehensive learning framework in financial literacy could be useful for building national policies and developing consensus, and as a basis for designing educational programs and initiatives. Two large target groups for educational initiatives can be identified. The first group deals with developing general capabilities essential for efficient behavior on the financial system, and it could be reached through a range of comprehensive courses, orientation programs and media programs based on the existing level of development of basic financial competences. The second group is more oriented to individuals who have decided to consume certain financial service or faced a concrete financial issue, and it could be reached through individualized just-in-time short-term counseling or tutoring and self-education with minimal guidance.

**Follow-up surveys and assessments should be conducted to evaluate the impact of policy interventions and the financial education programs.** In principle, the education system (schools, colleges and universities) provides a natural entry point for financial education. However experts are concerned about the capacity of schools to deliver adequate financial education. International experience demonstrates that increasing education programs can lead to increases in the levels of financial literacy or positive changes in consumer behavior when the programs are well-designed, for example by using interactive computer programs and focusing on "teachable moments" when consumers make long-term life decisions that have impact an on their finances. However design of financial education programs is not easy. It is therefore essential to evaluate the results of financial educational programs and identify the most efficient and
effective. Those that meet the test of efficiency and effectiveness should receive wide support and dissemination. Testing and surveys, such as the financial literacy survey conducted by the World Bank in 2008, are critical evaluation tools. The surveys should be conducted every three to five years to see if the financial education programs are working—and if they, or the financial consumer protection framework, need to be further revised.
Introduction

The Diagnostic Review of Consumer Protection in Financial Services in the Russian Federation is the sixth report in a World Bank-sponsored pilot program to assess consumer protection in financial services in emerging markets.¹ The objectives of the Review are three-fold to: (1) conduct a review of the existing rules and practices in Russia compared to international good practices on consumer protection in financial services; (2) provide recommendations on ways to improve consumer protection in financial services in Russia and (3) refine a set of good practices prepared by the World Bank for assessing consumer protection in financial services. The Diagnostic Review was prepared at the request of the Central Bank of the Russian Federation (CBR) and with the support of the Ministry of Finance, the Ministry of Economic Development, the Federal Financial Markets Service (FFMS), the Federal Service for Insurance Supervision (FSIS), the Federal Service for the Oversight of Consumer Protection and Welfare (CPS) and the Federal Antimonopoly Service (FAS).²

The good practices used in the Review were developed based on international approaches in both developed and developing countries on ways to improve consumer protection in financial services.³ A set of good practices was initially assembled for the Slovakia Review and was subsequently revised for the Romania, Croatia and Azerbaijan Reviews. The good practices incorporate the provisions of the EU Directives related to consumer protection and the reports of European financial regulatory and supervisory agencies as well as the laws, regulations and business practice codes in the United States, Australia, Canada and Northern Europe. The OECD has also prepared a draft set of good practices on financial education and awareness relating to credit, and released two sets of good practices to enhance awareness and education on risk and insurance, and on private pension issues⁴. These good practices, supplement the recommendations presented in its 2005 global review of financial education programs.⁵ Thus the Review presents recommendations that are applicable to the Russian financial sector based on international experience in Europe and elsewhere.

It is hoped that the publication of the Diagnostic Review for Russia will help develop financial consumer protection both in Russia and worldwide. In particular, it is anticipated that application of the good practices in middle-income countries, such as Russia, will contribute to international policy dialog on the key components of financial consumer protection and assist

¹ Other reports were prepared (in chronological order) for the Czech Republic, Slovakia, Azerbaijan Romania and Croatia. The full set of published reports on financial consumer protection can be downloaded at http://www.worldbank.org/eca/consumerprotection.
² An assessment mission was conducted June 16-27, 2008 in Moscow with a follow-up mission on October 20-23, 2008. In addition to the ministries and services noted above, the mission met with the Ministry of Internal Affairs, the financial sector professional associations, the Interrepublican Confederation of Consumer Societies (KonfOP), the National Agency for Financial Studies (NAFI), the Federal Program Financial Culture and Russian Citizen Financial Security, members of the financial and legal community and the financial press.
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
in the development of benchmarks that are widely accepted as generally applicable to consumer protection in financial services in any jurisdiction.

The Review is presented in two volumes. Volume I notes the importance of consumer protection in financial services, provides statistics on the size and growth of the retail financial sector in Russia and the Government's strategy, describes the World Bank survey on financial literacy in Russia, and sets out the key findings and recommendations of the Review. Volume II provides an assessment of the Russian consumer protection framework and practices compared to the template of good practices for five segments of the financial sector—banking, securities, insurance, private pensions, and credit reporting. In addition analysis of consumer protection issues for non-bank credit institutions is provided.

The Review is intended to be made public and easily accessible to stakeholders both in the public sector and civil society. Improvement of consumer protection and financial literacy requires a long-term commitment and the involvement of government agencies, professional associations, consumer organizations and individual financial institutions. Publication of the recommendations will provide useful ideas for those who are looking for concrete ways of strengthening financial consumer protection and literacy in Russia.

**Importance of Consumer Protection & Financial Literacy**

Each year the global economy adds an estimated 150 million new consumers in financial services. Most are in developing countries, where consumer protection and financial literacy are still in their infancy. Particularly in the countries that have moved from state planning to market economies, protecting the interests of consumers has become an important component of sound and competitive financial markets.

Weak consumer protection and financial literacy affect both middle- and low-income countries. Emerging countries worldwide have seen rapid development of their financial sectors over the last ten years and rapid growth of income has provided consumers with more resources to invest. Increased competition among financial firms, combined with improvements in their technology and infrastructure, has resulted in highly complex financial services sold to the public. However the public in many emerging markets (particularly the post-transition countries of Europe and Central Asia) lacks a history of using sophisticated financial services. Even in well-developed markets, weak consumer protection and financial literacy can render households vulnerable to unfair and abusive practices by financial institutions—as well as financial frauds and scams.

Recent developments in financial markets highlight the importance of consumer protection and financial literacy for the long-term health of the financial sector. Throughout Europe, the US and elsewhere, the rapid growth of household lending over the last decade has been accompanied by an increase in the number of households that had difficulty in understanding the risks and obligations that they have assumed—or the full range of choices available. In the US mortgage markets, complex financial contracts (such a hybrid adjustable-rate mortgages) were sold to borrowers, some of whom had weak credit histories. In today's deeply interconnected financial markets, the move towards securitization of such household credit highlights the importance of consumer protection and financial literacy (as well as risk management) in minimizing the systematic risk of the financial sector.
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 services well but individual retail consumers may find it difficult or costly to obtain sufficient information on their financial purchases. In addition, complex financial services can be difficult to assess, even when all relevant information is disclosed. Imbalances are also present in cases where:

- *Transactions are rare* (for example, when taking a mortgage on a personal residence),
- *Entry or exit costs are low* (such as for financial intermediaries), thus allowing disreputable firms to emerge, or
- *The cost or payoff to the consumer is postponed or very high.* For many long-term investment services such as life insurance, performance cannot be evaluated for many years after the service was bought.

A well-designed consumer protection framework can help reduce the imbalances of power and information between consumers and financial institutions.

**Consumer protection and financial literacy promote efficiency and transparency of retail financial markets.** The retail public operates in a marketplace where imbalances of information, resources and power are on the side of financial institutions. Consumer protection attempts to redress the imbalance, giving individuals clear and complete information on which to make informed decisions and by prohibiting financial institutions from engaging in unfair or deceptive practices. Consumers who are empowered with information and basic rights—and who are aware of their responsibilities—provide an important source of market discipline to the financial sector, encouraging financial institutions to compete by offering better products and services rather than by taking advantage of poorly informed consumers. Financial literacy helps consumers understand the information and make risk/return choices that optimize their financial wealth. By strengthening transparency in the delivery of financial services and accountability, consumer protection also helps to promote good governance of the financial sector.

**Strong consumer protection can also have an indirect impact in reducing risks to financial stability.** Both consumer protection and financial literacy are needed to build trust in financial systems and thus broaden and diversify the deposit base. This, in turn, reduces liquidity risk of the banking sector. Empowered consumers also help foster financial stability by protecting themselves from incurring large exposures to market risks. This increases transparency of the credit risk assumed by the financial system and lowers the related monitoring costs for outsiders, including financial supervisors.

**In addition, consumer protection helps financial firms in facing the specific risks that arise in dealing with retail customers.** In its April 2008 report, the Joint Forum of the Basel Committee on Banking Supervision, the International Organization of Securities Commission and the International Association of Insurance Supervisors identifies three key risks related to possible "mis-selling" financial products and services to retail customers. They are: (1) legal risk, if successful lawsuits from collective action by customers or enforcement actions by supervisory agencies result in obligations to pay financial compensation or fines; (2) short-term liquidity risk and long-term solvency risk, if retail customers are treated unfairly and thus shun the financial institution and withdraw their business; and (3) contagion risk, if the problems of one financial institution (or type of financial product or service) spread across the financial sector. Effective consumer protection can help ensure that the actions of financial firms do not make them subject to criticisms of mis-selling.
Consumer protection also protects the financial sector from the risk of political overreaction to financial crises. The political response to collapses of parts of the financial sector may be to over-compensate with heavy regulation. The impact of too little consumer protection became evident, for example, during the insurance and superannuation scandals in the United Kingdom and Australia. The result of the scandals was seen in extensive studies on recommendations for regulatory reform.

A financial sector should provide consumers with:

- **Transparency** by providing full, plain, adequate and comparable information about the prices, terms and conditions (and inherent risks) of financial products and services;
- **Choice** by ensuring fair, non-coercive and reasonable practices in the selling of financial products and services and collection of payments;
- **Redress** by providing inexpensive and speedy mechanisms to address complaints and resolve disputes; and
- **Privacy** by ensuring control over access to personal financial information.

In addition, consumers should have access to programs of financial education that enable them to develop the financial capability required to understand the risks, rewards and obligations of the financial products and services that they buy.⁶

**Addressing the main weaknesses in consumer protection can be done quickly with immediate impact although improving financial literacy and capability is a long-term effort.** The experience of industrialized countries over the last thirty years—and more recently in developing countries—has identified lessons of “what works and what does not” in consumer protection. By contrast, improving financial literacy is a long-term process for which little is clearly understood as to what works (and what does not) in improving financial behavior.⁷ Techniques of delivering financial education have been well-tested in the US, Europe and elsewhere over the last 30 years⁸ but their impact on levels of financial literacy is still unclear. Yet more unclear is the impact on consumer behavior. Taken together, financial literacy and consumer behavior determine the level of financial capability in households. The issues of consumer protection and financial literacy (and capability) are directly linked as “two sides of the same coin.” It is not practical to consider measures of improving financial consumer protection without also looking for ways of strengthening financial literacy. Financial education should therefore be encouraged in developing countries but it should be rigorously tested and evaluated and be viewed as a long-term investment.

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⁶ Financial education is also needed to help households in making long-term financial decisions, such as saving for retirement or sending children to college. However such "life-cycle" planning is beyond the direct scope of consumer protection in financial services.


Russian Policy regarding Consumer Protection in Financial Services

The Russian Government has announced plans to develop a nationwide financial literacy program in Russia. Public statements by the Russian Government leadership have highlighted the need to strengthen consumer information and financial education. In a statement during the November 2006 session of the State Council Presidium, Prime Minister Putin (then President) tasked the Ministry of Finance and the Central Bank of Russia to review what systems of measures could increase financial literacy and what information is currently available to the population regarding banking and banking services. He noted that "an important part of Russian citizens avoid banks, simply not understanding what banks do and considering that it is too hard to understand for themselves and requires specialized professional training." In addition, the Government has adopted a long-term strategy for strengthening of the financial sector. The program, which extends to the year 2020, includes measures to establish Russia as a global financial center. This will require deepening of the domestic financial sector, extending services to a broad range of the population and strengthening of consumer protection and financial literacy.

Consumer protection and financial literacy are also part of the Government’s long-term plan for financial sector development. On December 29, 2008, the Government adopted Order No. 2043-r, Strategy: Developments of the financial market of the Russian Federation for the period till 2020. The Strategy aims to improve the competitiveness of the Russian financial markets and lay a basis for Russia as a global financial center. Included in the strategy are programs to improve: (1) regulation of investor protection, including creation of the category of "qualified investor" separate from retail investors, (2) transparency of ownership of companies and market investors, (3) disclosure for retail investors, (4) retail financial advice through a newly created Institute of Independent Advisors, (5) out-of-court mechanisms for dispute resolution and (6) financial education for retail investors.

In addition, the Russian Government has highlighted the importance of financial literacy as a global issue. In its role as President of the Group of Eight (G-8) Meeting in June 2006 in Saint Petersburg, the Russian Government initiated an appeal (on behalf of the G-8) to countries worldwide to improve financial literacy and financial education. In December 2006, an international financial education conference was convened to discuss policy approaches. As a follow-up, the Russian Government allocated $15 million to a trust fund to be administered by the World Bank. The objectives of the trust fund are to: (1) support international research in measurement of financial literacy, (2) assess the effectiveness of various approaches to financial education and (3) disseminate best practices and lessons learned. The Organisation for Economic Co-operation and Development (OECD) is a key partner of the trust fund and will be responsible for programs of $3.2 million under the fund.

The Diagnostic Review is intended to support the Government’s program. The Diagnostic Review will provide background information to assist in developing a Financial Literacy and Financial Education Program, which is being prepared by the Government of the Russian Federation with the assistance of the World Bank. The Financial Literacy Program is a multi-sector long-term development program that will likely include not only programs of financial education but also initiatives to strengthen consumer protection through the financial regulatory and supervisory framework. The Review provides recommendations on ways of implementing many of the provisions of the 2020 Financial Market Development Program. In addition, the
Review is intended to take a long-term perspective on an issue that is likely to become increasingly important in the global discussion on international regulatory reform—and the measures needed to ensure efficiency and stability of financial systems worldwide.

**Background on Russian Household Finances**

The Russian household credit market has been expanding rapidly over the past years, registering one of the highest growth rates in Central and Eastern Europe. From 2003 to 2007, the volume of credit institutions’ lending to households in Russia increased at an average annual nominal growth rate of 94 percent compared to an average of 26 percent in Central and Eastern Europe (CEE). Despite a relative cool-down in 2006 and 2007, these figures remain almost unparalleled in a comparison with countries in the region. Equally strong developments were only witnessed in Romania and Lithuania (see Table 1).

**Table 1: Growth of Household Loans in Russia and CEE Countries**

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Romania</td>
<td>258.9</td>
<td>58.3</td>
<td>80.0</td>
<td>83.8</td>
<td>82.1</td>
<td>38.7</td>
<td>100.3</td>
</tr>
<tr>
<td><strong>Russia</strong></td>
<td><strong>121.0</strong></td>
<td><strong>116.4</strong></td>
<td><strong>96.2</strong></td>
<td><strong>78.3</strong></td>
<td><strong>57.8</strong></td>
<td><strong>35.2</strong></td>
<td><strong>84.2</strong></td>
</tr>
<tr>
<td>Lithuania</td>
<td>98.2</td>
<td>96.4</td>
<td>86.8</td>
<td>69.3</td>
<td>58.1</td>
<td>20.6</td>
<td>71.6</td>
</tr>
<tr>
<td>Latvia</td>
<td>76.2</td>
<td>74.8</td>
<td>84.2</td>
<td>75.5</td>
<td>39.2</td>
<td>6.9</td>
<td>59.5</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>80.7</td>
<td>74.8</td>
<td>58.4</td>
<td>30.6</td>
<td>52.2</td>
<td>31.4</td>
<td>54.7</td>
</tr>
<tr>
<td>Estonia</td>
<td>48.0</td>
<td>52.0</td>
<td>69.1</td>
<td>63.0</td>
<td>33.9</td>
<td>11.0</td>
<td>46.2</td>
</tr>
<tr>
<td>Slovakia</td>
<td>n.a.</td>
<td>45.5</td>
<td>44.5</td>
<td>44.7</td>
<td>31.0</td>
<td>39.4</td>
<td>41.0</td>
</tr>
<tr>
<td>Hungary</td>
<td>60.6</td>
<td>27.2</td>
<td>26.4</td>
<td>25.5</td>
<td>24.3</td>
<td>30.5</td>
<td>32.4</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>30.9</td>
<td>32.7</td>
<td>32.5</td>
<td>29.4</td>
<td>34.3</td>
<td>21.2</td>
<td>30.2</td>
</tr>
<tr>
<td>Slovenia</td>
<td>n.a.</td>
<td>n.a.</td>
<td>25.2</td>
<td>26.6</td>
<td>26.8</td>
<td>44.9</td>
<td>27.8</td>
</tr>
<tr>
<td>Poland</td>
<td>13.6</td>
<td>11.6</td>
<td>24.0</td>
<td>34.4</td>
<td>38.6</td>
<td>14.8</td>
<td>23.4</td>
</tr>
<tr>
<td>Croatia</td>
<td>27.7</td>
<td>18.7</td>
<td>20.3</td>
<td>21.8</td>
<td>18.0</td>
<td>12.1</td>
<td>19.8</td>
</tr>
<tr>
<td><strong>Weighted average (without Russia)</strong></td>
<td><strong>38.66</strong></td>
<td><strong>26.79</strong></td>
<td><strong>35.57</strong></td>
<td><strong>39.35</strong></td>
<td><strong>39.36</strong></td>
<td><strong>32.16</strong></td>
<td><strong>35.31</strong></td>
</tr>
</tbody>
</table>

*Source: European Credit Research Institute, Central Bank of the Russian Federation (CBR)*

Household lending was largely unknown in 2000 but had reached RUB 1 trillion by the end of 2005 and RUB4 trillion by the close of 2008. Household lending has grown from three percent of banks’ total loan portfolios in 2000 to over 20 percent in 2008 (see Table 2.) Such rapid increases carry some increased risk. Over the past years, past-due loans have risen from 1.3 percent of total household loans in 2005 to 4.1 percent in 2008. Nevertheless consumer lending in Russia remains very low by international standards at just nine percent of GDP. Note that most household loans in Russia are for consumption not related to housing. In 2008, housing loans represented only 30 percent of total bank lending to households. Foreign currency loans stood at just 20 percent of total housing loans (down from 24 percent in 2007).

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9 Household loans include both short-term unsecured loans and long-term loans collateralized by residential mortgages. Both are considered as “consumer credit” under Russian legislation.
Table 2: Bank Loans to Households  
(in billion RUB)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Household Loans</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>in RUB</td>
<td>35.1</td>
<td>75.1</td>
<td>112.5</td>
<td>248.7</td>
<td>538.2</td>
<td>1,055.8</td>
<td>1,882.7</td>
<td>2,971.1</td>
<td>4,017.2</td>
</tr>
<tr>
<td>in foreign currency</td>
<td>7.6</td>
<td>14.4</td>
<td>24.5</td>
<td>50.9</td>
<td>90.0</td>
<td>172.7</td>
<td>304.7</td>
<td>404.4</td>
<td>480.0</td>
</tr>
<tr>
<td>Housing Loans (including Mortgages)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>54.4</td>
<td>125.7</td>
<td>350.2</td>
<td>757.5</td>
<td>1,197.6</td>
</tr>
<tr>
<td>in RUB</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>36.5</td>
<td>77.4</td>
<td>239.4</td>
<td>579.4</td>
<td>960.6</td>
</tr>
<tr>
<td>in foreign currency</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>17.9</td>
<td>48.3</td>
<td>110.8</td>
<td>178.1</td>
<td>237.1</td>
</tr>
</tbody>
</table>

| Household Loans as % of Total Loans | 3.3 | 4.8 | 5.3 | 8.3 | 12.3 | 17.0 | 20.4 | 21.3 | 20.7 |
| Households Loans as % of GDP | 0.5 | 0.8 | 1.0 | 1.9 | 3.2 | 4.9 | 7.0 | 9.0 | 9.2 |

Source: CBR

Starting at the beginning of 2007 to the end of 2008, financial investments by Russian households grew by 49 percent, led by deposits in banks. Table 3 shows that bank deposits have strongly contributed to the increase, growing 55 percent in the same period. Household net equities in non-state pension fund reserves also went up a remarkable 43 percent over two years, although they likely had declined during the September-October 2006 decline in global stock markets, including in Russia.

Table 3: Household Financial Investments  
(in billion RUB)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Deposits</td>
<td>3,809.71</td>
<td>5,159.20</td>
<td>5,906.99</td>
<td>55.05</td>
</tr>
<tr>
<td>as % of GDP</td>
<td>14.16</td>
<td>15.58</td>
<td>14.22</td>
<td></td>
</tr>
<tr>
<td>Non-state Pension Funds</td>
<td>316.85</td>
<td>401.80</td>
<td>455.14</td>
<td>43.65</td>
</tr>
<tr>
<td>as % of GDP</td>
<td>1.18</td>
<td>1.21</td>
<td>1.10</td>
<td></td>
</tr>
<tr>
<td>Non-life Insurance *</td>
<td>140.7</td>
<td>159.5</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>as % of GDP</td>
<td>0.52</td>
<td>0.48</td>
<td>n.a.</td>
<td></td>
</tr>
<tr>
<td>Life Insurance</td>
<td>24.58</td>
<td>23.73</td>
<td>30.56</td>
<td>24.35</td>
</tr>
<tr>
<td>as % of GDP</td>
<td>0.09</td>
<td>0.07</td>
<td>0.07</td>
<td></td>
</tr>
</tbody>
</table>

* Includes motor third-party liability, personal accident and health insurance. 
Data on household investments in securities is not available.

Source: CBR, Axco

At the same time, household debt has increased in relation to household net worth. Borrowings by households have risen from 43 percent to 50 percent of total household investments, excluding securities (see Table 4).
Table 4: Household Loans and Financial Investments
(in billion RUB)

<table>
<thead>
<tr>
<th></th>
<th>December 2006</th>
<th>December 2007</th>
<th>December 2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Household Loans</td>
<td>1,882.7</td>
<td>2,971.1</td>
<td>4,017.2</td>
</tr>
<tr>
<td>Household Investments</td>
<td>4,291.8</td>
<td>5,744.2</td>
<td>6,392.69*</td>
</tr>
<tr>
<td>Ratio</td>
<td>43.9</td>
<td>51.7</td>
<td>62.8</td>
</tr>
</tbody>
</table>

* Excludes non-life insurance

Source: CBR

Despite the increases, participation in the formal financial sector remains low. Bank savings accounts are considered as “gateway products” (or services) that bring consumers into the financial sector and allow them to benefit from financial services. However a nationwide poll conducted by the National Agency for Financial Studies (NAFI) and Expert RA Rating Agency in April 2008 estimated that only 16 percent of the population had any type of bank savings account. The Deposit Insurance Agency notes that it provides deposit coverage for only about 50 million savings accounts. Investments in securities are still lower. MICEX Stock Exchange estimates that fewer than two percent of all Russians own publicly traded securities. Access to credit is also low, although rising. Surveys by NAFI suggest that more than 25 percent of all eligible citizens have borrowed from banks. The CBR estimates that as of January 2008, 104 million bank cards had been issued, of which 9 million are credit cards and the balance are debit cards. An estimated 60 million people (or 42 percent of the population) still have no access to financial services, not even a basic bank account. However one of the problems is that data is incomplete and more precise information on household participation in the financial system is needed.

At the same time, the credit reporting infrastructure is improving. More than 20 million consumers have credit histories in the credit reporting system. This number represents less than half of the estimated total number of borrowers. As regulation over credit reporting systems improves, it is expected that 50 million borrowers may eventually be part of the system of credit histories.

Increased demand for retail banking services and the resulting increase of debt service obligations on households emphasizes the need for efficient consumer protection and effective financial education. Financially illiterate consumers may undertake financial decisions that leave them vulnerable to the risks associated with the purchased service. Especially long-term credit engagements with variable interest rates constitute financial traps for inexperienced costumers. In addition, liabilities denominated in foreign currencies potentially generate higher burdens through exchange rate fluctuations. Given immense lending growth rates, the financial sector needs to ensure the implementation of effective and adequate tools for the assessment of credit risks.

Financial Literacy Survey

In June 2008, a financial literacy survey was conducted in preparation for the Financial Literacy Program in Russia. The survey consisted of 40 questions, covering consumer

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understanding of financial calculations, spending habits and confidence in financial institutions. Over a two-week period, more than 1,600 households in forty Russian regions were canvassed, thus providing a representative sample of consumers throughout the Russian Federation. The results of the survey were confirmed in discussions with four focus groups.  

The survey found that about half the population views its levels of financial literacy as unsatisfactory. This low level of literacy was confirmed by a simple quiz of six questions on basic issues needed to manage household finances. They related to: (1) awareness about consumer financial disclosure (e.g. effective annual interest rate, deposit insurance coverage); (2) understanding of basic financial concepts (e.g. inflation, interest on loans and deposits); and (3) financial mathematics skills (e.g. percentages). Only 19 percent of respondents gave at least five correct answers to the six questions. About 25 percent could not provide more than one correct answer.

Over half of households live paycheck to paycheck. The survey found that 60 percent of households run out of money before payday, either regularly or from time to time. During the last year, 35 percent of households had to borrow to pay back other debts either frequently or occasionally. Nine percent have no estimate of their monthly spending or revenues and 36 percent of households do not save any funds from their monthly income.

Compounding the problem is weak trust in the Russian financial sector. Of the consumers who do not save, nine percent gave the reason as "lack of trust in financial institutions." Only 11 percent of households have insurance policies, whereas 21 percent of consumers consider that they need life insurance policies, but do not buy them because they "do not believe that the insurance companies will pay the claims in case of their death."

Importantly more than half of consumers lack awareness of their legal rights as consumers of financial services. Over 60 percent of households are unaware of lenders' obligations to disclose the effective annual interest rate of a loan. Only 11 percent of the population is aware that the government does not cover losses from decreases in value of investment funds. Only 14 percent could provide the correct level of deposit insurance (at RUB 700,000 or about $20,000) Six percent of the population believes that the insurance covers all bank deposits in their full amount or up to a million rubles. Furthermore there is very little knowledge of reliable sources of information regarding rights of financial consumers.

Russian consumers have little confidence that problems with financial transactions can be easily and fairly solved. Three quarters (77 percent) give a 50:50 chance (or worse) that disputes with financial institutions "will be resolved quickly and justly." Consumers are also passive in defending their legal rights. Eight percent of consumers said that, over the past five years, they had bought a financial service (generally a consumer credit) that did not meet their needs. They concluded that they had been deceived by those who provided the service. Yet more than 60 percent of unsatisfied customers took no action. Only four percent complained to the financial institution and three percent submitted a report to the appropriate government authority.

At the same time, most of the population has unrealistically high expectations of Government support for individual welfare—and therefore fails to develop long-term financial plans. About half the population believes that the Government should compensate them for losses in the case of a bank’s bankruptcy. Another 15 percent believes that the government

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11 The survey was designed by the World Bank. Polling was conducted by the National Agency for Financial Studies, which conducts regular surveys of consumer behavior across the Russian Federation.
should compensate individuals from losses in the cases where the market value of shares in investment funds drop. In addition, 16 percent believe that any decrease in prices of residential real estate should be compensated by the government. Surprisingly, the share of population who feel they should be able to rely on Governmental support in case of personal financial losses is higher for those between ages 25 and 34 than for other age groups.

**Russian consumers already take some measures to protect themselves.** Over 40 percent of households say that they compare the terms and conditions of a financial service before purchasing it—although 46 percent use a bank's reputation (and only 37 percent use the cost of credit) as the determining factor in choosing a bank for borrowing. Over 80 percent receive financial information from newspapers, magazines and specialized TV shows. However when making a financial decision, 51 percent turn first to the advice of family and friends and 36 percent look to the "consultants" providing the service.

**Households would like to receive financial education.** Three-quarters of respondents said that they would like training on how to protect themselves financially and how to plan their financial future. One third (31 percent) wants to learn what laws protect financial consumers and what procedures should be followed when consumers feel that their rights have been violated. Over ten percent (13 percent) would like information about credits for household consumption and another 16 percent want to learn about credits to finance purchase a house or apartment.

**About quarter of the population is interested in pension planning and almost as many want to avoid over-indebtedness.** About 26 percent want to learn how the pension schemes work and what methods are available to secure one’s old age income. Another 22 percent of households wanted to learn "what to do to avoid getting up to one’s neck in debt when using credits." Young people are especially interested in strategies of planning significant purchases and mortgage services while older respondents focus on future pensions. High-income households point to the need for better understanding of what parts of the contract agreements with financial institutions should be studied with an extra attention in order to reduce a risk of future fraud or unfair business practices. However some communities will be difficult to reach for any form of financial education. About one-quarter of respondents expressed no interest in financial training on any topic.

**The first preference of households is to have government agencies, including financial supervisory agencies, provide financial training to the public.** One-third (or 34 percent) of households would like the governmental institutions responsible for regulating financial markets to deliver programs of financial literacy. Almost as many (29 percent) would like independent financial consultants to provide training. Fewer (23 percent) would rely on institutions of higher education with programs in economics and finance and the same number would look to non-government organizations to offer training. The same number (22 percent) would like pension funds and insurance companies to provide direct training but fewer (14 percent) trust the banks to give financial education. Only three percent would rely on investment funds and just 15 percent look to mass media for useful programs on financial education.

**The findings of the survey show that Russian consumers are interested in both better financial training and improved consumer protection.** They want to learn how to protect themselves when dealing with financial institutions, how to identify (and avoid) pyramids and other financial frauds, how to plan for the future, avoid over-indebtedness, and invest for their future retirement from the workplace. However the survey also points to a high level of consumer distrust of private financial sector institutions, particularly commercial banks but also insurance companies. Consumers compare terms and conditions of the services being offered but first want
to know if the financial institution is reputable. They also have little confidence in the existing systems of solving problems and do not feel they can resolve disputes over financial transactions, even when they feel that they have been deceived by the provider of the financial service.

Key Findings & Recommendations

The Diagnostic Review proposes that consumer protection in financial services be strengthened in ways that will improve consumer confidence in private financial institutions. Six measures are recommended:

1) Simplify and strengthen the government regulatory and financial supervisory structures related to consumer financial services,
2) Improve consumer disclosure for financial services to make it more clear and simple—yet more complete—than the current disclosure,
3) Prohibit deceptive and unfair business practices in consumer finance,
4) Make dispute resolutions systems for consumer finance inexpensive, efficient and easy for consumers to use;
5) Improve financial education programs (both formal and informal) for households; and
6) Conduct regular financial literacy surveys to evaluate the impact of policy interventions and financial education programs.

Regulatory & Supervisory Structures

The basic legal framework for consumer protection in financial services is in place but needs further refinements to fully address issues related to financial services. The concept of consumer protection was initially introduced into Russian legislation by the 1992 Law on the Protection of Consumers’ Rights. The Law was innovative in providing consumers with certain rights enforceable by an agency, consumer associations, as well as by individuals. Protection was, however, initially limited to what may be termed “traditional goods and services”. It was only as a result of successive definitive interpretations of the term “service”, as provided by the Plenary Commission of Russia’s Supreme Court, that Chapter III of the Law (dealing specifically with “services”) was made applicable to bank deposits, consumer and mortgage loans and other similar financial services.

In addition, the legislation is contradictory. The 1992 Consumer Protection Law addressed issues of consumer protection covering all economic activity other than profit-making “entrepreneurial” activity. This created some difficulty for financial services since the Civil Code notes that opening a bank account (even by a consumer) is considered to be an entrepreneurial activity. To resolve the contradiction, the Supreme Court provided guidance for lower courts. In its plenary session of September 29, 1994, the Court adopted a resolution regarding the procedure for reviewing cases of consumer protection. This resolution, which is binding on Russia’s courts, instructs courts that in case of contradiction between the laws, the courts should follow the Law on the Protection of Consumers’ Rights.

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However the consumer protection legislation does not cover all retail financial services. The Law on Consumer Protection covers contracts for financial services for the personal, family, household and other needs of consumers not connected with entrepreneurial activities.\(^{13}\) This includes granting of credits, opening of accounts, safekeeping of securities, and provision of consulting services as well as remittances and payments. However other retail financial services, such as securities, investment funds and pension funds, are not covered by the Consumer Protection Law. Furthermore it is not clear if financial services provided by credit cooperatives fall under the Consumer Protection Law. Neither is it clear if all the provisions of the Consumer Protection Law (specifically, Article III regarding protection of consumer rights in the rendering of services) apply to insurance services.

**Supervisory Structures**

The key issue on financial consumer protection is the complex structure of responsibilities of various supervisory agencies. The Federal Service for the Oversight of Consumer Protection and Welfare, called Rospotrebnadzor (or the Consumer Protection Service, or CPS, in this report) was established in 2004 to oversee and enforce the Law on the Protection of Consumers’ Rights.\(^{14}\) Under the Federal Law On the Central Bank of the Russian Federation (Article 56), a key goal of banking regulation and supervision performed by the Central Bank of Russia (CBR) is to maintain stability of the Russian banking system and protect the interests of depositors and lenders. While the CBR is not directly responsible for consumer protection—and cannot intervene in individual contract disputes between consumers and credit organizations—the CBR has a role to play in supporting improved financial consumer protection. Weak consumer protection and poor financial literacy by borrowers can undermine the quality of a bank’s loan portfolio and potentially the banking system. Similarly the 1996 Securities Law, the 1999 Law on Protection of Investor Rights and the 2001 Investment Funds Law provide strong mandates for the Federal Financial Market Service (FFMS) to protect retail investors.\(^{15}\) The Insurance Law provides a similar mandate for the Federal Service for Insurance Supervision (FSIS) to protect insurance policy-holders.\(^{16}\) The Federal Antimonopoly Service (FAS) is responsible for monitoring advertising in the financial markets but the FFMS reviews all advertising related to securities and makes referrals to the FAS where needed. A simplified structure for consumer protection in financial services would be helpful.

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\(^{13}\) Russian legislation does not distinguish between financial products (such as annuity contracts) and financial services (such as consulting services). For the purpose of the Diagnostic Review, financial services are assumed to also include financial products.

\(^{14}\) Also under Federal Law 294-FZ of December 26, 2009 on Protection of the Rights of Legal Entities and Individual Entrepreneurs in the Implementation of State Control (supervision) and Municipal Control, entities providing consumer services are obliged to make special declaration (in a to-be-defined procedure). They are also subject to unscheduled inspections in case of violations of consumer rights.


\(^{16}\) Federal Law No. 4015-1 of November 27, 1992 on the Organization of Insurance Business in the Russian Federation
Three options are available to ensure a clear and effective structure for financial consumer protection. The options are:

1) CPS retains authority for protection of the rights of financial consumers and has strengthened institutional capacity to handle financial issues—and co-ordination with the financial supervisory agencies is improved;

2) The CBR receives expanded authority for consumer protection (while FSIS and FFMS maintain their current policy-holder and investor protection responsibilities); and

3) A specialized financial consumer protection agency is established.

The first option requires substantial strengthening of the CPS but would be the best approach. If the first approach is selected—retaining responsibility for financial consumer protection with the CPS—then the CPS should build additional expertise in financial services. One of the difficulties is that, in a competitive and dynamic financial sector, retail financial services are constantly changing and modified. For officials without practical experience working in the financial sector, such in-depth expertise is difficult to obtain. Furthermore once such expertise has been developed, the officials are at risk of being offered higher paying positions in the private sector and training must begin anew. In addition, since financial services are very highly specialized, it would be helpful if CPS were to create a special department focusing on consumer protection in financial services. This is the approach used by some European consumer protection agencies, such as Konsumentverket of Sweden, which cover household financial services as well as the rest of the economy.

The second option would be difficult to implement. With a primary focus on soundness and stability in the banking sector, responsibility to resolve disputes with banking clients may place the CBR in a conflict of interest, at least in the short-run. Where decisions are in favor of clients, they may be to the financial disadvantage of the financial institution. Over time, disputes that are resolved quickly and fairly will build public confidence in the financial sector, thus strengthening the financial sector. However Russian legislation establishes that government control and legal and regulatory oversight in consumer protection is entrusted with CPS (under the Consumer Protection Law) while the Banking Law gives responsibility for supervising banks to the CBR. Rather than amending the legislation, it may be better to further delineate the division of responsibilities between the two agencies. Alternatively on issues that overlap between the two agencies, such as disclosure of consumer credits, the CBR may wish to consult the CPS on the most effective ways of ensuring clear and understandable consumer disclosure.

The third option—a specialized financial consumer protection agency (such as that of Canada)—may be a helpful approach over the long-term. Some countries have found the conflicts between the objectives of prudential supervision and consumer protection to be sufficient to transfer the consumer protection agenda to a special-purpose financial consumer protection agency (see Box 1 on the Financial Consumer Agency of Canada). A similar Financial Consumer Protection Agency is also under consideration by the U.S. Congress. Those in government often argue that central banks often have too many responsibilities—between monetary policy and prudential supervision. They argue that adding consumer protection is one too many areas and consumer protection is best handled by an outside agency. However establishing a new agency would also create issues since the new institutions will need time and resources to find office space and build its staff resources in the center and regionally.
Box 1: Financial Consumer Agency of Canada

The Financial Consumer Agency of Canada (FCAC) was established in 2001 under the FCAC Act. FCAC’s objectives are to: (1) supervise federally-mandated financial institutions to ensure they comply with federal consumer protection measures that apply to them, (2) promote the adoption by financial institutions of policies and procedures designed to implement the consumer provisions, (3) monitor if financial institutions follow their own voluntary codes of conduct and respect the public commitments they have made to protect the interests of consumers, (4) promote awareness of the obligations of financial institutions, and (5) foster an understanding of financial services and issues relating to financial services.

FCAC has the authority to issues notices of violations and levy fines of up to C$200,000 ($185,000). FCAC reports to Parliament through the Minister of Finance and is funded by assessments on the financial institutions it oversees.

Source: FCAC

If the first option is selected—and the current structure maintained—the allocation of responsibilities for financial consumer protection should be clarified among the various agencies. Some overlap of supervisory agencies is inevitable in all countries. In some countries, such as the United States, the government agencies have developed detailed memoranda of understanding (MOUs) describing the allocation of responsibilities among the agencies so that they do not duplicate their efforts. An alternative approach would be to develop joint working groups, both at the level of the chiefs of each agency and at the intermediate working levels. Such working groups should have regularly scheduled meetings, such as each 90 days, to decide how they will jointly address common issues.

The first option also requires substantial institutional strengthening of the CPS. To be effective in supervising consumer protection in financial services, the CPS should establish a special department working only on financial services. It should also be staffed by experts in financial services, with wide-ranging expertise on financial sector issues and the types of services offered by financial institutions. In most countries, such expertise requires pay-scales that are higher than the standard levels for civil service employees—and are comparable to those working for the financial supervisory agencies. Whatever approach is taken, the CPS should also take measures to improve co-ordination and communication with the financial supervisory agencies. Also needed is an effective monitoring system to follow implementation of the regulatory regime in consumer protection and changes in business practices for the delivery of financial services.

The CPS should also strengthen its own transparency and accountability regarding treatment of consumer complaints about financial services. In particular, the CPS should collect and publish statistics on the numbers of consumer complaints regarding financial services, the trends in types of complaints, and the final resolution of the complaints. The statistics should be sufficiently detailed that consumer advocacy organizations and professional associations can analyze the key issues and common trends. Both the CPS and civil organizations should prepare recommendations on measures to improve consumer protection in financial services, including methods of monitoring and evaluating the impact (as well as the costs) of the recommendations.

Whichever option is selected, co-ordination among the supervisory agencies is critical and efforts should also be made to avoid opportunities for "regulatory arbitrage". Cross-over financial contracts present their own complexities for supervisors. The current supervisory structure for financial services leaves the door open for financial service providers to create financial services with the objective of minimizing the level of government supervision. For
example, unit-linked life insurance policies and variable annuities are largely indistinguishable from investment funds from the perspective of the consumer. However under the current supervisory structure, insurance falls under the FSIS while collective investment schemes are supervised by the FFMS. Unit-linked insurance policies are more akin to securities in their risk profile and legal structure than to insurance. However because they are sold by insurance companies, unit-linked insurance policies are supervised by the FSIS. At a minimum, close coordination of the agencies (at both the chief executive and working levels) is needed to ensure consistent supervision across the financial sector.

Credit Cooperatives

All credit cooperatives should be licensed and operate under a clear regulatory framework. Three specific laws cover three types of credit cooperatives. However the activities of some credit cooperatives are not covered by any of these laws but fall instead under the general provisions of the Civil Code. This conflicting framework allows for regulatory arbitrage and makes it difficult for consumers to identify the applicable legal framework. In addition, the laws do not require licensing of cooperatives. Furthermore there exists no central register of cooperatives that could provide consumers with basic information for credit cooperatives.

All credit cooperatives should be subject to supervision by a financial regulator or supervisory agency. With the total amount of loan portfolio estimated at less than one percent of consumer loans, the credit cooperatives are a small part of the Russian banking system. However they receive funds from the public, make consumer loans to their members and provide access to credit for small businesses that would otherwise have difficulty obtaining loans. Furthermore their unsupervised status leaves opportunity for abuses of the rights of financial consumers. The Law on Citizen Consumer Credit Cooperatives states that a federal agency should regulate and supervise the activities of these entities. However the specific agency has not yet been designated. One approach would be for the Ministry of Finance to be responsible for supervising credit cooperatives. Another alternative would be to have the CBR supervise all credit institutions, including credit cooperatives. The second approach would be difficult for the CBR to implement, since it would involve broadening CBR's mandate to supervise institutions that are not systemically important for the financial sector. Whichever approach is taken, a separate department should be set up to provide light supervision, such as that needed for business conduct rather than prudential requirements. The supervision might be limited to ensuring publication of annual audited financial statements and ensuring that the board members and significant shareholders have not been convicted of economic crimes.

Financial Pyramids

All entities (be they legal or physical persons) that, for the purpose of investment or speculation, solicit funds from the public should be obliged to obtain licenses from the financial supervisory agencies. A key measure in preventing the emergence of financial pyramids is the requirement for licensing of all entities that contact the public and solicit funds for investment or speculation. The Ministry of Finance estimates that as many as 120,000 individual entrepreneurs currently solicit funds from the public. However a distinction should be made between private solicitations of friends and family versus a public solicitation to an indeterminate number of investors. For the latter, different jurisdictions use different thresholds to identify what is an "indeterminate number" but the threshold is generally between 15 and 50
investors. All persons, legal and physical, that solicit funds from more than 50 investors should be required to be registered with the financial supervisory agencies and be obliged to obtain a license for their activities.

The FFMS should take a leading role in dealing with financial pyramids. In the case of a pyramid that is selling a security without a license, the FFMS could use Article 51.6 of the Law on the Securities Market to deal with it. The provision considers illegal any professional activity in the securities market carried on without a license. However many pyramids do not fit clearly into the narrow definition of a security under Russian law and are therefore not handled by the FFMS. The pyramid schemes that do not fit clearly into the strict definition of a security are turned over to the Ministry of Internal Affairs to be dealt with as a criminal matter. However, the Ministry of Internal Affairs is not a financial expert agency. It would be better if the FFMS were to take the leading role in investigating pyramid schemes, since most pyramids involve the sale of financial instruments that in most countries are considered as securities (see Box 2 on Financial Pyramids). Criminal referrals to the Ministry of Internal Affairs should be made after the FFMS has finished its investigation. In addition, the FFMS should have the legal authority to freeze assets of the scheme as needed to protect the investors’ assets. If a court action is needed before the assets of pyramids can be frozen, the assets will likely be dissipated before they can be frozen.

The penalties for operating or being affiliated with any such scheme should be severe. In particular, the FFMS should be given increased powers to deal with pyramids, such as the authority to freeze assets of the operator of the pyramid scheme.

Of particular concern are consumer cooperatives. According to the Ministry of Internal Affairs, consumer cooperatives have become the most criminal version of financial pyramids in Russia. A step in the right direction to deal with this issue has been to propose an amendment in the Law on Citizen Consumer Credit Cooperatives that would require that managers have educational certificates and be free of convictions of an economic crime. A general provision of making pyramid schemes illegal might also be included under the Law on Competition or the Criminal Code.

Special attention should also be paid to multi-level selling schemes, which often arise in insurance markets in emerging countries. A multi-level scheme is typically a program with three or more levels that promotes the supply of a product (or service) to participants of the scheme. (See Box 3 on Multi-Level Insurance Schemes in Australia for further illustration.) Participants in the scheme earn compensation based on the supply of the product or service to other participants or non-participants of the scheme. While multi-level selling is often used for legitimate purposes, its structure (of having each customer be responsible for selling products or services to new customers) is highly vulnerable to abuse. A legitimate multi-level scheme focuses on the supply of products or services—rather than the recruitment of prospective participants into the scheme. A legitimate scheme also offers products or services that consumers value and are willing to purchase. The law should identify a multi-level sales scheme as an illegal pyramid scheme if: (1) payment is required for the right to receive compensation for recruiting new salespersons into the scheme; (2) there is inventory loading, that is, new salespersons must purchase an unreasonable quantity of a product or service; and (3) purchases of services are required as a condition of entry into the scheme.
Financial pyramids, Ponzi schemes and other financial frauds are present in all active financial markets and Russia is not immune. Between 1994 and 2007, about 1700 pyramid schemes were discovered. As of mid-2008, the Ministry of Internal Affairs had opened 653 criminal cases against the operators of pyramids. In May 2008, the Ministry released the results of its investigation of about 17 financial frauds involving RUB 32 billion (US$ 1.2 billion).

An initial wave of financial pyramids surged in the early 1990s (especially after the privatization of 1992), when millions of Russians became securities investors for the first time. Many of these new investors feared that the privatization vouchers might lose their value or get stolen. In this context, operators promised to cash in the vouchers. MMM, Lords and Stroymetresursa were some of the most infamous cases of financial pyramids in the 1990s.

Financial pyramids made a comeback in 2008. The Ministry of the Internal Affairs exposed at least 28 financial pyramids. The organizations fraudulently attracted money under various high-interest investment schemes, promising from 30 to 150 percent annual returns. The Ministry of Internal Affairs estimates that more than 400,000 Russians suffered losses exceeding RUB 40 billion (about $1.4 billion).

Among the financial pyramids that collapsed in 2008, the greatest damage to investors was caused by a group of companies operating in the insurance market: Stock Reserve, SWS Saving World System SA and ISG. According to preliminary data, the losses are estimated at RUB 30 billion. The owner of these companies sold long-term life insurance policies of the Austrian company Si Save-Invest Limited, without having a license for this activity. Another infamous case was Rubin Business Club which promised 25-50 percent annual returns on financial investments. This company operated in around 300 cities including St Petersburg (the center of operations with 20,000-50,000 customers), the Republic of Chuvashia and the city of Ulyanovsk. It also had branches in all CIS countries. The losses are estimated at RUB 2 billion, affecting more than 200,000 investors. Other pyramids include OOO Irkutsk Stock Center, which promised between 30 and 45 percent of annual return and caused losses of RUB 51 million. About 250,000 investors were affected by Company Region Center, Garant Invest and Guarantor Credit.

Sources: Kommersant, No 101 (3918), June 17, 2008

Disclosure on supervisory arrangements can also help in cracking down on financial frauds. In their advertising, financial institutions should be obliged to publicly state that they are regulated—and to indicate which financial agency supervises their institution. In so doing, financial firms separate themselves in their advertising from financial pyramids and other frauds and help the consumer decide which institutions are safe and reliable financial firms with whom to entrust their finances.

Consumer alerts of possible frauds would be helpful. Where all financial institutions are required to be licensed, the supervisory agencies can be effective in issuing consumer alerts. For example, the CBR, FFMS and FSIS could create a special page for consumers on their websites. Under a section of consumer alerts, the agencies could state that they license all activities related to each area and that company ABC is not licensed to provide investments for the public—and that care should be taken. However careful consideration should be given as to how best to design the legislation in order to avoid overregulation but effectively fight against financial frauds.
Box 3: Multi-Level Insurance Schemes in Australia

Australia provides a useful case study in multi-level selling schemes for insurance policies. In a typical multi-level selling scheme, the objective is to convert all purchasers of insurance policies into agents selling policies. This is done through a "point" system.

The purchase of a policy—typically a 10- or 15-year life insurance policy including accident coverage—is a requirement for becoming an agent. The commission paid to the agent is based on the points earned. The agent earns "points" for each policy sale, depending upon the details of the policy. Points are also earned for the recruitment of new agents.

High levels of commission are only accessible to those with sufficient recruitment points. At these levels, although the agent may still sell policies directly, the primary commission is usually earned on the policies sold by agents and sub-agents. As the agent progresses up the pyramid, he or she will also earn commission on the earnings of local managers selling policies. According to the training manuals of one agency in Australia, the basic grade agent will receive 16.9% of the annual premium paid by purchasers of policies plus 9.3% of commissions up to the level of local network manager, the third stage of the pyramid and the first level of its permanent structure. As agents increase their points, they are also eligible for other incentives, such as free holidays and gifts.

Due to the high levels of commission that can be earned from rising up the pyramid, sellers often take measures to evade supervision by the local authorities, including putting potential customers on buses to take them across borders where the individuals are pressured to sign insurance policies.

Source: Commission on Financial Services and Insurance (Australia)

Financial Intermediaries

The role of financial intermediaries in Russia has been increasing. Financial intermediaries play valuable roles in improving the efficiency of the financial sector. It is estimated as much as ten percent of all consumer credits in Russia are originated by the newly created institutions of credit brokers—and the percentage is rising. In addition, the expansion of consumer credit and increased past-due loans has put pressure on banks to improve their debt collection processes. Debt collectors are active both as agents for banks and as standalone entities, whereby they purchase past-due loans from the banks. Lending institutions have started to use debt collection agencies to collect past-due loans, with as much as 30 percent of all delinquent consumer credits being transferred to debt collection agencies for final collection.

However all financial intermediaries (such as credit brokers, debt collection agencies and insurance intermediaries) should be regulated. Experience in the new member states of the European Union suggests that many consumer protection abuses are conducted by financial intermediaries. Under Russian law, when a bank sells a loan to a debt collector, the consumer is no longer protected under the consumer protection legislation since the consumer protection provisions are not transferred to the debt collection agency. At a minimum, credit brokers and debt collection agencies should be registered with a financial supervisory agency (in addition to the register of legal entities maintained by the Tax Service). This will require revision to the legislation, perhaps preparing a special federal law to regulate credit brokers and debt collectors. Federal Law 394-1 on the Central Bank of the Russian Federation lists the objectives of the CBR as: (1) maintenance of the stability of the ruble, (2) development and strengthening of the banking system and (3) maintenance of the settlement system. However it would be useful if the CBR
were also authorized to maintain a register of credit brokers and debt collection agencies. In addition, the CBR should receive annual audited financial statements for the companies. In addition, the register should be open to the public. For the insurance sector, the FFMS should maintain a public register for insurance intermediaries. Insurance agents should also be tied to one insurer for each class of insurance sold and they should be liable for the policies they sell.

**A system of qualification and certification of intermediaries should be established.** The training should be consistent with the complexity of the product and the nature of the intermediary--a travel agent selling short term travel insurance does not need the same training as a financial planner. The revised securities legislation creates a formal role for financial/investment consultants who would provide expert and non-biased advice for retail investors. The consultants would be subject to special training and certification. A similar approach could be taken for credit and insurance intermediaries who assist consumers in obtaining bank loans or insurance policies. It may be advisable to create a system of tiered consultants. Those with the highest level of expertise may be subject to certification by the supervisory agency. However the certification process should be clear and transparent and subject to external review to ensure that it achieves its intended objectives. The certification should also include training on a code of ethical standards, including issues of conflicts of interest.

**Non-credit payment Service Providers**

**Non-bank institutions involved in retail payments have emerged in recent years.** Due to the largely cash-based economy, Russian consumers generally use cash to pay bills, such as utility services and rent. Starting in 2005, a number of non-bank companies were created, specializing in retail payments for utility and other services. The companies began by taking cash via prepaid scratch cards for mobile telephone services and they later expanded their services to cover other types of payments, although payments for cellular telephone service still represent 70 to 85 percent of all transactions through the service providers.

**Non-credit payment service providers offer a valuable service to Russian consumers.** Using ATM-type terminals, consumers can pay rent, mobile telephone, utility and other bills without having to visit bank branches or the offices of the utility providers. The terminals can also be used to pay interest and principal on bank loans and make card-to-card transfers of cash. It is estimated that over 95 percent of such payments are one-off payments of small amounts of under RUB 100 ($4) and the maximum amount that can be transferred is RUB 30,000 (or just over $1,000). Terminals are provided throughout Russia in communities as small as 50 households, where no bank branch or even post office is located. Representatives of the sector estimate that at least 70 million consumers, or virtually all of the Russian working population, use such terminals at least occasionally. For the estimated 60 million Russian consumers who do not maintain bank accounts, the non-bank services provide an easy mechanism for payments of routine bills. The CBR roughly estimates that, in aggregate, the non-credit payment services handle as much as $60 billion in cash each year.

**The difficulty is that no financial supervisory agency is responsible for supervising non-credit payment service providers.** Under the Consumer Protection Law, the CPS supervises

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17 The revised securities law also distinguishes between “qualified” and “non-qualified” investors, with special investor protection for non-qualified retail investors. Investment consultants would provide services only for non-qualified investors.
payment service providers from a consumer protection perspective but no financial supervisory agency licenses payment providers. The companies can be divided into two groups: (1) those that maintain customer accounts (such as WebMoney and Yandex Money) and (2) those that limit their activities to transferring retail payments and thus do not maintain customer accounts (such as Qiwi). Unlike PayPal in the US, customers of the payment services in Russia are not required to provide either a credit card or access to a current (checking) account with a bank. Both types of payment services are licensed by the Ministry of Telecommunications and Mass Communications but neither is supervised by the financial supervisory authorities. Under the Law on Banks and Banking Activities, supervision of the CBR is limited to that of credit organizations. Both types of companies thus lie outside the banking sector even though companies that maintain customer accounts from retail consumers are in effect deposit-taking institutions.

Draft legislation would clarify the authority of the CBR to supervise the payments system. The absence of legislation on the national payments systems reduces the regulatory clarity for non-credit payment services and the law should clarify the responsibility of the CBR for supervision of the national payments system. Specifically, the law should give the CBR authority to license non-credit institutions not only when they provide payment services but also but also where they provide payment infrastructure services (such as central clearing). In addition, the law should authorize the CBR to provide oversight for the payment systems, including infrastructure and payment instruments. Draft legislation is under preparation to provide such authority to the CBR.

Consideration could also be given to regulating the outsourcing of banking operations and services. Some organizations, such as federal postal entities, may have a useful role to play as agents of credit institutions with regard to specific banking services. The law should authorize the CBR to establish a list of technical functions that could be outsourced to third party service providers. Also needed are procedures to ensure that the credit institutions maintain accountability for the actions of their agents. Useful guidance may be taken from the 2005 report of the Joint Forum on Outsourcing in Financial Services.

The CBR should ensure a minimum level of governance by payment service providers. The CBR sets minimum requirements for corporate governance of credit institutions, particularly on the roles of boards of directors. However payments service providers should also be legally obliged to disclose the significant ultimate beneficial owners (or “real owners”) of the companies and the significant owners should be free of criminal records. In addition, the companies should be required to publish annual audited financial statements and they should provide daily emails with reporting of transactions volumes to the CBR.

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18 The Consumer Protection Law (Article 37) notes the procedure for payment of consumer services but does not provide further detail.
19 Note that Federal Law No. 103-FZ (signed June 3, 2009) on the Acceptance of Payments from Individuals by Payment Agents (which goes into effect on January 1, 2010) requires that payment agents be registered with an authorized body.
21 See CBR letters № 119-T of September 13, 2005 “On contemporary approaches to corporate governance in credit institutions” and № 11-T of February 7, 2007 “On the list of check points for corporate governance assessments.”
22 Under Russian legislation, only the Ministry of Internal Affairs (General Information and Analytical Center) can issue certificates confirming the absence of a criminal record.
Also legislation should provide a clear definition of “electronic money.” Initial steps have been taken with a decision of the Security Council to regulate the use of electronic money for settlements and to recognize such payments as a banking operation. An interdepartmental task force, consisting of the CBR and relevant ministries and agencies, has been established. As part of their work, it may be useful to implement the EU Directive 2007/64/EC on Payment Services in the Internal Market, as a means of attracting international payment service providers and increasing competition in the sector.

**Other Regulatory Measures**

**Work is underway to improve regulation of consumer credit.** Both the Ministry of Finance and the Association of Regional Banks are preparing draft legislation to govern consumer credit. The final legislation is expected to cover issues such as measures to improve consumers’ understanding of the conditions of the transaction, potentially curb interest rates which can be charged by the credit institutions on consumer credit, and regulate terms under which loan applications of unsuited borrowers can be turned down.

**Consideration should be given to amending the Law on the Protection of Consumers’ Rights to allow for standard contracts.** One of the basic provisions of financial consumer protection is the adoption of standardized contracts for basic retail financial services, such as consumer loans and insurance policies. The issue is complex but it is one that needs to be addressed. Standard contract provisions help address the asymmetry in knowledge and expertise between an individual consumer and a financial institution. The contracts can be amended as needed to respond to a particular issue but the standard contract is the starting point for the consumer. However the Law on the Protection of Consumers’ Rights permits the contract to be adapted to the consumer, creating potentially a different contract for each consumer—and potential abuse of consumers’ rights. In practice, non-standard contracts are commonly used for banking services in Russia.

**Each of the professional associations should prepare standard contracts for common retail services and recommend their use by the members of the association.** Note that the standard contracts should include basic conditions in the financial institutions' treatment of retail customers and may the use of standard contracts may achieve many of the objectives of the proposed codes of business conduct. The associations should develop and adopt standard contracts—or at least standard clauses for contracts—for basic financial services. Although many types of financial institutions are exempted from the Law on Self-Regulating Organizations, the Law does allow SROs to take disciplinary measures (such as imposing fines and expels violating members).\(^{23}\) The professional associations could play a useful role in setting standards for financial institutions that are members of the association.

**Regulation of retail insurance contracts should be improved.** Russia has a relatively well developed legal environment to deal with business-to-business contractual obligations and to ensure that a competitive market exists. However, insurance sector business-to-consumer contract law and regulation is largely missing from the consumer protection law and civil code. There are some limited specific provisions in the Civil Code, the 1992 Law about the Organization of Insurance Business and several Decisions of the Government. However the provisions do not cover: (1) allowing for some underinsurance before applying average, (2) limitations on the right

\(^{23}\) Federal Law No. 315-FZ of December 1, 2007 on Self-Regulating Organisations
of an insurer to avoid a claim based on irrelevant technicalities, (3) the requirement to make proposals and contracts easy to read and understand, (4) adequate notice of cancellation or non-renewal of a contract, (5) limitations on use of warranty clauses and (6) inclusion of cooling-off periods for certain retail contracts. Modern rules on business-to-consumer insurance contracts and the responsibilities of insurance intermediaries need to be introduced to the Russian law. This could be effectively achieved through special laws to supplement the Civil Code or alternatively through amendments to the Insurance Law. Some possible examples to follow include countries with separate insurance contracts law (UK, Australia) and countries with general contracts law (Germany, Czech Republic, Austria and Latvia). In Russia, insurance contracts should be part of the general contracts legislation.

**Regulation on non-state pension funds should also be strengthened.** The financial structure of non-state pension funds should be made more robust, possibly by establishing risk-based capital requirements that would modify investment policies. Non-state pension funds should also have a higher priority of payment as creditors in the event that a bank in which they hold deposits fail. They are currently ranked at fifth place.

**Enhanced protection of personal data is also needed.** The Law on Personal Data provides protection to ensure that the personal data of individuals is kept confidential and not widely distributed. Despite the enactment of this legislation, there still is illegal trade with data from government databases of personal information on the internet. Such information includes not only passport details but also tax records and car registrations. One issue is that the supervisory agency for personal data protection has not yet assumed responsibility for protection of personal data. Responsibility for enforcing the data protection law currently lies with the Federal Service for Supervision of Mass Media, Communications and Protection of Cultural Heritage. Full implementation of the law is not required until 2010.

**Credit bureaus should create a professional association that could make recommendations for its members.** Currently there exists no association of credit bureaus that establish a code of conduct or an ethical code or could provide recommendations on business practices for credit bureaus. Article 9(3) of the Law on Credit Histories allows the formation of associations for the protection of interests of credit bureaus. Initial discussions were held but no association has yet been created.

**Consumer Disclosure**

**Consumer disclosure lies at the heart of any effective program of consumer protection in financial services.** Before making any purchases, consumers should receive easy-to-understand information about financial services. Once a service has been bought, consumers should receive clear information about any changes to terms and conditions—and be able to withdraw without penalty to the consumer where the changes are not satisfactory.

**A Key Facts Statement for all retail financial services would be useful.** Consideration should be given to measures that allow consumers to easily identify and understand the terms and conditions of the financial services being purchased. International practice is to require that financial institutions give each consumer a one-page Key Facts Statement that summarizes—in easy-to-read print and plain language—the key terms and conditions for the financial service. The Key Facts Statement should also indicate what mechanisms for recourse are available to the borrower or investor. All providers of financial services, particularly for complex financial
services, should be encouraged by the professional associations to give consumers a Key Facts Statement or other standardized report at the point of sale of the contract. In the case of insurance contracts, for example, an easily readable and comprehensible Key Facts Statement should appear at the front of all proposal and policy documents. The professional associations for each part of the financial sector should develop a standardized format and recommend its use for the financial institutions that are members of the association. The Key Facts Statement would not replace the contract for legal purposes but each financial institution should ensure that the Statement had no incorrect information.

The financial supervisory agencies should ensure that useful comparative information is made available for consumers. The CBR should publish information (or require that financial institutions publish data) to allow easy comparisons of fees, charges and commissions charged for the same service. For example, for life insurance the FSIS could review the insurance rates by all the major insurance companies for similar types of life insurance using a standard reference, such as 30-year non-smoking male head of household. Publication of the different costs by each institution would allow consumers to do accurate cost comparisons. The result would be seen in informed consumers and an increasingly competitive financial sector.

The Russian Civil Code permits contracts of adhesion, which put consumers at a disadvantage vis-a-vis financial institutions. Under Article 1 of the Civil Code, individuals and legal entities are free to establish their rights and obligations on the basis of a contract, establishing the terms and conditions, as long as the terms and conditions do not conflict with the law. Moreover under the Code, the general terms and conditions of consumer lending are to be determined by the lender. The Civil Code (Article 428) also allows for contracts of adhesion, where any party (including banks) can determine the conditions of any contract by means of its own separate “records or other standard forms” and have this additional contract as accepted by the consumer as part of the whole contract being offered. While contracts of adhesion are useful for business-to-business (B2B) financial contracts, in business-to-consumer (B2C) contracts, they put consumers at a disadvantage vis-a-vis the financial institution. However individual consumers lack the legal expertise and technical capacity to negotiate with financial institutions. Furthermore if the consumer opposes specific sections of a financial institution's contract, the choices are to either sign the contract without modification or decide not to purchase the financial service. Consumers have no possibility of negotiating the terms of their contracts with financial institutions.

One solution would be for the professional associations to develop standardized contracts—or at least standard provisions of contracts. Standardized contracts could be developed by the professional associations, which would recommend the contracts for use by the financial institutions that are members of the associations. The standardized contract should include all the key terms and conditions of the financial product or service. In particular, lending contracts should include a clear methodology for changes in interest rates and other key terms, using independent objective benchmarks such as the LIBOR rate. For sophisticated investors, financial institutions may wish to develop specific contracts for their large financial services. However for individuals, standardized contracts would be an effective measure for consumer protection.

It would be useful to conduct surveys of consumers to see how they understand the current consumer disclosure. Credit institutions are obliged to disclose to customers not only the nominal rate of interest for a loan but also the effective interest rate, starting from July 2007. The definition of “effective interest rate” is however difficult for the typical consumer to understand and there are concerns that this term was not properly applied. Some banks declare a specific interest rate and hide additional charges, either in particularly small print or else by cross-
referencing to another document that is not annexed to the loan agreement. The amendments to the Law on Banks and Banking Activities (enacted in April 2008) requiring that banks disclose the “full cost of credit” in rubles attempted to address this issue. However recent experience in the United States has shown that consumers often do not clearly understand or know how to use interest rate disclosure. One approach would be to conduct a survey of financial consumers to see how they understand the terminology used in consumer credits.

Another problem is that consumers are not directly advised of changes to the terms of their borrowings. There should be a statutory requirement for banks to notify customers in writing of any change in: (1) the interest rate to be paid or charged on any account, as soon as possible and (2) a non-interest charge on any account, a reasonable period in advance of the effective date of change. Consumers should be able to withdraw without penalty to the consumer where the changes are not satisfactory (as is proposed in the draft consumer credit legislation.)

For consumer credit, a Key Facts Statement would be helpful for borrowers. The Statement should follow a simple clear format with all the essential terms and conditions. The Key Facts Statement should include: (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—particularly prepayment and overdue penalty fees—and 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 calculation is made; and (8) if any additional insurance (such as personal mortgage insurance) is required to maintain the credit. If the credit is used to finance a consumer product, such as a television or washing machine, the consumer should be advised of the cash price of the product without financing charges. The Key Facts Statement should also disclose any prepayment penalty, which in some countries can be as high as the original cost of the loan. While the existing regulations specify in some detail the information to be provided to retail borrowers, there is no clear standard format used by credit institutions. Such a standard format would provide comparability so that consumers could easily compare offers by different lenders. The Key Facts Statement should be developed by the banking associations, which should recommend its use to the financial institutions that are members of the associations.

Key Facts Statements should be developed for all basic retail financial services. This would include retail insurance policies, private pension funds and collective investment funds. The Key Facts Statement should lay out the key terms and conditions, including fees and charges, for all types of retail financial services.

Quick loans should also have improved disclosure. A large proportion of the household loans are “quick loans” whereby loans are made through banks located in shopping centers. Such quick loans are ready for disbursement within one hour but little documentation is provided to the borrower.

Consumer disclosure for non-credit payment services could also be improved. The experience since 2005 has shown that the large payment services maintain a high level of consumer protection. Companies such as Qiwi provide a copy of the contract available at the terminal (as well as on the company’s website) and disclose the relevant fees before transactions are completed. However not all companies are required to do so. The draft legislation on the national payments system would require that all payment service operators provide information to retail consumers before they purchase services. Such information would be accessible to the

24 According to the CPS, the Civil Code prohibits charging fees on consumer credits but in practice, some banks do levy fees and charges on consumer loans.
consumer at any time and would be presented in simple and easy-to-understand language. In addition, the newly formed National Association of Electronic Commerce Participants (NAUET) should prepare a standardized format for the presentation of key information for consumers.

**Detailed regulations on advertising by investment brokers, asset managers and insurers would be helpful.** The Law on Advertising provides legal responsibilities for financial institutions and intermediaries when they are advertising or soliciting for sales. In particular, Article 28 stipulates that advertising of banking services should not conceal other conditions involved in the provision of such services. However the provisions of this law are general in nature and could be improved to give more specific guidance, especially to investment brokers and collective investment undertakings. Also for insurance services, it is not clear if the Law on Advertising covers benefit illustrations. Benefit calculations allow consumers to estimate their future payments from insurance contracts. However benefit illustrations under life contracts, if permitted, should be capped according to realistic future earnings prospects (e.g. using a proportion of the benchmark bond rate). In addition, the legal provisions on insurance should be amended in order to cover the obligations of insurers regarding sales and promotional materials and the way in which such materials should be presented. Insurers should be responsible for undertakings provided in official sales materials.

**Supervision of advertising in the securities market should also be supervised by FFMS.** FAS is responsible for enforcing this law by monitoring advertising practices and ensuring that financial institutions do not engage in deceptive or misleading advertising. However for asset management companies, the Law on Investment Funds/Trusts creates additional legal responsibilities regarding advertising and marketing. Responsibility for the implementation and enforcement of advertising and marketing rules for the securities market should be supervised not just by the FAS but also by the FFMS.

**Specific rules on disclosure and account handling for insurance customers should be issued.** The Insurance Law should specify that traditional life insurance savings contract policyholders will receive statements of value at least annually (possibly after the first two years). Non-life insurance policy wordings should be set by the professional association (and recommended for all association members) and any variation should be formally disclosed through an attached derogation statement. Policies for retail customers should not permit denial of a claim or arbitrary cancellation of an insurance contract for reasons other than material non-disclosure and other rules already in the Civil Code. A claim should not be deniable after it has occurred if the cause of the claim was unrelated to a non-disclosed risk factor, although a premium adjustment may be justified. Regulations should also require the use of separate bank accounts for policyholder funds while they are being held by intermediaries, and the establishment of appropriate audit trails. In addition, if brokers accept commission from insurers, they should disclose both the practice and the amount or structure of the commission to the policyholder. Insurance agents should have some liability for the policies they sell. The insurance company is ultimately responsible for the actions of its agents but should be able to seek restitution from the agent for the consequences of any misrepresentation and malfeasance by the agent.

**There should be specific disclosure requirements for non-state pension funds.** The Law on Non-State Pensions includes broad disclosure rules that a fund must adopt. However for both mandatory and voluntary pension programs, consumers have difficulty comparing offers by privately-managed non-state pension funds (NPFs) and asset management companies (AMCs). A wide range of different practices have emerged in this area, many of which remain opaque to plan members, being a major source of complaints. There should also be specific disclosure rules to cover point-of-sale practices for retail sales of voluntary pensions. Disclosure rules on annuities
provided by non-state pension funds are also needed. The nature of annuities should be disclosed to members at the time they enter the fund. Ideally annuities would be provided by specialized insurers or by the solidarity fund of the Pension Fund of the Russian Federation, and the range of options should be small and transparent.

**Consumer disclosure on the payout of annuities is needed as soon as possible.** Under the voluntary pension plan, participants are to receive annuity payments from either the life insurance plan or the NPF defined-benefit plan, established by the employer. Although the payments are scheduled to start in 2013, no clear disclosure is available to allow participants to plan their financial futures. A still more fundamental issue is that male mortality rates in Russia have been changing in recent years (and in some cases, becoming more volatile). As a result, insurance companies and NPFs have difficulty in determining future annuity payment streams. As the supervisory agency, the FFMS should undertake the studies necessary to establish mortality tables for the industry. The FFMS should also put in place clear rules on disclosure of estimated benefits for plan participants.

**A professional association for credit bureaus, if created, should develop an information brochure for consumers.** Some credit bureaus and credit institutions publish information for consumers regarding their rights regarding the credit reporting system. In addition, the CBR maintains a section on the Central Catalogue of Credit Histories, which also contains instructions on how consumers can obtain access to their credit information. This is very useful but more could be done. At the point of purchase of a financial service, consumers should receive an easy-to-read key information brochure. This brochure would explain the basics of a credit report, credit score and the credit reporting system, and indicate sources of information, where the consumer can access his or her credit report, and how to resolve complaints.

**Consumers should have access to all databases in the private sector that store information on them.** This is necessary to allow consumers to check and review their personal information upon proper identification: no secret databases should be used in the process of credit evaluation. In addition, since credit scoring is fully operational, consumers should have the right to see the latest calculated score, the range of scores possible, the average score of the population and the four main factors that impact on the score. This would allow consumers to learn how they could improve their score. In addition, self-inquiries, credit inquiries at lenders, and initiated disputes should not be scored so as to avoid negatively affecting the credit score.

**Improvements could be made in the practices related to sharing of personal information with third parties.** The Law on Credit Histories requires that banks provide a general "consent clause" to the consumer. Some banks explain to consumers that they may contact the Central Catalogue of Credit Histories to locate their credit reports. However lenders are not obliged to provide detailed information to consumers. The proposed association of credit bureaus could play a valuable role, developing standardized model clauses on information sharing to be used by association members and improving the clarity of consumer disclosure where information is shared with third parties. In the securities market, regulations should specifically require market participants to inform investors of the sharing of their personal information and allow investors to opt out of information sharing.

**An information campaign would help consumers learn about their legal rights on protection of personal data.** In Russia, consumers are not generally aware of their rights to maintain privacy of personal information. Although the Law on Personal Data will not be effective until 2010, the data protection authority should consider preparation of an extensive nation-wide information campaign, designed to inform consumers about their rights to keep private their personal data.
Business Practices

Unfair sales practices should be specifically prohibited. In addition to placing restrictions on plastic card distribution, other high-pressure sales tactics should be discouraged. The “Do Not Call” system of online registration in the US provides an effective method of reducing marketing calls made to the residences of consumers. Those who provide financial services should also be obliged to ask enough questions to help the consumer decide if a particular financial service meets his or her financial needs and goals. In addition, over time consideration should be given to consumer protection issues related to commerce conducted by mobile telephones, including issues on small size of screen for disclosure and concerns over targeting of minors in the sale of services.25

Close watch should also be made of collection practices to ensure that they are not abusive. The Civil Code provides protection for consumers that they cannot be evicted from their homes without substitute housing being made available. However abuse of “administrative resources” such as courts and police cannot be ruled out and should be monitored by consumer protection advocates such as NGOs. There should also be a legal framework for the operation of debt collection agencies that requires, among other things: (1) the licensing and oversight of all properly registered collection agencies by an appropriate regulatory authority, (2) the provision of services on the basis of generally accepted fair and reasonable principles of conduct and (3) the provision of statistics by each licensed agency to the regulatory authority on a regular basis for public dissemination. The principles of conduct for debt collectors should include restrictions on the times of day that the debt collectors can contact consumers and prohibitions against other abusive debt collection practices.

Also needed is a law on personal bankruptcy. A draft federal law has been prepared by the Ministry for Economic Development of the Russian Federation on amending the legislation related to rehabilitation procedures for personal bankruptcies. However until a regime for personal insolvencies is operational, a delinquent debtor may still be vulnerable to undue pressure from debt collectors. Thus, it is essential that legislation on personal bankruptcy be enacted. This law would also encourage negotiated settlements between banks and their customers and allow for the re-scheduling of individual debt as part of those settlements.

Cooling-off periods should be set for all consumer financial contracts except securities and investment funds. Cooling-off periods provide an effective method of protecting consumers from high-pressure sales tactics, such as doorstep selling of consumer loans. The cooling-off period provides consumers the opportunity to study their loan agreements and make a final decision. During this period, the service provider is not permitted to change the terms of the agreement, without the approval of the customer. Following the approach of the EU Consumer Credit Directive approved in April 2008, the Russian draft consumer credit law establishes a 14-day cooling-off period, during which the consumer can change his or her mind and cancel the contract without conditions.26 The 14-day cooling-off provision is an important form of protection for consumer loans, but it should also apply to all contracts for financial services, except securities and investment funds. (For traded securities and funds, rapid changes in market prices

26 An alternative draft prepared by the Ministry of Finance allows for a penalty not greater than 0.5 percent of the amount of credit. It would be better if no penalty applied, except in specified cases, for example, housing or mortgage loans.

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make unworkable any form of cooling-off period.) In particular, a cooling-off period should apply to contracts with a long-term component, such as housing and mortgage loans. Cooling-off periods are also important for any service that has a large savings component. Approval of the consumer credit legislation will be helpful in regulating the consumer credit sector and ensuring a transparent consumer credit market. A cooling-off period provision should also be introduced for long-term life insurance savings contracts and for voluntary individual pensions.

**Financial institutions should be prohibited from granting unsolicited credit to consumers.** Credit card lending is particularly vulnerable to abuse. In several markets worldwide, pre-cleared credit cards are distributed to consumers who did not request the cards. Activation of the card requires only a telephone call from the card-holder. Especially among unsophisticated consumers, card-holders may not realize that when they use their card, they incur a personal debt that must be repaid—and with accumulating interest. Distribution by mail of pre-cleared credit cards may also make consumers vulnerable to identity theft, where the letters delivering credit cards are opened by unauthorized parties. Several EU countries have taken measures to discourage distribution of unsolicited credit cards. In Romania, consumers must place a telephone call to request a credit card. In Ireland, distribution of unsolicited plastic cards is prohibited. Furthermore the financial institutions issuing credit cards should be responsible whenever fraud has occurred using plastic cards (either credit or debit cards).

**Tied selling of financial services should also be discouraged.** As seen in many rapidly expanding financial markets, as consumer credit becomes an increasingly competitive sector, financial institutions look to be creative to appear competitive while maintaining high profit margins. One method is to require that contracts for certain financial services, such as insurance, be obtained in order for the borrower to receive a loan. Other tied services might include account handling and maintenance or safekeeping for collateral, where the lending institution requires that the borrower obtain such services—and that the services must be purchased from an institution affiliated with the lender. Such arrangements open the opportunity for lenders to conceal the true cost of the loan since the lending profits may be concealed in higher-than-market prices for the related services. Currently, the Consumer Protection Law bars tied sales and involuntary cross-selling (Article 16). However, regulations should clarify that, if a specific financial service must be purchased in order to obtain another service, the consumer has the right to choose the supplier of the related financial service. Bundling falls under Article 16 of the Consumer Protection Law and Article 13 of the Law on Competition restricts the ability of financial institutions from making such agreements. However this is not sufficient.

**Bundling of financial services should be explicitly discouraged.** Whenever a borrower is obliged by a bank to purchase any financial service, including an insurance policy, as a pre-condition for receiving a loan from the bank, the borrower should be free to choose the provider of the service. From a competition point of view, service bundling (also known as tying) in retail banking may weaken competition. Firstly, tying raises costs and therefore is likely to reduce customer mobility. Secondly, by binding customers into buying several services from the same bank, tying is likely to discourage the entry of new players and growth of smaller players. Thirdly, by introducing additional and perhaps unnecessary services into the transaction, tying reduces price transparency and comparability among providers.

**A frequent case of bundling in Russia is the requirement for borrowers to sign an insurance policy before receiving a bank credit.** Such insurance might cover whole life policies or disability policies. This practice is used by many banks that: (1) set their own requirements as to insurance company qualifications and insurance coverage needed for consumer credits, (2) provide borrowers with lists of approved insurance companies that meets the banks’ “stringent”
requirements, (3) ensure that the only insurance companies on the bank’s list are affiliated with the bank, and (4) do not inform the borrowers of these facts. In the case of auto loans, some banks have offered zero-interest loans but only if the borrower accepts an inflated insurance premium from a company affiliated to the bank. The contract agreement generally includes a provision that states that all insurance claims will be denied in the event that the consumer is found in any way responsible for an accident.

Legislation should regulate the practice of bundling financial services. Bundling should only be permissible by law if: (1) the consumer receives prior notice of the bundling in writing along with clear statements regarding the cost and nature of bundling, as well as what specifically is and is not covered; and (2) then the consumer agrees in writing to waive his or her right to proceed with the unbundled services.

Professional associations should develop codes of business practice for their respective parts of the financial sector. The two banking associations (Association of Russian Banks and Association of Regional Banks of Russia) are in the process of preparing codes of business practice, which would be combined if the two associations were to merge. (The Association of Russian Banks already has a code of ethics applicable for their member banks.) The professional associations for insurance, asset management, pensions and other parts of the financial sector should also draft codes of business practice for their respective areas. Once the codes have been approved by each of the associations, they should ask their members to endorse the code and make it part of their internal regulations, and publicize them to the general public through appropriate means. At the time of on-site supervision, the supervisory agencies could review if the institution was following its own internal regulation regarding the code of business practice. Where the institutions were failing to do so, the supervisory agency could make recommendations on ways in which the institution could improve. While such recommendations would not be binding for the financial institution, credit organizations looking for ways to improve their business practices would likely welcome such recommendations and implement them voluntarily. The codes should also provide for mechanisms for consumers to complain about non-compliance with the codes to the professional association, which should also establish sanctions for misconduct or violations of the code.

Codes of business practice should focus on minimum procedures needed to ensure fair and transparent relations with retail customers. Codes of practice address many internal issues for financial institutions but they should also highlight their rules on customer relations. This would address issues such as the number of days which the institution could take to respond to a routine customer complaint, the process for following up on complaints submitted to the institution, and the length of time for maintaining customer records. The codes should also ensure that representatives of financial institutions asked enough questions to ensure that the service being sold was suitable for the purchaser. Codes of practice are also important in light of the unclear definitions of “unfair practices” that are part of current legislation. While codes of practice are not mandatory—and thus cannot be fully enforced—they set an ethical tone for each financial institution and help to improve common business practices in the financial sector.

Suitability requirements are particularly important for the securities sector. One of the most important vehicles for consumer protection in the securities market is the requirement that a broker or collective investment undertaking advise a client as to the suitability of an investment for the client. This can only be done if the broker knows the financial situation and investment goals of the client. The self-regulatory organization National Association of Stock Market Participants is working on a suitability rule for its members. However, since membership is
voluntary, this rule will not apply to all market participants. The FFMS should make membership in self-regulatory organizations mandatory or else incorporate suitability rules in its regulations.

**Special training should be established for those in financial institution who deal with retail customers.** As a starting point, regulations (or legislation) should introduce the concept of those who work with the public and sell financial services to consumers. Then the financial supervisory agencies and professional associations should collaborate to set competency requirements for staff of financial institutions who work with retail customers. Currently in Russia, there is no specific competency requirement for staff in the banking, insurance and pensions sectors. In the securities sector, the law and regulations contain provisions on the qualifications that specific securities market professionals need to meet. However there is no requirement of competency exams for staff of financial institutions. Competency standards should be improved. The Consumer Protection Service, the financial supervisory agencies and the professional industry associations should work together in order to establish and administer specific minimum competency requirements at least for any staff member of a financial institution that: (1) deals directly with consumers, (2) prepares any Key Fact Statement or any advertisement for the institution, (3) markets the financial institution’s services. In the insurance sector, the law should require that all insurance intermediaries have to pass qualification tests relevant to the complexity of the service being sold or offered. In the case of agents and for less complex financial services (such as motor insurance), the educational processes and subsequent tests could be given by the individual insurers. For more complex services (such as life insurance with a savings component), the educational requirements and tests could be the responsibility of the industry association or the FSIS.

**Dispute Resolution Mechanisms**

**Financial consumers need a mechanism that works for them in resolving disputes with financial institutions.** Consumers sit on the weak side of a power imbalance between themselves and the financial institution. The banker or insurer or asset manager all know their technical fields and have access to the resources of the financial institution. By contrast, the financial consumer may lack direct experience in using specific financial services and so may feel intimidated by the officer of the financial institution. Consumers need a body that is clearly impartial and independent from the financial institution, the industry and the appointing authority, and is willing to defend the interests of the consumer in a dispute with a financial institution—and consumers need a mechanism that is fast, efficient and cost-effective in addressing their problems.

**Consumers in Russia complain to six different types of institutions.** Financial consumers submit complaints to any (or all) of several institutions: (1) the financial institution such as a bank, (2) the professional association, (3) the financial supervisory service, (4) the consumer protection service, (5) the office of the Presidential administration or (6) the prosecutor-general. The issue is complex. Under Government Orders (June 30, 2004 No. 322 and May 16, 2005 № 303) the authority of the CPS does not include consideration of consumer complaints regarding financial services. Similarly under Government Order January 17, 1992 № 2202-1, the office of the Public Prosecutor does not have authority to review complaints of financial consumers. However the 2006 Law on Procedures to Deal with Consumer Complaints\(^\text{27}\) regulates the

\(^{27}\) Federal Law № 59-FZ On the Procedures to Deal with Consumer Complaints in the Russian Federation of May 2, 2006
treatment by federal, regional and local government authorities of consumer complaints and requires that government agencies establish procedures to handle complaints from customers. Typically, consumers send their written complaints to the financial institution with a copy to the consumer protection service, the financial supervisory agency and the prosecutorial authorities.

None of the institutions is responsible for finding a solution to financial consumer disputes. The financial institution will review the complaint and see if the contract has been violated. The financial supervisory service will be interested in identifying trends in customer complaints that may hurt the institution’s public reputation but the service cannot intervene in a specific case. The Consumer Protection Service, the Presidential administration and the prosecutor’s office will initially refer all complaints to the financial supervisory service, which will again look for worrisome trends but not solve the problem. Only the Consumer Protection Service will take the position of the consumer and act as its advocate in a court of law. Between January and September 2008, 19 regional offices of the CPS have gone to court representing financial consumers in a total of 109 cases, of which 86 were resolved in favor of consumers. However in light of the number of complaints that are in fact inquiries or questions about facts, another approach may be helpful.

The existing system in Russia leads primarily to resolution through the courts. Small claims courts (known as “ justices of the peace”) help resolve customer complaints but they are at risk of being overwhelmed by financial consumer cases. The federal system of small claims courts consists of over 2,500 state courts presided over by justices of the peace. These courts will review and decide over all formal claims submitted by consumers throughout Russia that are below 200 times the monthly minimum wage (RUB 2,300 effective from September 2007) which is less than $14,000. The Federal Courts of General Jurisdiction have exclusive jurisdiction over all such claims at or in excess of that sum. If the consumer cites the Law on the Protection of Consumers’ Rights when preparing the initial claim, all court costs are waived for the consumer. Decisions are generally made relatively quickly in a period of four to six months. Furthermore the court system in Russia is becoming increasingly transparent, with recent legislation providing the legislative framework for disclosure of court activity to the public and the media.  

Detailed statistics on financial consumer complaints are hard to obtain. The CPS does not publish detailed statistics on the number of complaints received of any type of financial service. However the FFMS and FSIS publish analytical reports on the number of types of complaints. In 2007, the FSIS received over 17,000 complaints about insurance policies. Over 80 percent of complaints related to the amount of payment under the claim, and each of the complaints needs to be individually reviewed. The FFMS received 11,000 inquiries and complaints in 2007 (compared to 8,500 in 2006) of which about half were received in the central office of FFMS and half in the territorial offices and subordinated organizations of FFMS. The CBR estimates that they receive over 200 complaints per month about retail banking services.

29 During the first nine months of 2008, 63 regional offices of the CPS conducted 452 inspections to credit institutions, which led to 103 administrative decisions.
30 The primary complaints were: (1) disagreements on compensations or dividends on shares, including related issues on the exchange, purchase and sale of securities, disclosure of information on securities and on the financial situation of companies, etc.; and (2) violation of the Law on the Securities Market by financial market participants, for example suspension of operations in the register of shareholders of the companies BiznesAktiv, Siberian capital - R and Rushiminvest - R and signature forgery and unauthorized write-off of shares from the applicant's personal account in the register of holders of securities of the Unified Energy System of Russia. According to the FFMS, the disputes on dividends is mainly due to
As financial services aimed at consumers continue to expand, the number of complaints is expected to increase dramatically. Furthermore as noted by the financial literacy survey conducted in June 2008 only three percent of dissatisfied customers pressed their claims with the financial supervisory agencies. Based on the experience of other countries (such as the United Kingdom and Ireland) where consumers have confidence that their claims would be resolved quickly and fairly, the number of complaints would be expected to increase by at least ten-fold.

International experience shows that most complaints reflect more inquiries than disputes. For example, a study conducted in 2006 in Romania regarding complaints over financial services found that many of them were in fact inquiries. However both disputes and inquiries provide valuable early warning signals to both the institution’s executive management and the supervisory service regarding possible future problems.

As a starting point, all financial institutions should be obliged to establish a specific procedure to deal with consumer complaints. Financial institutions should be required to: (1) have a written procedure for handling consumer complaints and include a summary of this procedure in the bank's general terms and conditions that are part of any agreement with customers; (2) provide the customer with the detailed information of the department or person appointed by the bank to deal with the complaint; (3) provide the complainant with a regular written update on the progress of the investigation of the complaint; (4) inform the customer in writing of the outcome of the investigation within a maximum number of days; (5) explain in simple terms the nature of any offer of settlement made to the customer; (6) offer to treat any verbal complaint as a written complaint; (7) maintain up-to-date records of all complaints received, including information of the nature of the complaint, copies of the bank’s responses and other relevant documents, information of the action taken to resolve the complaint and whether resolution was achieved and on what basis; (8) make these records available for review by the competent authorities.

In addition at a minimum, a central location should be established to collect, record, redirect and publish statistics on complaints related to financial services. The central service should receive all financial service complaints and pass them on to the financial institution or supervisory service. However the central service should also follow up on complaints to ensure that each complaint is addressed. In addition, the central service should publish aggregate statistics on the number of complaints received each month (or for the year) and what happened to the complaints—whether they resulted in a payment by the financial institution or were referred to the courts, and of those complaints that went into litigation, the number resolved in favor of the consumer and the number in favor of the financial institution.

It may be helpful to go a step further and authorize the central complaints service to make decisions on small cases. In well-developed financial markets, most disputes regarding financial services are over relatively small amounts of money of under $5,000. Analysis of complaints would determine if the same were true in Russia. Such small amounts are troublesome for the financial institution but important for maintaining public confidence in the financial sector. The experience of the several European countries, notably the United Kingdom, Ireland and Germany, is that an ombudsman can efficiently deal with the small cases. This reduces the burden on the financial institution, the supervisory agency and avoids an unnecessary lawsuit.

insufficient knowledge of the legislation of the securities market (including the Law on Stock Companies) under which the general meeting of shareholders is authorized to approve the level of dividends to be paid.
Two options are available—an ombudsman established under the professional associations or an independent ombudsman established by legislation. One of the banking associations is considering the option of an ombudsman established under the professional association. However one of the issues for association-based ombudsmen is that they lack public credibility, particularly where the legal system is not fully developed and refined. Most consumers might think that the ombudsman represented the interests of the financial institutions (such as banks) that covered the costs of the ombudsman. The alternative approach of an independent statutory ombudsman might have the advantage of maintaining public confidence. One of the key issues is the stable funding source for the ombudsman’s work. However regardless of the type of ombudsman, it is likely that the final cost will be paid by financial consumers. It may therefore be useful to conduct a cost-benefit study of the different options for an ombudsman as part of the discussion about whether or not to establish an ombudsman.

A two-stage strategy may be the best approach. As a first step, a professional ombudsman should be established for an entire segment of the financial system. For example, clients of banks of the two associations—Association of Regional Banks of Russia and Association of Russian Banks—plus clients of the few banks that are members of neither association would have an ombudsman established whereby consumers could present complaints and inquiries. The easiest and most efficient model might be that of the Ombudsman Scheme of the Private Commercial Banks of Germany, which provides services for customers of the German private commercial banks only, excluding savings banks, cooperative banks and public sector banks. The Ombudsman Scheme consists of five ombudsmen who had previously served in the Courts or in the Ministry of Justice. Their decisions are binding on the banks for amounts up to €5,000 although the consumer retains the right to appeal to the courts. The service is paid by the banks but is free to retail consumers. The ombudsman maintains his reputation as being impartial (and not protecting the interests solely of the banks) by requiring that the consumers union approve the selection of the ombudsman for each case. An ombudsman under a professional association can be established quickly and easily and would not require government funding, while providing a useful third-party review of cases by retail consumers.

However the most effective long-term solution would be to create a statutory financial ombudsman—or perhaps a Commission on Protecting Financial Consumer Rights. While the experience of Germany demonstrates the valuable role of an ombudsman under the professional association, the history in the United Kingdom, Ireland, Canada and Sweden suggest the need for a full-time office of financial ombudsman established by law and standing independently of financial institutions. Rather than looking at each complaint on a case-by-case basis, a statutory financial ombudsman can look at complaints that reflect systemic issues. However three key issues will need to worked out: (1) how complaints will be submitted to the ombudsman or Commission, (2) what dispute resolution mechanisms will be put in place and (3) how the ombudsman or Commission will be funded.

Consideration should also be given to the alternative of strengthening the system of mediation and arbitration. A mediation law has been drafted (and in May 2009 submitted to the Duma) to facilitate the use of mediation as an alternative to litigation, particularly for business-to-business relations regarding economic activities carried out by Russian and foreign organizations and citizens, and also for disputes arising out of labor, family and other relations (Article 2). The Chamber of Commerce and Industry of the Russian Federation has plans to establish an arbitration court which would deal with cases involving a wide range of activities, including retail consumers. The Chamber already has set up the Court of Arbitration for Resolution of Economic Disputes (in 1992) and the Panel of Mediators in Conciliation Proceedings (in 2006), which deal with commercial disputes. In addition, the Association of Russian Banks is planning to expand
the work of its Arbitration Court in Moscow to cover not only disputes between member banks, but also disputes from customers of member banks. So far, the Association has been dealing with banking services (of which, according to the Association, 90 percent are solved to the benefit of consumers). In the securities market, the National Association of Stock Market Participants and the National Securities Market Association have set up arbitration courts, whereas the Russian Trading System Stock Exchange and the Moscow Interbank Currency Exchange have included arbitration clauses in their contracts with customers, which refer disputes to their own arbitration courts. These arbitration courts require expensive procedures, arbitrators and counsel and are not necessarily useful to customers with small claims. One weakness of arbitration courts is that they do not force the financial institution into a final discussion in order to resolve a customer complaint. However arbitration courts play a useful role in mediating consumer disputes and reduce the number of disputes that are referred to the general courts.

In addition, it may be helpful to further strengthen the system of consumer advocacy organizations. KonfOP provides an excellent service for consumers of financial services, taking issues to court but they can only handle a limited number of cases. A system of consumer non-governmental organizations is needed throughout the 83 regions to serve low-income as well as heavily-indebted households. Consideration should be given to the role of non-profit financial advisors, which can help indebted people sort out their debts and provide them with necessary counseling. These organizations should also be encouraged to keep records of the cases they receive, conduct trend analysis of this data and propose changes in legislation where appropriate. The CPS maintains frequent consultation with consumer advocacy organizations and plans increased coordination in the future. However on a regular basis, relevant consumer advocacy organizations should be included in the preparatory work on legislation affecting consumers of financial services. Consideration should be given to the inclusion of these organizations in the drafting of disclosure rules, to make sure that the information provided to consumers is easy to understand. In addition, an umbrella organization could be created to bring together all the consumer advocacy organizations involved in financial services and give them a clear voice in the public discussion of measures to strengthen consumer protection in financial services. As seen in the countries of the European Union, government funding for consumer advocacy organizations may be needed to ensure that they are financially viable.

Dispute resolution mechanisms for non-credit payment services could also be strengthened. The most common error occurs when a consumer inputs the wrong amount of money into the keyboard of the terminal. Companies such as Qiwi maintain a 24/7 toll-free call center which can correct errors of one or two digits. For more complex errors, consumers must visit a company office to sort out the error. However all companies should be obliged to maintain such effective systems for correcting mistakes. In addition, the National Association of Electronic Commerce Participants (NAUET) should consider establishing an ombudsman’s office to whom consumers can complain (or just make inquiries) when a transaction goes awry and the company fails to resolve the issue.

Financial Education

In the long-run, one of the most effective forms of consumer protection is ensuring high levels of financial literacy. A financially literate consumer is best able to understand financial disclosures and weigh the risks and rewards of each type of financial service that is available. However strengthening financial literacy requires a long-term investment in consumer education.
Financial education is needed throughout the country, not just in the major urban areas but also in small villages where the range of available financial services may be limited.

The number of financial education initiatives is growing in Russia. Development of the market economy followed by the emergence of new financial services has escalated personal liability in financial decisions of Russian citizens, for the sake of their present and future financial wellbeing. The financial education services are not limited to Moscow and many initiatives are being implemented throughout the country (e.g. Saint Petersburg, Novosibirsk, Samara, Penza, Krasnoyarsk, etc.)

Most of the financial supervisory agencies have programs to improve financial consumer education and awareness. For example, the CBR uses its public website (www.cbr.ru) to provide information to the public, including the list of credit institutions in its register, the list of administrators accredited by the CBR as bankruptcy receivers, and information on credit institutions whose license has been withdrawn by the CBR. The website also provides consumer information on such issues as the legal basis for consumer loans, mechanisms for addressing disputes with financial institutions, procedures for creation of credit histories and the role of a guarantee in consumer borrowings. The CBR also has plans to develop a special page on financial literacy. The FFMS has similar programs available for retail investors and has set up an expert working group to focus on ways of improving financial literacy and investor awareness. All financial supervisory agencies should create a special Consumer Affairs page on their websites, where information for consumers can easily be found.

The public sector has also initiated a number of financial education programs that target primarily school population. There are examples of introducing financial education topics and modules into some economics classes of grades 10-11 within formal curriculum. In most cases, during these classes students are taught basics of financial markets. Very little attention is paid to developing appropriate behavioral patterns in financial markets and educating responsible consumers. Russian legislation requires the implementation of a system of consumer protection education. According to the Consumer Protection Law, “the consumers’ right to education on consumer rights protection shall be ensured by the inclusion of the respective requirements in state educational standards and by programs of general education and vocational training, as well as by the organization of a system to inform consumers of their rights and the necessity of protecting them” (Article 3).

The majority of grass-root financial education initiatives focuses on specific topics and rarely covers the broad range of topics. As recommended by the OECD, financial education is needed in areas such as pensions and insurance. Recent growth of personal incomes and increase in the number of financial services available to population has triggered various private financial education and investment orientation initiatives. These concentrate primarily on explaining consumer rights, conflict resolution mechanisms, and specific investment services. They rarely cover such topics as financial planning, basic savings, private debt management or elementary financial mathematics, which are recommended by OECD as good practices for financial education awareness.

Private institutions provide some financial literacy training but are narrowly targeted. Numerous private sector financial institutions provide useful financial literacy training and provide orientation and counseling for individuals. The programs are quite active in delivering

31 The CPS has also proposed to the Ministry of Education that financial literacy be added back to the competitions among students known as the “Olympiads”.
educational services through mass media. Several magazines and websites focus on the issues of personal finance, including “Nashi dengi” (Our money), “Semeiniy bjudzhet” (Family budget), “D”, “Lichnie dengi” (Private money), “Money&Ya” (Money&Me), “Populiarnie finansi” (Popular finances) and “Credit.ru”. However the programs are generally targeted to economically active adults and the most affluent segments of the population.

Several non-governmental organizations and professional associations have also implemented financial education initiatives. Non-governmental organizations have developed programs such as the Program of Financial Culture and Russian Citizen Financial Security (www.gorodfinansov.ru), supported by the United Russia political party. In addition the International Business Forum (www.azbukafinansov.ru) provides valuable financial training for participants. Other programs are provided by the National Foundation for Financial Literacy, Center for Financial Education, Institute of Independent Financial Advisors, Junior Achievement Program, Center of Investment Education, Research Group CIRCON, “Finstart”, Financial Literacy Center “Potok”, the Associations of Russian Banks and the Association of Regional Banks of Russia. The Association of Credit Brokers is also planning to develop a consumer education and outreach program through credit brokers. However the programs reach only a limited number of consumers and need to be expanded and scaled-up.

Diverse informal extracurricular financial education initiatives have emerged. These include competitions, elective classes, workshops and summer schools. The initiatives are relatively new and there is little networking exchange of good practices or impact evaluation applied. Their coverage is also rather limited to few urban areas due to shortage of financing, and lack of any coordinating and quality ensuring arrangements within education system. While informal education has proved to be efficient solution for developing basic behavioral patterns among youth (for example in the United States and Australia), the effect depends a lot on the quality of the program’s design, including setting educational goals, targeting the right audience, evaluating the results, etc. Unfortunately, most of these success ingredients are poorly utilized in Russia’s informal financial education system.

A national policy for financial literacy and education is needed. Education for consumers of financial services is being discussed as a part of the general financial literacy policy. The Ministry of Finance provides overall guidance in the area of financial literacy and education. The Ministry has developed a draft document on the Promotion of Financial Literacy and Development of Financial Education in the Russian Federation. The draft document should be finalized and approved. Other government bodies (e.g. CPS, CBR, FAS and FFMS) are also developing their own financial education policies and setting up coordination mechanisms. The CPS is also taking an active role in coordinating financial education activities related to consumer protection. In addition, the Ministry of Education is beginning to consider financial education of children but more could be done. The Departments of Education in the 83 regions may be able to play an important role in providing basic financial education in the school system. A national policy on financial literacy and education—and an effective national task force—would help improve coordination of efforts.

There is a strong case for public involvement in financial education for consumers. While there is a reasonable supply of private “commercial-type” investment-related training programs, provision of general financial education programs for consumers is inadequate. This leads to a situation where middle- and low-income population groups are underserved and unprotected vis-

\[32\] During the financial crisis of 2008-09, some publications have had financial difficulties and ceased operation.
à-vis the financial sector. In addition, public sector intervention is needed in order to assess the quality of financial education initiatives and differentiate between commercial and educational purposes. Many financial institutions support and deliver financial education programs promoting their own interests. The quality of such programs is difficult to assess and the participants of such programs bear the risk of receiving biased information and advice.

It may also be helpful to find ways to bring together the initiatives of the private sector, consumer advocacy organizations and professional associations. For example, umbrella-type private sector organization could receive information from all the non-public sector initiatives and make the information available to other participants to all member companies as well as to the public. Such an umbrella organization would help encourage synergies in the individual programs prepared by different non-public sector organizations.

Consideration might also be given to establishing a Federal Center for Financial Literacy and Education. The Center could be helpful in pulling together the numerous programs on financial education and financial literacy from not only the public sector but also private sector agencies. The Center might also identify best practices being used in Russia and be engaged in pilot testing, using for example, randomized control trials to identify which measures are the most effective for different parts of the Russian Federation and to target different groups and communities.

Financial literacy programs should be differentiated between those that provide broad financial education vs. those that give targeted consumer information. Broad-based financial education delivered through the educational system gives students the essential life-skills to understand risk-reward trade-offs and the need for long-term financial planning. However a different (and more focused) approach is needed to provide consumers with the basic financial skills needed to understand the terms, conditions and obligations of the financial services that they buy. For the second approach, consumer information and disclosure—for example, providing a simple and easy-to-understand key facts statement and explaining to consumers how and where to present complaints (as described above)—are key to ensuring functional literacy of Russian consumers.

The targeted information should include reliable, comprehensive and clear information about consumer protection in the area of financial services. Consumers should have access to a source of high quality information which is specially designed to address their needs. While there are few websites which explore financial issues and give advice on related issues (including websites of regulatory authorities), none provides a reliable and easy-to-use resource. There is a need for gateways to a wide range of information resources: consumer protection legislation and regulation, educational materials, training courses, counseling and advice, etc.

Gateways should be tailored to specific consumer needs. These gateways should be designed around the issues consumers face (e.g. need to buy a car, to report a fraud or unfair business, to resolve a conflict with a local bank, to find an appropriate mortgage, etc.) rather than financial services (e.g. shares and bonds, insurance, pension, credit cards, etc.). They should use a plain language that is easy to understand for an inexperienced financial consumer. A gateway/portal should also provide an access to easy-to-use financial math tools (e.g. calculator of effective annual percentage rate, expected size of future pension, estimation of excessive debt, etc.). The portal should also have a page of Frequently Asked Questions (FAQ). A toll-free hotline to receive consumer inquiries may also be helpful. A well-planned informational campaign in the mass media should raise awareness about these resources and contribute to dissemination of consumer protection information.
For the broad program, a comprehensive learning framework would be useful. A broad learning framework would help to develop policies and build consensus and could be used as a basis for designing educational programs and initiatives. For instance, the Adult Financial Capability Framework in Great Britain specifies the requirements to a well-equipped and prepared consumer. According to this framework, a consumer with advanced capabilities should: (1) know about the different sources of advice and the differences between generic and personal advice; (2) be able to assess and compare different sources of financial advice and information; (3) understand there are different rights and responsibilities in relation to different financial services; and (4) understand how to identify if it is appropriate to comment or complain and be able to access the procedures. A similar learning framework is needed for Russia. The experiences of countries more advanced in developing financial literacy initiatives and providing educational services to consumers should be studied carefully. The best approaches should be adjusted to the Russian context, considering legislation and regulations, level of financial deepening, general culture of consumption and tradition of dealing with personal finance, etc.

Long-term financial education programs should be based on life-cycle planning. Evidence from current Russian and international experience shows that rigid academic educational programs aimed at providing audience with fundamental knowledge about financial services and institutions are less efficient in affecting actual behavior of the consumers on a money marketplace than programs designed around human life cycle. People are more responsive to education which directly addresses the issues they face on the exact moment, e.g. mortgages for young families, educational loans for young people planning educational and professional paths, etc. A concept of “teachable moment” has proven to work well in western countries. Russia needs to take advantage of existing knowledge and experience and design educational initiatives for current and future consumers based on the life-cycle education approach and particular events of the life cycle.

Different target groups for educational services can be identified and each target group should aim for reaching concrete learning objectives. Analysis of the current consumer-related issues on the financial marketplace and existing trends of financial deepening allows distinguishing two large groups of possible learning objectives. The first group deals with developing general competences and capabilities essential for efficient behavior on financial marketplace. The second group is directly linked to particular financial services and individuals who have made a decision to consume certain financial service or faced a concrete financial issue would aim for such objectives. This division of learning objectives among target groups is relative and various combinations of the objectives are possible depending on the demands of individuals.

Different types of educational services and programs will be needed to reach these objectives. The first group of objectives could be reached through comprehensive courses, and the modality of learning will largely depend of the existing level of development of basic competences, e.g. analytical thinking, reading and mathematics skills, planning skills, etc. The second group of objectives will be most likely efficiently reached through individualized just-in-time short-term counseling or tutoring and self-education with minimal guidance. Special consideration should be given to the challenges of delivery vehicles for financial education of adults.

International experience shows that the programs should be carefully tailored to the learners' needs and be appropriate for learners' age. This is especially important for youth populations. For instance, development of habits, such as regular saving or planning, can be
started at an early age while pension-related issues should be addressed at a stage when individuals have flexibility in setting personal priorities and financial targets, etc. Infrastructure and capacity for delivering educational programs aiming all types of objectives has to be developed in Russia.

Financial education programs should be delivered by both professional educators (e.g. university and school staff) and technical experts in financial markets. The latter can include representatives of government authorities and professionals from the private sector. The degree of involvement of professionals with different backgrounds and affiliations would vary depending on the type and topic of educational program. A major role of the educators would be to ensure appropriate design and quality of the instruction, while financial sector experts would contribute their knowledge of recent legislation, financial services, general trends of the financial marketplace, and so on. Therefore, educators are likely to play a greater role in the programs to the audience seeking for an improvement of general financial competences and to the future consumers (e.g. youth). At the same time, financial sector technical experts may be in leading programs for individuals who look for advice in particular personal finance-related areas.

Schools provide a natural entry point for financial education. General schools are often considered as a natural opportunity to equip youth with basic financial knowledge and skills and to prepare the cohort for future activities on the financial marketplace. Information about basic financial services (such as current and savings accounts, credit cards and personal loans), along with basic principles of life course planning and financial literacy (such as personal budget, consumer credit as a form of debt, risk-return tradeoffs etc.) should be taught in schools. Opportunities to provide basic financial education need to be explored, at least as a pilot program for students in primary and intermediate schools.

However many experts are concerned about the capacity of schools to deliver adequate financial education. Indeed, the general school curriculum is overloaded, there is a lack of teaching and learning materials proven to be efficient, the majority of teachers are not prepared to deliver education in this area, and schools often deal with urgent issues of providing regular education services of appropriate quality. Consideration should be given to initiatives that seek to evaluate efficient ways to provide financial education in schools.

Surveys and Evaluation

Evaluation of the effectiveness of financial education programs is needed. International experience in financial education demonstrates that increasing number of financial education programs and initiatives does not automatically lead to increases in the levels of financial literacy or positive changes in the behavior of consumers who are involved with the programs. It is very important to introduce a practice of evaluation of the results of educational programs and identify the most efficient ones. Controlled trials provide an effective mechanism of determining the effectiveness of financial education programs, using controlled groups as a basis for comparison against the results of education programs provided to experimental groups. The programs which prove to be efficient should receive wide support and dissemination.

Testing and surveys are critical tools in the evaluation of financial education programs. The financial literacy survey conducted in 2008 should be expanded to cover areas related to financial capability of specific groups, such as women. The survey should also be conducted every three to five years to see if the financial education programs are working—and if they, or the financial consumer protection framework need to be further revised.
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### Annex: Summary of Recommendations

<table>
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<tr>
<th>RECOMMENDATION</th>
<th>ACTION REQUIRED</th>
<th>PRIORITY</th>
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<tr>
<td><strong>REGULATORY AND SUPERVISORY STRUCTURES</strong></td>
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<tr>
<td>Establish a clear, effective, and simplified structure for financial consumer protection. Choose one of three options:</td>
<td>Build institutional capacity of CPS</td>
<td>High</td>
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<tr>
<td>1. CPS to retain authority for protection of the rights of financial consumers but strengthens its institutional capacity to handle financial issues.</td>
<td>Amend Law on the Central Bank</td>
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<td>• Improve coordination among the various supervisory agencies.</td>
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<td>• Establish a special CPS department working only on financial services.</td>
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<td>• Strengthen the transparency and accountability of CPS. The CPS to collect and publish statistics on the numbers of consumer complaints regarding financial services, the trends in types of complaints, and the final resolution of the complaints. Both the CPS and civil organizations to prepare recommendations on measures to improve consumer protection in financial services, including methods of monitoring and evaluating the impact (as well as the costs) of the recommendations.</td>
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<td>2. The CBR, FSIS and FFMS to receive clear authority for consumer protection for their respective segments of the financial sector. Modify the Law on the Central Bank to include an explicit mandate for consumer protection in the banking sector. OR</td>
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<tr>
<td>3. Establish a specialized financial consumer protection agency.</td>
<td>New law</td>
<td>High</td>
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<td>Require all entities (be they legal or physical persons) which solicits funds from the public for purposes of investment or speculation to obtain licenses from the financial supervisory agencies.</td>
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<td><strong>Financial Pyramids</strong></td>
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<td>Make pyramid schemes illegal in the Law on Competition or the Criminal Code.</td>
<td>Law on Competition or the Criminal Code</td>
<td>Medium</td>
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<tr>
<td>The FFMS should take the leading role in dealing with pyramid schemes and should have legal authority to freeze the assets of financial pyramids. Impose severe penalties for operating or being affiliated with any such scheme.</td>
<td>Amend Law on the Securities Market, Build institutional capacity of FFMS</td>
<td>Medium</td>
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<tr>
<td>Require that managers of consumer cooperatives have educational certificates and be free of convictions of an economic crime.</td>
<td>Amend Law on Citizen Consumer Credit Cooperatives</td>
<td>Medium</td>
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<td>Amend legislation to identify a multi-level sales scheme as an illegal pyramid scheme: (1) payment is required for the right to receive compensation for recruiting new salespersons into the scheme, (2) new salespersons must purchase an unreasonable quantity of a service and (3) inventory purchases are required as a condition of purchase of the service.</td>
<td>Amend Law on the Securities Market</td>
<td>Medium</td>
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<td>Require financial institutions to state that they are regulated and indicate the name of the agency.</td>
<td>New regulation</td>
<td>Medium</td>
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<tr>
<td>Encourage supervisory agencies to issue consumer alerts of possible frauds.</td>
<td>New policy</td>
<td>Low</td>
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<tr>
<td><strong>Financial Intermediaries</strong></td>
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<td>• Prepare special law to authorize CBR to maintain public register of credit brokers and debt collectors. The law should also set forth a legal framework (and related procedures) for regulation of debt collection, guiding principles and minimum requirements for debt collection companies, including that the owners be free of criminal records.</td>
<td>New law on financial intermediaries</td>
<td>Medium</td>
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<td>• The principles of conduct for debt collectors should include restrictions on the times of day that the debt collectors can contact consumers and prohibitions against other abusive debt collection practices.</td>
<td>New law on debt collectors</td>
<td>Medium</td>
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<td>• Require insurance intermediaries to be registered in a public register and agents tied to one insurer for each class of insurance sold.</td>
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<td>• Insurance agents should have liability for the policies they sell. The insurance company is ultimately responsible for the actions of its agents but should be able to seek restitution from the agent for the consequences of any misrepresentation and malfeasance by the agent.</td>
<td>Amend Law on the Securities Market</td>
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<tr>
<td>For intermediaries, establish a system of qualification and certification that is clear, transparent, and subject to external review. The certification should include training on a code of ethical standards.</td>
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<td><strong>Non-credit payment Service Providers</strong></td>
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- Give the CBR authority to supervise the national payments system and license non-credit payment services.
- Require the CBR to ensure a minimum level of governance by the payment services. Oblige payments service providers to disclose the ultimate owners of the companies. Require that the significant owners be free of criminal records. Require companies to publish annual audited financial statements and report daily transactions volumes to the CBR.
- Amend legislation to provide a clear definition of electronic money.
- Implement EU directive (2007/64/EC) on payment services.

**Other Regulatory Measures**

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<tr>
<td>Require all credit cooperatives to be supervised by a financial regulator or supervisory agency.</td>
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<td>Amend legislation on non-state pension funds to establish risk-based capital requirements. Require non-state pension funds to have a high priority of payment as creditors in case a bank in which they hold deposits fails.</td>
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<td>Credit bureaus should create a professional association and approve a code of conduct.</td>
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<td>Enhance protection of personal data. Amend the law on Personal Data to ensure that the user of the data is bound by restrictions applying to the source of the data, including government sources.</td>
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**CONSUMER DISCLOSURE**

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<tr>
<td>Provide consumers with clear and easy-to-understand information about financial services, about any changes to terms and conditions, and ability to withdraw without penalty if changes are not satisfactory.</td>
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<tr>
<td>The professional associations should develop a Key Facts Statement for each type of retail financial service.</td>
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<tr>
<td>Encourage the financial supervisory agencies to make available to consumers useful comparative information. Encourage the CBR to publish information (or require that financial institutions publish data) to allow comparisons of fees, charges and commissions charged for the same service.</td>
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<td>Improve the Law on Advertising to give more specific guidance, especially to brokers and collective investment undertakings.</td>
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<td>Provide responsibility for the implementation and enforcement of advertising and marketing rules for the securities market to the FFMS (as well as FAS).</td>
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<td>Require benefit illustrations under life contracts to be capped according to realistic future earnings prospects. Amend the legal provisions on insurance to cover the obligations of insurers regarding sales and promotional materials and the way in which such materials are presented. Require insurers to be responsible for the verifiable statements of their agents and for undertakings provided in official sales materials.</td>
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<tr>
<td>Conduct a survey of financial consumers to see how they understand the terminology used in consumer credits.</td>
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<td>Encourage professional associations to develop standardized contracts for all consumer financial services.</td>
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**Credit Institutions**

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<tr>
<td>Require financial institutions or intermediaries to provide consumers with a written copy of the general and the service-specific terms and conditions, prior to the purchase.</td>
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<tr>
<td>Require banks to provide terms and conditions that set clear rules on the reporting of unauthorized transactions, stolen cards and liabilities. Amend the draft law on Consumer Credit to require that each loan agreement between a bank and a customer sets a detailed schedule that itemizes the customer’s monetary obligations and discloses the penalties for pre-payments and for breaches of the loan agreement, expressed in Rubles as well as in percentage terms.</td>
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<tr>
<td>Amend legislation to require banks to notify customers in writing of any changes in interest rates and non-interest charges. Improve disclosure of quick loans.</td>
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**Payment Service Providers**

Encourage NAUET to prepare a code of conduct that requires non-credit payment service providers to provide consumers with a copy of the contract available at the terminal (as well as on the company’s website)
disclose the relevant fees.

**Insurance**

Require the issuance of specific rules on disclosure and account handling for insurance customers.

- Amend the Insurance Law to specify that traditional life insurance savings contract policyholders will receive statements of value at least annually and that standard non-life insurance policy wordings are agreed at industry level and any variation should be formally disclosed through an attached derogation statement.
- Ensure that standard policies do not permit denial of a claim or arbitrary cancellation of an if for reasons other than material non-disclosure and other rules already in the Civil Code. Ensure that a claim is not deniable after it has occurred, if the cause of the claim was unrelated to a non-disclosed risk factor.
- Implement regulations that require the use of separate bank accounts for policyholder funds while they are held by intermediaries, and the establishment of appropriate audit trails. Require brokers to disclose the practice and the amount or structure of the commission to the policyholder. Allow policyholders buying single premium and long term savings contracts to request details of the commission to be received by the agent/broker.

**Pensions**

Provide specific disclosure rules for point-of-sale practices for retail sales of voluntary pensions and annuities by non-state pension funds. Disclose the nature of annuities to members at the time they enter the fund.

Improve consumer disclosure on the payout of annuities as soon as possible. The FFMS should put in place clear rules on disclosure of estimated benefits for plan participants.

**Credit Reporting & Personal Data**

If created, association of credit bureaus should create an easy-to-read key information brochure, which given to the consumer at the point of purchase of a financial service.

Give consumers the right to see the latest calculated score, the range of scores possible, the average score of the population and the main factors that impact on the score. Clarify that self-inquiries, credit inquiries at lenders or initiated disputes are not part of credit score.

The association of credit bureaus, if created, should improve disclosure of practices on sharing of personal information with third parties. In the securities market, market participants should be required to inform investors of the sharing of their personal information and allow investors to opt out of information sharing.

Design an information campaign to help consumers learn about their legal rights on protection of personal data.

**BUSINESS PRACTICES**

Prohibit unfair sales practices. Place restrictions on plastic card distribution. Oblige those who provide financial services to ask enough questions to help the consumer decide if a financial service meets his/her financial needs and goals.

Ensure that collection practices are not abusive.

- Develop a legal framework for the operation of debt collection agencies that requires: (1) the licensing and oversight of all properly registered collection agencies by an appropriate regulatory authority, (2) the provision of services on the basis of generally accepted fair and reasonable principles of conduct, and (3) the provision of statistics by each licensed agency to the regulatory authority on a regular basis for public dissemination. The law should set forth a legal framework (and related procedures) for regulation of debt collection, guiding principles and minimum requirements for debt collection companies.
- Enact draft Law on Personal Bankruptcy.

Set cooling-off periods for contracts for all consumer financial services, except securities and investment funds. A cooling-off period should apply to: contracts with a long-term component, with a large savings component, long-term life insurance savings contracts, and voluntary individual pensions.

Prohibit financial institutions from granting unsolicited credit to consumers. Make financial institutions issuing credit cards responsible in case of fraud.

Discourage tied selling of contracts for financial services. Enact regulations to clarify that if a specific financial service must be purchased in order to obtain another service, the consumer has the right to choose the supplier of the related service.

Encourage professional associations to develop codes of business practice for their respective parts of the financial sector. Ensure that the codes provide for mechanisms for consumers to complain about non-compliance with the codes to the professional association. Once the codes have been approved, members should endorse the code, make it part of their internal regulations, and publicize them to the general public through appropriate
means. Supervisory agencies could review if the institution is following its own internal regulation regarding the code of business practice. Codes of business practice should: focus on minimum procedures needed to ensure fair and transparent relations with retail customers, highlight their rules on customer relations, and ensure that representatives of financial institutions ask enough questions to ensure suitability.

Ensure suitability requirements, particularly for the securities sector. The FFMS should make membership in self-regulatory organizations mandatory or incorporate suitability rules. In the case of insurance, the Consumer Protection Law should derogate suitability requirements to the Insurance Law.

Improve collaboration amongst financial supervisory institutions and professional associations to set competency requirements for staff of financial institutions.

- Regulations (or legislation) should introduce the concept of those who work with the public and sell financial services to consumers.
- Establish minimum competency requirements for any staff member of a financial institution that deals directly with consumers.
- Amend the Insurance Law to require that insurance intermediaries pass qualification tests relevant to the complexity of the service being sold.
- Encourage individual insurers to give educational processes and subsequent tests, in the case of agents and for less complex services.
- Give FSIS or the industry association the responsibility for establishing educational requirements and tests for more complex contracts.

**DISPUTE RESOLUTION MECHANISMS**

Oblige all financial institutions to establish a specific procedure to deal with consumer complaints. Require financial institutions to: (1) have a written procedure for handling consumer complaints and include a summary of this procedure in the bank’s general terms and conditions; (2) provide the customer with the detailed information of the department or person appointed by the bank to deal with the complaint; (3) provide the complainant with a regular written update on the progress of the investigation of the complaint; (4) inform the customer in writing of the outcome of the investigation within a maximum number of days; (5) explain in simple terms the nature of any offer of settlement made to the customer; (6) offer to treat any verbal complaint as a written complaint; (7) maintain up-to-date records of all complaints received, including information of the nature of the complaint, copies of the bank’s responses and other relevant documents, information of the action taken to resolve the complaint and whether resolution was achieved and on what basis; (8) make these records available for review by the competent authorities.

Establish a central location to collect, record, redirect and publish statistics on complaints related to financial services. Ensure that the central location: receives all complaints and passes them on to the financial institution or supervisory service; follows up on complaints; publishes statistics on the number of complaints received and what happened to the complaints.

Establish a financial sector ombudsman. As a first step, establish a professional ombudsman for an entire segment of the financial system. In the long-term term, establish by law an ombudsman for all financial services, or a Commission on Protecting Financial Consumer Rights. Strengthen the system of mediation and arbitration. The professional associations should establish arbitration courts for their financial services, if they do not already have one in place.

Strengthen the system of consumer advocacy organizations.

- Establish a system of consumer non-governmental organizations throughout the 83 regions to serve low-income and heavily-indebted households.
- Encourage non-profit financial advisors that council indebted people to keep records of the cases they receive, conduct trend analysis of this data, and propose changes in legislation.
- Include consumer advocacy organizations in the preparatory work on legislation affecting consumers of financial services.
- Create an umbrella organization to bring together the consumer advocacy organizations involved in financial services and give them a clear voice in the discussion of measures to strengthen consumer protection in financial services.
- Provide government funding for consumer advocacy organizations to ensure that they are financially viable.

Strengthen dispute resolution mechanisms for non-credit payment services. Oblige all companies to maintain effective systems for correcting mistakes. The Association should consider establishing an ombudsman’s office to handle complaints.
## FINANCIAL EDUCATION

Design a national policy for financial literacy and education. Coordinate efforts amongst the various institutions developing financial education policies. The Ministry of Finance should finalize and approve its draft document on the Promotion of Financial Literacy and Development of Financial Education in the Russian Federation.

Provide the Departments of Education in the 83 regions with a role in providing basic financial education in the school system.

Bring together initiatives of the private sector, consumer advocacy organizations and professional associations.

Consider establishing a Federal Center for Financial Literacy and Education that can pull together the numerous programs on financial education and literacy, identify best practices, and be engaged in pilot testing.

- All financial supervisory agencies should create a special Consumer Affairs page on their websites, where information for consumers can easily be found. Create a toll-free hotline for consumer inquiries.

- Base long-term financial education programs on life-cycle planning.

Design concrete learning objectives for each target group. Develop different types of educational services and programs to reach these objectives. Tailor programs to the learners’ needs and age. Require both professional educators and technical experts in financial markets to deliver financial education programs.

### Surveys and Evaluation

Evaluate the effectiveness of financial education programs via controlled trials, testing, and surveys. Expand the financial literacy survey of 2008 to cover areas related to financial capability of specific groups, such as women, and conduct the survey every three to five years.

Use the results of the survey to revise design of financial education programs and consider review of the consumer protection framework.