

KAZAKHSTAN

Diagnostic Review of Consumer Protection in Financial Services

Volume I Key Findings and Recommendations

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Kazakhstan

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Volume I – Key Findings and Recommendations

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Abbreviations & Acronyms

ACP	Agency for Competition Protection
ADR	Alternative dispute resolution
AFN	Agency on Regulation and Supervision of Financial Market and Financial Organizations
AMC	Asset management company
AMFOK	Association of Microfinance Organizations
APF	State-owned Pension Fund
APR	Annual Percentage Rate of Charge
CIU	Collective investment undertaking
COE	Council of Europe
CP	Consumer Protection
CSD	Central Securities Depository
FCAC	Financial Consumer Agency of Canada
FIAK	Financial Institutions' Association of Kazakhstan
FX	Foreign Exchange
GDP	Gross domestic product
IFL	Investment Fund Law
IMF	International Monetary Fund
IMPA	Pension Assets Investment Management Companies
JERP	Joint Economic Research Program
JSC	Joint Stock Company
KASE	Kazakhstan Stock Exchange
KYC	Know your customer
KZT	Kazakh Tenge
LCIVO	Law on Compulsory Insurance of Civil Liability of Vehicle Owners
LIB	Law concerning Insurance Business
LIBOR	London Inter-bank Offered Rate
LPS	Law on Pensions System
MOF	Ministry of Finance
MPPG	Minimum Pension Guarantee
MTPL	Motor third party liability
NBCI	Non-bank credit institution
NBK	National Bank of Kazakhstan
NGO	Non-government organization
PAYG	Pay as you go
RFCA	Regional Financial Centre of Almaty
SML	Securities Market Law
SPPC	State Pension Payment Centre
UK	United Kingdom
US	United States of America

Currency Equivalents

(Exchange Rate Effective November, 2010)

US\$1 = KZT 147.57

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Foreword

Consumer protection in financial products and 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 Diagnostic Review of Consumer Protection in Financial Services in Kazakhstan and thank the Kazakh authorities for their valuable cooperation and collaboration in its preparation. The Review not only looks at financial products and services for retail consumers in Kazakhstan but also contributes to the international dialogue to develop a set of good practices or benchmarks for use in reviewing consumer protection in financial services in any jurisdiction

EXECUTIVE SUMMARY

- 1. Recent developments in the financial markets highlight the importance of consumer protection and financial literacy for an efficient and healthy financial sector.** The rapid growth of household lending in many countries 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.
- 2. Consumer protection helps address imbalances of power, information and resources between consumers and financial institutions, which place consumers at a disadvantage, and thereby also builds trust among consumers in their financial institutions.** Financial institutions are very familiar with the terms and conditions of their financial products and services, but retail consumers may find it difficult or costly to obtain sufficient information on their financial purchases. 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.
- 3. In Kazakhstan, rapid expansion of household credit has highlighted the need for strong consumer protection and financial capability.** From 2004 to 2007, household lending increased rapidly at an annual average growth rate of 116 percent, and was accompanied by increased risk as households became more indebted. In addition, households increased their borrowings in foreign currency, and when the Kazakh tenge depreciated in February 2009, it further increased leverage. Nonperforming loans as a share of total loans for housing and mortgage loans increased from 5 percent in 2008 to 30 percent in 2010.
- 4. Improved consumer protection can be achieved through reforms in five key areas:** (i) institutional structure for protecting consumers of financial services; (ii) disclosure of information of financial products and services for consumers; (iii) prohibition of deceptive and unfair business practices in consumer finance; (iv) dispute resolution mechanisms for consumers; and (v) financial education programs for households.

Institutional structure

- 5. The basic institutional framework for consumer protection in financial services is largely in place.** The financial sector supervisory agency (AFN) is statutorily responsible for ensuring the stability of the financial sector and maintaining strong consumer protection in financial services. It has a Consumer Protection department that is responsible for collecting, analyzing, and dealing with consumer complaints.
- 6. The Competition Agency also plays an important role in protecting financial consumers' rights.** The Agency oversees the Law on Competition, which identifies the violation of consumer rights as a source of unfair competition. In addition, the Agency plays a role in monitoring business practices by financial institutions, especially those related to advertising of financial services. The role of the Competition Agency is critical in monitoring the banking

sector closely and encouraging better competition. The Agency could publish the competition assessment of the banking sector.

7. The capacity of the AFN should be strengthened, or consideration should be given to establishing a separate financial consumer protection agency. Having the financial supervisor responsible for both prudential supervision and supervision of business conduct/consumer protection practices is a good institutional arrangement. However, the capacity of AFN, particularly of the Consumer Protection department, should be strengthened significantly to ensure adequate implementation of consumer protection regulations in financial services. Alternatively, the authorities should consider setting up a separate financial consumer protection agency.

8. Consumer organizations could be provided with funding and resources to take on a more active role on consumer protection matters. These grass root organizations are sometimes the only accessible points for the poor and socially disadvantaged in Kazakhstan. However, they remain small and suffer from lack of funding. Accessing the input of these organizations could strengthen the work of AFN in consumer protection in financial services.

Disclosure of Information

9. Consumers in Kazakhstan do not clearly understand the key terms and conditions of the financial services or products they purchase, as indicated by complaints raised to AFN. This leads in difficulty understanding the risks and obligations they assume. Therefore, the authorities and industry associations should undertake a series of initiatives to provide financial consumers with adequate disclosure of clear and easy-to-understand information about financial services. These initiatives are as follows:

- a. **Industry associations could develop simple and easy-to-read standard Key Facts Statements for all retail financial products and services for use by their member institutions.** The Key Facts Statement, which summarizes in easy-to-read print and plain language the key terms and conditions, including fees and charges, should be given to consumers at the point of sale of the contract. The Key Facts Statement should also indicate what mechanisms for recourse are available to the borrower or investor in the event of a complaint.
- b. **Industry associations could develop standardized contracts for use by their member institutions.** This would ensure that consumers receive standard contract provisions that are fair and balanced, and that have been reviewed by the AFN. While it is recognized that financial institutions will need to tailor specific contracts for sophisticated investors involved in large-scale transactions, standardized contracts would be an effective measure for the protection of most individual consumers.
- c. **The AFN could require financial institutions to publish useful comparative information on financial services, and should publish a glossary of key terms.** The AFN should require financial institutions to publish their fees, charges and commissions, in a manner that allows consumers to easily compare the costs charged for the same service by different financial institutions. The AFN (or one of the consumer advocacy organizations) could then publish comparable offers. The AFN should also prepare of a

glossary of key terms and conditions that would help consumers understand better the financial service being purchased, since financial institutions sometimes use complex terms to differentiate their services from those of competitors.

- d. **Legislation on insurance, private pension funds, and securities markets should be strengthened to ensure adequate disclosure requirements and account handling for customers.** For example, legislation on insurance should require insurers to notify policyholders about the need to renew policies that are due to expire, and to disclose commissions on non-mandatory insurance policies to the customer. Legislation on pension systems should require disclosure requirements at the point of sale, which will be particularly important once pension funds and investment management companies are authorized to introduce riskier portfolios within the pension funds (starting in January 2012). The Law on Securities Markets should specifically require market participants to inform investors of the sharing of their personal information, and allow them to opt out of information sharing.
- e. **The Law on Advertising, and legislation on insurance, pension funds, and securities markets should be strengthened to ensure proper advertising practices by securities intermediaries, investment management companies, and pension funds.** The Law on Advertising provides a basic legal framework on advertising that is also applicable to financial services. However, the provisions of this law need to be more specific. For example, for insurers and pension funds, the law should explicitly state that these entities are legally responsible for all statements that are made in marketing and sales materials.
- f. **The capacity of AFN should be enhanced to monitor advertising practices in the securities, insurance and private pension sectors.** AFN should coordinate with the Competition Agency to ensure effective mis-selling of financial products and misleading advertisements by entities not supervised by AFN.
- g. **AFN could require financial institutions to strengthen disclosure requirements for credit records and personal information sharing, and to inform financial consumers about their right to dispute credit records and correct mistakes.** The Law on Loan Offices and Formation of Credit Histories requires credit institutions to obtain the consent of the consumer to share his/her information with the credit bureau. However, it is not clear if credit institutions explicitly inform customers that they are allowing the credit institution to share their credit history. Credit institutions should inform consumers about their rights to dispute entries into their credit records and correct mistakes. At the point of purchase of a financial service, consumers should receive an easy-to-read key information brochure that explains the basics of a credit report, credit score and the credit reporting system, and indicate how the consumer can access and correct mistakes in the credit report.

Business Practices

10. Unfair business practices of financial sector participants highlight the need for significant measures in this area. Some of these business practices include: abusive debt collection practices, unilateral and seemingly arbitrary changes in interest rates in loan contracts; the value of collateral being determined by a valuation agent chosen by the bank; banks failing to

release collateral when additional property was provided to back up a loan; banks requiring the customer to use the insurance company chosen by (and often affiliated with) the bank providing the loan to the consumer; insureds being unable to obtain payment under legitimate claims for car insurance, or a pension beneficiary finds that the investment fund has been changed without the approval of the beneficiary. The recent cases of fraud of “shared construction” of apartments in Kazakhstan, which were Ponzi schemes to solicit funds from the public by promising apartments at half the market price, highlight the need for special attention in this area. In order to improve business practices in the banking, securities, insurance, and pensions sector, the following measures should be taken:

- a. **AFN could adopt a regulation to ensure that debt collection practices are not abusive.** There have been complaints of abusive debt collection practices in Kazakhstan. Since there is no regulation regulating debt collection activities, the AFN should obtain feedback from consumer associations on consumers’ experiences on debt collection and it should adopt a regulation that balances the right of borrowers to fair and reasonable collection methods with the right of lenders to enforce contractual rights in a cost-effective and speedy manner.
- b. **The AFN could require financial institutions to set cooling-off periods for all consumer financial contracts, except for securities and investment funds, to protect consumers from high pressure sales tactics.** There is no cooling-off period in Kazakhstan for any financial product or service. 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. Cooling-off periods should apply to all contracts for financial products and services, except for securities and investment funds, in which rapid changes in market prices 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.
- c. **AFN could adopt a regulation to discourage the practice of tying and bundling of financial services.** Many banks in Kazakhstan are requiring borrowers to sign an insurance policy before receiving a bank credit. However, banks provide borrowers with a list of approved insurance companies that meet the banks’ requirements, and the banks tend to include only insurance companies that are affiliated with the bank. Therefore, the AFN should adopt a regulation that clarifies 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.
- d. **The financial industry associations should develop Codes of Business Practices for all segments of the financial sector to be adopted by their member institutions.** The Codes should focus on minimum procedures needed to ensure fair and transparent relations with retail customers, such as the number of days which the institution could take to respond to a customer complaint, or the length of time for maintaining customer records. Financial industry associations should ask members to make the Codes part of their internal regulations, and publicize them to the public. The financial industry associations should also establish sanctions for misconduct or violations of the Codes.

- e. **The AFN and industry associations could collaborate closely to set competency requirements for staff of financial institutions, and legislation (or regulation) should require financial institutions to comply with these requirements.** For example, legislation on insurance should be amended to require that insurance intermediaries pass qualification tests relevant to the complexity of the service being sold.
- f. **The AFN could take a leading role in dealing with illegal financial schemes, and should require the licensing of all entities that solicit funds from the public for investment or speculation.** The AFN should take the leading role in investigating pyramid schemes and should have the legal authority to freeze assets of the scheme (as can the Financial Police) as needed to protect investors' assets. The recent cases of fraud of "shared construction" of apartments in Kazakhstan, which were Ponzi schemes to solicit funds from the public by promising apartments at half the market price, highlight the need for special attention in this area. Multi-level selling schemes should also be regulated to ensure that illegal schemes, which often arise in insurance markets in emerging countries, do not occur. Requiring all entities that solicit funds from more than 50 investors to be licensed by the AFN is a key measure in preventing the emergence of financial pyramids.
- g. **The AFN could also make it compulsory for financial institutions to indicate that they are regulated by the AFN.** This enables financial institutions to separate themselves from financial pyramids or other frauds.

Dispute Resolution Mechanisms

11. Financial consumers need an effective mechanism that handles their complaints and resolves disputes with financial institutions. The dispute resolution mechanism in Kazakhstan is fragmented. An ombudsman has been established for the compulsory motor third party liability insurance. Similarly, the draft legislation on financial consumer protection provides for an ombudsman for consumers of residential mortgages. Authorities should either: (1) expand the scope of existing ombudsmen for banking and insurance, and set up new ombudsmen for securities and pensions sector; or (2) establish a single financial ombudsman for all financial services under the draft financial consumer protection law. Establishing a single ombudsman for all financial services would provide a single point of contact for financial consumers.

12. AFN could require all financial institutions to establish a specific procedure to deal with consumer complaints. Since there are no legal requirements for financial institutions to establish complaint procedures for effective resolution of complaints and disputes, industry associations should develop recommendations for their members on complaints' handling procedures. Financial institutions should establish detailed internal procedures to deal with consumer complaints. These internal procedures include, inter alia: having a written procedure for handling consumer complaints; providing the complainant with a written update on the progress of the investigation of his/her complaint; informing the customer in writing of the outcome of the investigation within a maximum number of days; etc.

Financial Education Programs

13. Financial education initiatives should be strengthened in order to improve financial consumer protection in the long run. A financially literate consumer is best able to understand own rights and responsibilities, financial disclosures and weigh the risks and rewards of each type of available financial product and service. Strengthening financial literacy requires a long-term investment in financial education.

14. There are several financial education initiatives by government entities, consumer associations, and private institutions, but an umbrella organization could coordinate all these initiatives. RFCA, AFN, the National Consumer League and other organizations are undertaking financial education initiatives. However, it would be useful to have an umbrella-type organization that would encourage synergies in the individual programs prepared by different organizations and dissemination of best practices. Consumers would benefit from having access to a single source of reliable, comprehensive and clear information, which is especially designed to address their needs. Gateways are needed to a wide range of information resources: consumer protection legislation and regulation, educational materials, training courses, counseling and advice, comparative tables of the costs of financial products and services, and financial planning tools, etc.

15. Financial education programs should be based on life-cycle planning approach. Evidence from current international experience shows that people are more responsive to education which directly addresses the issues they face in the 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.

16. Financial education programs should be designed and delivered by both professional educators (e.g. university and school staff) and technical experts in financial markets. A major role of educators would be to ensure appropriate design and quality of instruction, while financial sector experts would contribute their knowledge of recent legislation, financial products and services, general market trends, etc.

17. Ongoing evaluation of financial sector practices, financial literacy, and financial education programs is needed to ensure that programs remain effective. Randomized controlled trials and surveys provide an effective means of determining the effectiveness of consumer protection initiatives and financial education programs. A well designed nationwide household survey on financial literacy should be undertaken every 3-5 years to measure the impact of financial literacy initiatives and evaluate whether consumer protection initiatives and financial education programs are working—or need to be improved.

SUMMARY OF RECOMMENDATIONS

RECOMMENDATION	ACTION REQUIRED	RESPONSIBLE PARTY	Priority
INSTITUTIONAL STRUCTURE			
<p>Enhance the institutional structure for financial consumer protection. Choose one of the two options: <i>(Vol 1-Pg 18)</i></p> <ol style="list-style-type: none"> 1. AFN to retain financial consumer protection authority but strengthens its capacity to handle consumer protection matters. 2. Establish a specialized financial consumer protection agency. <p>AFN should devise a long term plan to encourage industry associations to play a more active role in financial consumer protection. <i>(Vol 2- Pg 19; 65; 97)</i></p> <p>For example, FIAK should:</p> <ul style="list-style-type: none"> • Have standardized rules on addressing complaints mechanisms and ensure disclosure of these mechanisms on banks' website • Adopt a voluntary code of conduct and publish it on its website • Provide comprehensive information on its website that promotes consumer financial literacy • Establish permanent working groups on banking, securities markets, insurance and pension. <p>AFN should require the licensing of all entities (be they legal or physical persons) who solicit funds from the public for the purposes of investment or speculation. <i>(Vol 1- Pg 28; Vol 2-Pg 66)</i></p> <p>The Government and the AFN should consider strengthening the capacity of consumer organizations to take on a more active role on consumer protection matters. <i>(Vol 1- Pg 32; Vol 2- Pg 18; 49; 63; 66; 95; 98; 110; 120; 121; 131)</i></p> <p>The Competition Agency should monitor the banking sector closely and encourage better competition. It should publish the competition assessment of the banking system. <i>(Vol 2- Pg 52)</i></p>	<p>Build institutional capacity of AFN or establish new agency</p> <p>New policy</p> <p>New regulation</p> <p>New policy</p> <p>New policy</p>	<p>AFN, Government</p> <p>AFN</p> <p>AFN</p> <p>AFN, Government</p> <p>Competition Agency</p>	<p>High</p> <p>High</p> <p>High</p> <p>Medium</p> <p>Medium</p>
CONSUMER DISCLOSURE			
<p>AFN should make available to consumers useful comparative information. AFN (or one of the consumer advocacy organizations) should publish information to allow easy comparisons of fees, charges and commissions charged for the same service. <i>(Vol 1-Pg</i></p>	<p>New policy</p>	<p>AFN</p>	<p>Medium</p>

<p>20, Vol 2-Pg 31)</p> <p>AFN should publish a glossary of key terms. (Vol 1- Pg 21)</p> <p>Professional associations should develop standardized contracts for all financial services to be adopted by member institutions. (Vol 1 - Pg 21)</p> <p>Professional associations should develop Key Facts Statements for all retail financial products and services to be adopted by member institutions. (Vol 1-Pg 21; Vol 2- Pg 24; 102; 123)</p> <p>The Law on Advertising, and legislation on securities, insurance, and pension funds should be amended to ensure proper advertising practices by securities intermediaries, investment management companies and pension funds. AFN should strengthen its the capacity of monitoring advertising practices in the securities, insurance and private pension sectors. (Vol 1- Pg 23; Vol 2- Pg 69; 73; 101; 122)</p> <ul style="list-style-type: none"> • For insurers, securities intermediaries, and pension funds, the laws should explicitly state that these entities are legally responsible for all statements that are made in marketing and sales materials. • For insurance services, the Law on Advertising should cover benefit illustrations, which allow consumers to estimate their future payments from insurance contracts. <p>AFN should coordinate with the Competition Agency to ensure effective mis-selling of financial products and misleading advertisements by entities not supervised by AFN. (Vol 2 – Pg 73; 101; 122)</p> <p>Insurance</p> <p>Insurance legislation should be strengthened to provide specific provisions on disclosure and account handling for insurance customers. (Vol 1- Pg 23)</p> <p>It should:</p> <ul style="list-style-type: none"> • Specify that traditional life insurance savings contract policyholders shall receive statements of value at least annually (possibly after the first two years), and shall have mechanisms to dispute the accuracy of the statement. (Vol 2- Pg 105) • Require insurers to notify policyholders about the need to renew policies that are due to expire, and to provide a renewal notice to that effect. (Vol 2-Pg 105) • State explicit requirements for insurance companies to disclose 	<p>New policy</p> <p>New policy</p> <p>New policy</p> <p>Amend the Law on Advertising, Securities Markets Law, Investment Funds Law, Pension Systems Law, insurance legislation, Build capacity of AFN</p> <p>New policy</p> <p>Amend insurance legislation, Build capacity of AFN</p>	<p>AFN</p> <p>Industry associations</p> <p>Industry associations</p> <p>AFN</p> <p>AFN, Competition Agency</p> <p>AFN</p>	<p>Medium</p> <p>High</p> <p>High</p> <p>Medium</p> <p>High</p> <p>Medium</p>
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credit reporting system, and indicate sources of information where the consumer can access his/her report. This brochure should be given to the consumer at the point of purchase of a financial service. <i>(Vol 1- Pg 24)</i>			
BUSINESS PRACTICES			
AFN should take a leading role in dealing with illegal financial schemes. It should have legal authority to freeze the assets of the financial pyramids and impose severe penalties for operating or being affiliated with any such scheme. <i>(Vol 1- Pg 28; Vol 2-Pg 67)</i>	Amend the Law on Securities Markets, build institutional capacity of AFN	AFN	High
Legislation should be amended to identify a multi-level sales 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. <i>(Vol 1-Pg 29)</i>	Amend legislation	AFN	Medium
AFN should require financial institutions to state that they are regulated by AFN. <i>(Vol 1- Pg 29; Vol 2- Pg 22)</i>	New policy	AFN	High
AFN should issue consumer alerts of possible frauds. <i>(Vol 1- Pg 30; Vol 2-Pg 67)</i>	New policy	AFN	Medium
AFN should adopt a regulation to ensure that debt collection practices are not abusive. <i>(Vol 1- Pg 25; Vol 2-Pg 32)</i>	New Regulation	AFN	Medium
AFN should introduce cooling-off periods for all consumer financial products, except for securities and investment funds. A cooling-off period should apply to: contracts with a long-term component, (such as housing and mortgage loans; or a large savings component. <i>(Vol 1- Pg 25; Vol 2- Pg 21; 102; 104; 125)</i>	New Regulation	AFN	High
AFN should adopt a regulation to discourage tied selling of financial products. The regulation 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 service. <i>(Vol 1- Pg 25, 26; Vol 2- Pg 22; Pg 99)</i>	New regulation	AFN	Medium
Industry associations should develop codes of business practice for their respective parts of the financial sector. <i>(Vol 1-Pg 27; Vol 2 - Pg 18; 41; 64; 97)</i>	New policy	Industry associations	High
AFN should require financial institutions to develop a “Know Your Customer” policy, to improve the suitability of financial products. <i>(Vol 2 - Pg 20; 71; 72; 102; 125)</i>	New policy	AFN	Medium
AFN and professional associations should collaborate closely to set	Legislation/regulation	AFN, industry	Medium

<p>competency requirements for staff of financial institutions. <i>(Vol 1- Pg 27; Vol 2-Pg 27; 71; 124)</i></p> <ul style="list-style-type: none"> • Establish minimum competency requirements for any staff member of a financial institution that deals directly with consumers. • Give AFN or the industry association the responsibility for • establishing educational requirements and tests for more complex contracts. <p>The legal and regulatory framework for securities sector should be strengthened to: <i>(Vol 2- Pg 72; 75; 76)</i></p> <ul style="list-style-type: none"> • Require more detailed sales practice rules for the securities industry • Require more detailed requirements on the contents of the contract note on an industry-wide basis for securities. • Require more specific regulations on the procedure for contesting the accuracy of statements by the client of the securities intermediary. • Introduce clear provisions that require broker/dealers and management companies to immediately pay the customers any cash balances in their accounts and proceeds from sales when the payment is received by them. 	<p>Amend Securities Market Law, Investment Funds Law, and applicable regulations</p>	<p>associations</p> <p>AFN</p>	<p>Medium</p>
<p>DISPUTE RESOLUTION MECHANISMS</p> <p>AFN should require all financial institutions to establish a specific procedure to deal with consumer complaints. The professional associations should develop recommendations on complaints' handling procedures for their member institutions. <i>(Vol 1- Pg 30; Vol 2- Pg 41; 79; 107; 124; 129)</i></p> <p>Improve the mechanism of handling and addressing complaints by: (1) expanding the scope of existing ombudsmen and setting up new ombudsmen for securities and pensions sector; and (2) consider establishing a single financial ombudsman for all financial services under the draft financial consumer protection law. <i>(Vol 1 – Pg 31; Vol 2-Pg 43, 66; 81; 98; 108; 129)</i></p> <p>Under (1):</p> <ul style="list-style-type: none"> • Expand the scope of the new ombudsman to be established under the draft consumer protection law to cover all banking services. • Expand the scope of the insurance ombudsman to cover all insurance services. • Set up an ombudsman covering securities intermediaries. • Consider setting up an ombudsman covering the pensions sector. 	<p>New regulation</p> <p>Amend legislation, new regulation</p>	<p>AFN</p> <p>AFN</p>	<p>High</p> <p>Medium</p>

<p>FINANCIAL EDUCATION</p> <p>An umbrella organization could be created that brings together initiatives of government entities, consumer associations and private institutions. <i>(Vol 1- Pg 33)</i></p> <p>Long-term financial education programs should be based on life-cycle planning. <i>(Vol 1- Pg 34)</i></p> <p>Financial literacy programs should be differentiated between those that provide broad financial education vs. those that give targeted consumer information. <i>(Vol 1- Pg 34; Vol 2- Pg 49)</i></p> <ul style="list-style-type: none"> • The targeted information should include reliable, comprehensive and clear information about consumer protection in the area of financial services. • For the broad program, a comprehensive learning framework would be useful to develop policies and build consensus, and could be used as a basis for designing educational programs and initiatives. <p>Require both professional educators and technical experts in financial markets to deliver financial education programs. <i>(Vol 1- Pg 35)</i></p> <p>Consumer organizations should be encouraged to deliver financial education awareness programs. <i>(Vol 2-Pg 110; 131)</i></p>	<p>New policy</p> <p>New policy</p> <p>New policy</p> <p>New policy</p> <p>New policy</p>	<p>New umbrella organization</p> <p>AFN, RFCA, new umbrella organization</p> <p>AFN, RFCA, new umbrella organization</p> <p>AFN, RFCA, new umbrella organization</p> <p>AFN, RFCA, new umbrella organization</p>	<p>Medium</p> <p>Medium</p> <p>Medium</p> <p>Medium</p> <p>Medium</p>
<p>SURVEYS AND EVALUATION</p> <p>Evaluate the effectiveness of financial education programs via controlled trials and surveys. <i>(Vol 1- Pg 35; Vol 2-Pg 51; 83; 110)</i></p> <p>A nationwide household survey should be conducted every 3-5 years to measure impact of initiatives. Use the results of the survey to revise design of financial education programs and consider review of the consumer protection framework. <i>(Vol 1- Pg 35; Vol 2- Pg 51;83)</i></p>	<p>New policy</p> <p>New policy</p>	<p>AFN, RFCA, new umbrella organization</p> <p>AFN, RFCA, new umbrella organization</p>	<p>Medium</p> <p>Medium</p>

Introduction

18. The Diagnostic Review of Consumer Protection in Financial Services in Kazakhstan is the 11th report in a World Bank program to assess consumer protection in financial services in emerging markets.¹ The objectives of the Review are to: (1) conduct a review of the existing rules and practices in Kazakhstan compared to international good practices concerning consumer protection in financial products and services and (2) provide recommendations on ways to improve consumer protection in respect of financial products and services in Kazakhstan. The Diagnostic Review was prepared at the request of the Agency for Competition Protection (ACP) with the support of the Agency on Regulation and Supervision of Financial Market and Financial Organizations (AFN) and the Presidential Administration. Also supporting the Review were the National Bank of Kazakhstan and the Regional Financial Center of Almaty. Funding for the Review was provided under the Joint Economic Research Program (JERP) managed by the Ministry of Economy.²

19. 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 respect of financial products and services.³ A set of good practices was initially assembled for the Slovakia Review and was revised in the course of subsequent country 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 released sets of good practices to enhance awareness and education on risk and insurance, private pensions and credit 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 Kazakh financial sector based on international experience in Europe and elsewhere.

20. It is hoped that the publication of the Diagnostic Review for Kazakhstan will help develop financial consumer protection both in Kazakhstan and worldwide. In particular, it is

¹ Other reports were prepared for Azerbaijan, Bosnia and Herzegovina (banking only), Bulgaria, Croatia, the Czech Republic, Latvia, Lithuania, Romania, the Russian Federation and Slovakia. The full set of published reports on consumer protection and financial literacy can be downloaded at <http://www.worldbank.org/consumerprotection>.

² An assessment mission was conducted on September 27-October 8, 2010 in Almaty and Astana. In addition to the ministries and services noted above, the mission met with the Prosecutor's Office, the Association of Financiers, the Association of Microfinance Organizations, the Council of Association of Pension Funds, the National Economic Chamber Atameken, the Public Policy Research Center, the Kazakhstan Mortgage Company, the Kazakhstan Stock Exchange, the Eurasian Trade System Commodity Exchange, the National Consumers League of Kazakhstan, the Almaty Committee for Consumers Protection and members of the Kazakh and international financial and legal community.

³ See World Bank, *Good Practices for Consumer Protection and Financial Literacy in Europe and Central Asia: A Diagnostic Tool*, 2010. See <http://www.worldbank.org/consumerprotection>.

⁴ See OECD, *Improving Financial Education and Awareness on Insurance and Private Pensions* (2008) available at http://www.oecd.org/document/8/0,3343,en_2649_34851_41210376_1_1_1_1,00.html and OECD, *Financial Literacy and Consumer Protection: Overlooked Aspects of the Crisis, OECD Recommendation on Good Practices on Financial Education and Awareness relating to Credit* (2009) available at http://www.oecd.org/document/39/0,3343,en_2649_15251491_43269479_1_1_1_1,00.html.

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

anticipated that application of the good practices in middle-income countries, such as Kazakhstan, will contribute to international policy dialog on the key components of financial consumer protection and assist in the development of benchmarks that are widely accepted as generally applicable to consumer protection in financial products and services in any jurisdiction.

21. The Review is presented in two volumes. Volume I notes the importance of consumer protection in respect of financial products and services, summarizes the Government's policy on financial consumer protection, provides statistics on the size and growth of the retail financial sector in Kazakhstan, and sets out the key findings and recommendations of the Review. Volume II provides an assessment of the Kazakh consumer protection institutional, legal and regulatory framework, as well as business practices compared to the template of good practices for four segments of the financial sector—banking, securities, insurance, and private pensions.

22. 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 Kazakhstan.

Importance of Consumer Protection & Financial Literacy

23. Until the financial crisis of 2007-2009, the global economy was adding an estimated 150 million new consumers of financial products and services each year. Rates of increase have since slowed but growth continues apace. Most of such new consumers 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, stable and competitive financial markets.

24. Weak consumer protection and financial literacy affect both developed and developing 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 products and 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 products and 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.

25. 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 had assumed—or the full range of choices available. In fact, as a result of the recent financial crisis, several governments have already

undertaken measures to improve their financial consumer protection framework, as shown in Box 1.

26. 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 products and 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 providing 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 payoff to the consumer is postponed or very high* (for example, long-term investment products, where performance cannot be evaluated for many years and expenses may consume a large part of profits).

27. Consumer protection and financial literacy promote efficiency, transparency and deepening 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. A well-designed consumer protection framework can help reduce the imbalances, by giving individuals clear and complete information on which to make informed decisions, by prohibiting financial institutions from engaging in unfair or deceptive practices, and by providing adequate mechanisms to resolve disputes between individuals and financial institutions. 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 products and services and accountability, consumer protection also helps to promote good governance of the financial sector.

28. 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 the liquidity risk of the banking sector. Empowered consumers also help foster financial stability by avoiding 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.

Box 1: Highlights of Consumer Protection Measures taken by Countries after Global Financial Crisis

Hungary: On September 16 2009 Hungary's leading banks signed a code of conduct on retail lending activities. The code covers all types of consumer loan and applies to all financial institutions in the retail lending market. The code is a self-regulatory instrument. The FSA will have the power to monitor the signatories and fine them if they do not act in accordance with the code. 90% of the market has signed. Market participants refusing to sign the code will be posted on the website of the FSA. **Unilateral amendments by Banks:** Parliament has adopted a bill that restricts banks' rights to unilaterally amend or modify consumer loan agreements and allowing customers to rescind such agreements without charge. The act also introduces the principle of symmetry, whereby financial institutions must modify the terms of contracts in favors of their clients in the event of an advantageous change to the factors on which the interest rates and fees depend. The new provisions came into effect on August 1 2009.

Colombia: The new Colombian Financial Reform Law (1328/2009) establishes a new Financial Consumer Protection Regime. The law establishes a system for the fair treatment of customers (including consumer protection procedures, mechanisms for information disclosure, procedures to answer consumers' complaints and requests, mechanisms to produce statistical data on complaints); ii) obligation for financial institutions, consumer associations, governmental financial supervisory agencies and self-regulatory organizations to educate consumers; iii) definition of abusive practices and clauses; iv) extension of the *Superintendencia Financiera's* penalties for violation of the financial consumer protection regime.

Mexico: Bank of Mexico Issues Guidelines on Bank Charges- On July 17 2009 the General Guidelines on the Collection of Bank Charges were issued by the Bank of Mexico. The guidelines aim to eliminate inappropriate practices in connection with bank charges, ensuring that such fees and the mechanisms for their collection are transparent and that charges are incurred only for services rendered. The law states circumstances where fees cannot be charged for. Regarding orders to transfer funds, the guidelines state that credit institutions may not vary their commission charges according to the amount being transferred.

Estonia: On February 25 2009 the Law amending the General Part of the Civil Code and the Law of Obligations Act was approved. Transactions entered into under extremely unfavorable conditions or unbalanced contract are considered to go against good faith and void. In such cases the burden of proof lies with the creditor to show otherwise. Furthermore, in case of a consumer credit contract, it is assumed that the value of the parties' mutual obligations deriving from the contract is unbalanced if, at the moment of granting the credit, the APR in such contract is more than three times greater than the latest average consumer credit APR offered by Estonian credit institutions.

Canada: Real Costs of Proposed New Credit Card Regulations. On May 21 2009, New Credit Business Practices Regulations was proposed. Most notably, the regulations require a minimum 21-day interest-free grace period on new credit card purchases. The regulations will prohibit financial institutions to increase credit limits unless the customer gives express consent. In addition, the regulations will impose limits on the debt collection practices. The Regulations will modify disclosure to customers. Customers must be provided with information on their credit card statement each month as to the time it will take to repay an entire balance if only the minimum payment is made each month. The regulations will also require advance disclosure of interest rate increases before they take effect. Co-borrowers must receive the required disclosures unless a designated borrower is identified by some or all co-borrowers.

Latvia: Government Program for Troubled Borrowers: On August 4 2009 the government approved a support program for troubled borrowers. The program was prepared in cooperation with Latvian banks and the International Monetary Fund. Under the program, the state will underwrite mortgage loans which have previously been restructured and on which the borrower, due to the economic situation, is likely to default or has defaulted. The program stipulates two main principles to be applied when deciding how mortgage loans should be restructured: (i) at least 20% of the loan amount should be blocked until the end of the program and no interest should apply to that part of the loan; and (ii) after the restructuring of the loan, the monthly payments should not exceed 40% of the borrower's income.

Source: World Bank

29. In addition, consumer protection helps financial firms in facing 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 sector⁶. Effective consumer protection can help ensure that the actions of financial firms do not make them subject to criticisms of mis-selling.

30. Consumer protection also protects the financial sector from the risk of government over-reaction. The impact of too little consumer protection became evident, for example, during the insurance and superannuation scandals in the United Kingdom and Australia, resulting in extensive studies on recommendations for regulatory reform, including consumer disclosure. The political response to collapses of parts of the financial sector may be to over-compensate with heavy regulation. Some governments have also resorted to interest rate caps for consumer loans (with questionable results especially on the development of credit markets), as a reaction to increasing public pressure to adopt consumer protection measures.

31. Competition policy will not fully address consumer protection issues on its own—some regulation of financial markets is needed. George Benston (1999) also suggests that one of the (few) justifications for regulating financial markets is "protection of consumers from the loss of their investments, fraud and misrepresentation, unfair treatment and insufficient information, incompetent employees of financial-services providers, and invidious discrimination."⁷ Mark Armstrong (2008) notes that in most competitive markets, competition policies are sufficient to ensure that firms succeed by providing consumers with the products and services they want. However Armstrong also argues that more is required to ensure efficient retail financial markets. He notes that policies are needed to provide consumers with comparable information, to increase consumer awareness of market conditions, to reduce consumer search costs, and to clarify hidden costs. They help give consumers essential information on which to make decisions. He also points to the need for policies to prevent misleading and fraudulent marketing directed at consumers.⁸

32. 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 and advertising of financial products and services and collection of payments;

⁶ Joint Forum of Basel Committee on Banking Supervision, International Organization of Securities Commission and International Association of Insurance Supervisors, Customer suitability in the retail sale of financial products and services, April 2008

⁷ George J. Benston, *Regulating Financial Markets: A Critique and Some Proposals*, American Enterprise Institute for Public Policy and Research, 1999

⁸ Mark Armstrong, "Interactions between Competition and Consumer Policy", *Competition Policy International*, Volume 4, Number 1, Spring 2008

- **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 financial products and services and exercise their rights (and responsibilities) as financial consumers. Training in financial issues should also empower consumers to make wise and informed decisions about their finances—and to plan their financial needs over a lifetime. Financial education cannot, however, substitute for adequate financial regulation.

33. Addressing the main weaknesses in consumer protection can be done quickly with immediate impact, but 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 in terms of what works (and what does not) in improving financial behavior.⁹ Techniques of delivering financial education have been well tested in the US, Europe and elsewhere over the last 30 years¹⁰ 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, but it should be rigorously tested and evaluated and be viewed as a long-term investment.

Kazakh Policy regarding Consumer Protection in Financial Services

34. The Kazakh Government policy on financial sector development includes the objective of strengthening consumer protection in financial services. The global financial crisis of 2007-09 highlighted weaknesses in the financial sector in Kazakhstan, particularly for banks that relied on the capital markets as their primary source of funding. The Presidential Decree № 923 of February 1, 2010 notes the need to create a modern, sustainable and competitive financial system in Kazakhstan. The post-crisis “concept” builds on the 2007-2011 financial sector development program approved in December 2006. In particular, the post-crisis concept aims to achieve a “qualitatively new level of control and management” by: (1) increasing the resilience of the

⁹ For a summary of academic research on the limited effectiveness of financial education in the US, see Shawn Cole and Gauri Kartini Shastry, *If You Are So Smart, Why Aren't You Rich? The Effects of Education, Financial Literacy, and Cognitive Ability on Financial Market Participation*, October 2007. Other analysts go further and argue that financial education fails to improve consumer decision-making and may even be harmful by developing consumer over-confidence. See Lauren E. Willis, "Against Financial Literacy Education", *University of Pennsylvania Law School, Public Law and Legal Theory Research Paper Series* Research Paper No. #08-10. However most analysts agree that both consumer protection and financial education are needed.

¹⁰ For a summary of programs see Shaun Mundy, *Financial Education in Schools: Analysis of Selected Current Programmes and Literature—Draft Recommendations for Good Practices*, published in proceedings of OECD-US Treasury International Conference on Financial Education, Washington DC, May 2008, Volume II

financial sector, (2) creating conditions to prevent deficiencies and unstable events seen during the financial crisis, (3) stimulating investment activity as a tool for implementing macroeconomic decision-making, and (4) *building confidence in the financial sector of the part of investors and consumers of financial services*. In addition, the program includes measures to establish Kazakhstan as a regional financial center, supporting financial sector development throughout Central Asia. This will require deepening the domestic financial sector, extending services to a broad range of the population, and strengthening consumer protection and financial literacy.

35. The Kazakh Government has developed a national program to improve financial literacy. The Government Order No. 536 from June 27, 2007 approved the Program for increasing the level of investment culture and financial literacy of the population of Kazakhstan for 2007-2011. The institution responsible for the execution of this program is the Agency on Regulation of Activity of Regional Financial Centre of Almaty. As part of the program, in 2008 the Agency developed and approved the Plan for increasing the financial literacy of population of the Republic of Kazakhstan for 2008-2011.

36. The Diagnostic Review is intended to support the Government's program. The Review is intended to take a long-term perspective on consumer protection and financial literacy providing a strategic map for actions going forward. Improved consumer protection and financial literacy is becoming increasingly important in the global discussion on international regulatory reform—and the measures needed to ensure efficiency and stability of financial systems in the European Union and worldwide. The Diagnostic Review will assist the Government of Kazakhstan in implementing emerging best practices on consumer protection in financial services.

Background on Kazakh Household Finances

37. During the pre-crisis period, banking lending to households grew significantly, contributing to the increase of the banking loan portfolio. From 2004-2007, retail lending increased at an annual average growth rate of 116 percent while corporate lending increased at 54 percent. As a result, household indebtedness stood at 22 percent of GDP in 2007. The share of real estate lending doubled between 2004 and 2007, amounting to 30 percent of GDP at end-2007. Loans to the construction sector increased rapidly by over 100 percent from 2006 to 2007, and comprised on average 25 percent of total loans in 2006-2008.

38. During the global financial crisis, the stop in capital inflows caused a severe credit crunch, as banks faced significant liquidity constraints. Kazakh banks also lost virtually all access to rollover opportunities in the global financial markets. This created significant liquidity pressure on the banks, which had relied extensively on capital market funding, and they responded by attempting to shrink the credit portfolio and increase domestic deposits. Starting in mid-2007, lending to the economy stalled and grew very slightly in 2008 and 2009, by 2.8 percent and 2.5 percent, respectively.

39. Despite the negative impact of the credit crunch on the domestic demand and business activity, decrease in lending to households by the banks and continued growth of the disposable income have improved households' financial position. In particular, the household debt burden dropped from the levels recorded at the peak of a credit boom. Thus,

the debt-to-GDP ratio decreased from 22 percent in 2007 to 17 percent in 2009 and the debt-to-disposable income ratio dropped from 45 to 29 percent in such timeframe (see Table 1).

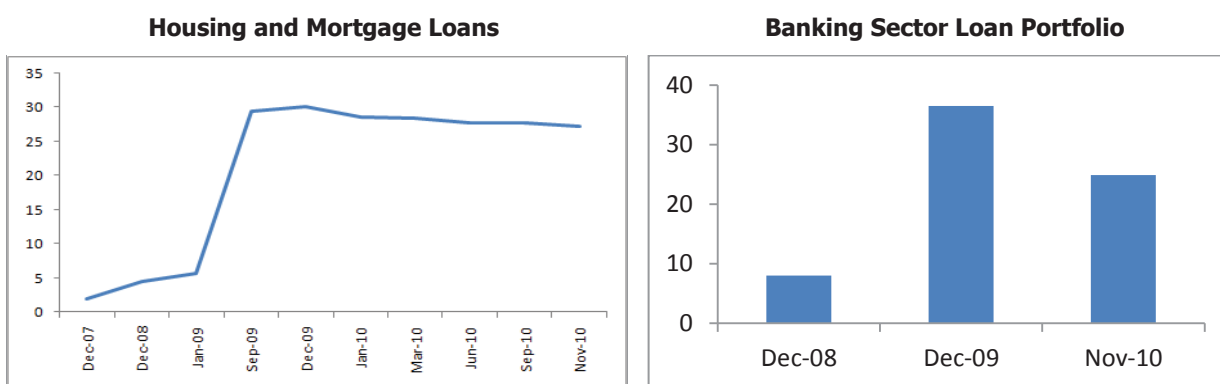
Table 1: Kazakh Households' Financial Position

	2006	2007	2008	3Q -2009
Household Assets/GDP	25.9	28.2	24.4	30.1
Household Debt/GDP	16.5	22.3	16.8	17.2
Household Debt/Disposable Income	35.7	45.2	33.0	29.4
Household Debt/Household Assets	10.5	12.7	13.1	13.4
Liquidity Coefficients	97.0	77.5	89.8	105.6
Household Foreign Exchange Position/Disposable Income	-7.9	-6.2	-2.2	0.9

Source: NBK, *Financial Stability Report, 2009*

40. The impact of the global financial crisis in the Kazakh economy has deteriorated the quality of the household loan portfolio. The percentage of total non-performing loans increased significantly in 2009 and represented around a third of the total loan portfolio by the end of 2009. This jump was mostly explained by the deterioration of the housing and mortgage lending portfolio, which increased from around 5 percent by end-2008 to almost 30 percent by end-2010. The ratio has slightly decreased in 2010 but still accounts for over a quarter of the total credit portfolio¹¹.

Figure 1: Non-performing Loans Ratios

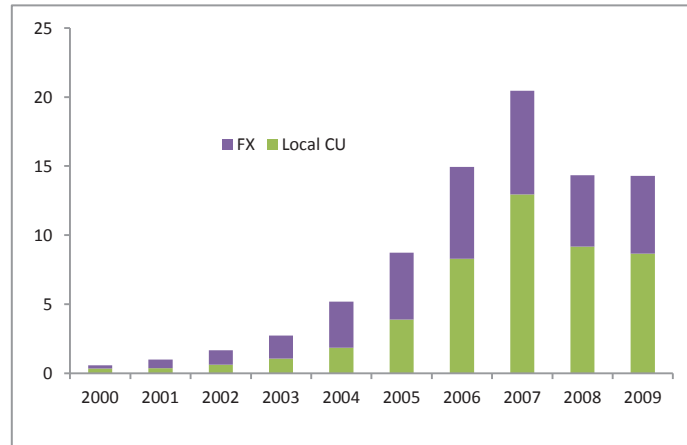


Source: AFN

41. Household exposure to foreign currency risk has also increased significantly. Lending to households reached its peak in 2007 when it represented 22 percent of GDP. That year the level of household lending in foreign currency represented more than 7 percent of GDP (about twice the share of 2004), increasing the level of risk faced by financial consumers (see Figure 2).

¹¹ Measured as loans in arrears for more than 90 days. Statutory NPLs are calculated differently according to local regulations and amount to 34 percent of the loan portfolio.

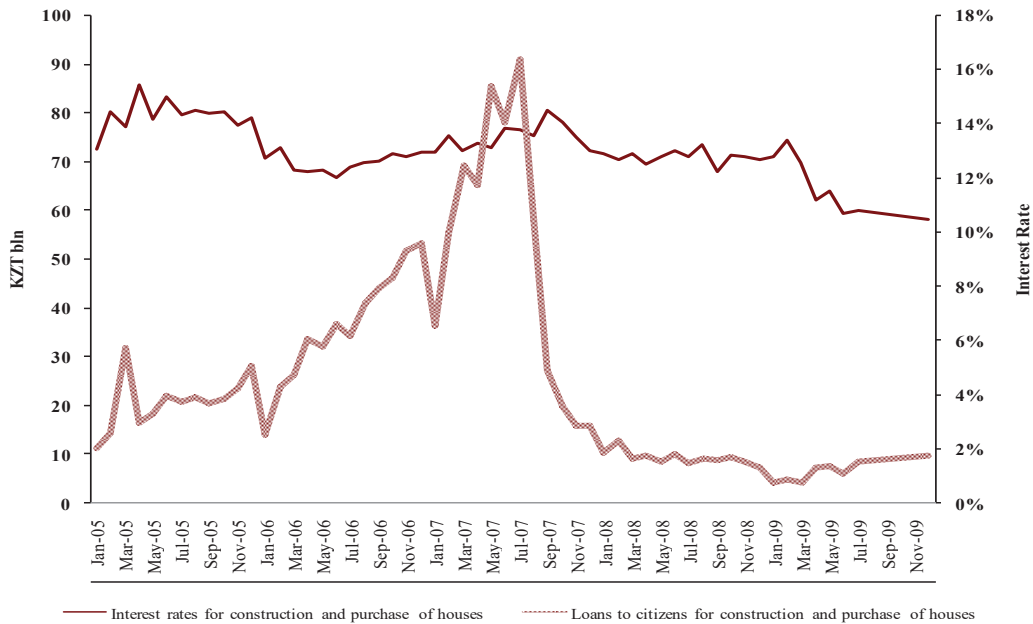
Figure 2: Household Loans in Local and Foreign Currency
(as percentage of GDP)



Source: AFN

42. Mortgage lending also experienced significant growth in the years before the crisis, and now the real estate market is starting to adjust. Mortgage lending also reached its peak in 2007. The real state prices started to fall by the end of 2007 and the adjustment has continued until 2010 but at a lower rate. This adjustment coincided with a period of credit crunch that not only limited the offering of mortgage loans but also reduced lending to the construction sector.

Figure 3: Volumes and Interest Rates of Mortgage Lending *

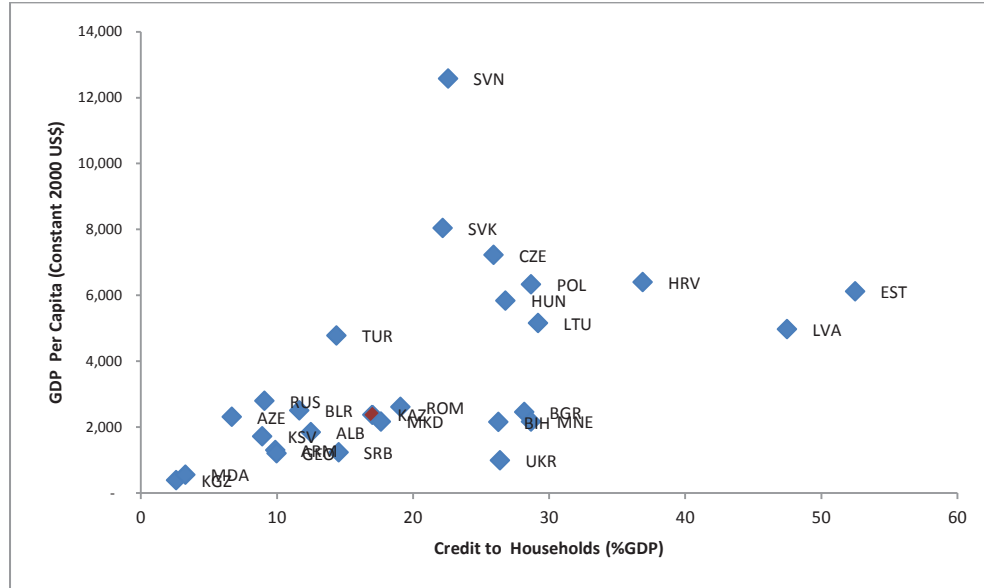


Source: NBRK

43. Despite the increases of household lending, the banking penetration ratios are still relatively low. The ratio of household lending over GDP is around 17 percent, below the average level of countries in Europe and Central Asia (Figure 4). At the same time, the level of retail

deposits is also low—at 11% of GDP, compared to 16% in Russia, 22% in Ukraine, 30% in Turkey.

Figure 4: Credit to Households – International Comparison (% GDP)



Sources: World Bank, AFN

44. Indicators of participation of the population in the formal financial sector are also low.

It is difficult to estimate the size of the unbanked and underserved population in Kazakhstan. The Deposit Insurance Fund covers 14.5 million accounts and estimates that each individual has three or four personal accounts at various banks, suggesting that 4.1 million (or just 25 percent of the population) maintain current accounts with banks. Bank savings accounts are considered as “gateway products” (or services) that bring consumers into the financial sector and allow them to benefit from financial products and services. As a result, bank current accounts are a useful proxy for use of formal financial services. Similarly the credit register notes that it maintains credit records for 3.7 million individuals. This suggests that more than half the adult population of Kazakhstan has no access to formal financial services. However, data is incomplete and more precise information on household participation in the financial system is needed.

45. 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 consumers. 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.

Key Findings & Recommendations

46. Currently the AFN is responsible for consumer protection in financial services in Kazakhstan. The AFN is statutorily responsible for both the stability of the financial sector and maintenance of strong protection of consumer rights in financial services. According to Article 3 of the Law on State Regulation and Supervision of Financial Market and Financial Organizations (Law No. 474-2003), one of the purposes of state regulation and supervision of financial markets and financial organizations is “ensuring appropriate level of protecting interests of financial services users”, and one of the key principles for financial regulation and supervision is “integrity of measures for ensuring protection of financial service user interests, by way of supporting the development of new financial instruments and services as well as introduction of advanced technologies in financial market”.

47. The Agency for Competition Protection (ACP) also plays an important role in protecting financial consumers’ rights. ACP oversees the Law on Competition, which identifies the violation of consumers’ rights as a source of unfair competition. In addition, ACP monitors business practices by financial institutions, especially those related to advertising of financial services. For the new Law on Consumer Protection (Law No 274 of 2010), ACP is expected to be assigned the role of enforcement agency for competition purposes, although the Consumer Protection Law specifically exempts financial services from the scope of the legislation.

48. The Diagnostic Review identifies that the current institutional framework for consumer protection in financial services in Kazakhstan is one that is used internationally, but consideration could also be given to setting up a special financial consumer agency. The rise of consumer financial services—and the extensive nature of consumer complaints—has prompted both developed and developing countries to consider the establishment of a special financial consumer agency. Canada established one of the first self-standing financial consumer agencies in 2001 (see Box 2). Under the US Wall Street Reform and Consumer Protection Act of 2010, a special financial consumer protection bureau was established under the US Federal Reserve Bank. While funding for the Bureau of Consumer Financial Protection is to be provided by the Federal Reserve, the head of the Bureau will report directly to the US President. The UK has also proposed establishment of a Consumer Protection and Markets Authority to review the business conduct practices of financial institutions. Proponents in favor of a separate agency argue that consumer protection is never given as much importance as prudential supervision in a financial supervisory agency. Those in favor of keeping prudential and business conduct supervision in one institution argue that the insights gained by supervising consumer protection practices provide an essential early warning signal for the prudential supervisor. However establishment of a new institution is a complex process and the approach of the US—in creating a financial consumer protection bureau within the central bank—suggests supporting the current structure of having the financial supervisor be responsible for both prudential supervision and supervision of business conduct/consumer protection practices.

Box 2: 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 products and services and issues relating to them.

FCAC has the authority to issue 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

49. According to the banks, over 90 percent of consumer complaints relate to the consumer's inability to pay their obligations. According to Atameken, following the devaluation of the Kazakh Tenge in 2009, most banks revised the interest rates or loan repayment schedules on consumer loans to cover the banks' losses. These practices, combined with the economic collapse that followed the global financial crisis of 2007-09, made it difficult for borrowers to meet their financial obligations.

50. Most complaints submitted to AFN point to cases where financial institutions failed to follow the law. AFN receives about 300 – 400 consumer complaints a month. In the banking sector, the common complaints are that the banks incorrectly revised the interest rate or repayment schedule. The most common complaints regarding banking services were excessive interest rates on loans and fees for banking services, unilateral increase of rates and fees, high commission rates and improper calculation of commission rates of loan agreements and bank deposits. Some of these complaints sought assistance of AFN to remove penalty fee for delay in repayment of loan, obtain grace period to pay off loans and prevent foreclosure of pledged property. Investors in securities complained of problems in registration of shares, in calculation of dividends and bond interest amounts and in non-payment of dividends and interest due. Insurance beneficiaries complained primarily of failure to pay claims. In private pensions, the issues related to reduction in the value of pension accounts; employers not giving employees a choice and requiring them to enter into pension contracts with a particular pension fund, consumers discovering that their mandatory pension contributions have been transferred to other pension funds without their consent and pension funds' refusal to transfer contributors / beneficiaries' pension savings to pension funds of their choice and non-payment of their pensions. Most complaints against insurance companies relate to late insurance payments, disputes on signature of insurance companies and adverse terms signed by insured without understanding the implications, insurance companies not complying with the court rulings in favor of the insured, and disagreement on the amount of damages for motor vehicle accidents.

51. However many of AFN's complaints were also specific requests for financial education. Consumers asked, for example, about interpretation of current and draft legislation, procedures for granting mortgage and consumer loans, explanation of how to calculate the effective interest

rates of specific consumer loans. Many complaints also showed lack of understanding of the rights and responsibilities of consumers when taking a loan and pledging a property.

52. The broad range of consumer complaints about financial services suggests that reform is needed at many different levels. As of October 2010, draft legislation on consumer protection in financial services was being discussed by the Kazakh Parliament. However once the legislation is in place, much work will still be needed to both strengthen AFN regulations regarding the operations of financial service providers and encourage development of self-regulatory mechanisms to improve common business practices by financial institutions in working with households.

53. The Diagnostic Review proposes that consumer protection in respect of financial products and services be strengthened in ways that will improve consumer confidence in private financial institutions. Four measures are recommended:

- i) Improve consumer disclosure for financial products and services to make it more clear and simple—yet more complete—than the current disclosure;
- ii) Prohibit deceptive and unfair business practices in consumer finance;
- iii) Make dispute resolutions systems for consumer finance inexpensive, efficient and easy for consumers to use; and
- iv) Improve financial education programs (both formal and informal) for households.

Consumer Disclosure

54. Consumer disclosure lies at the heart of any effective program of consumer protection regarding financial products and services. Before making any purchase of a financial product or service, a consumer should receive easy-to-understand information about that product or service. Consumers should also be able to easily compare offers from financial service providers so that consumers can “shop around” for the pricing or other terms and conditions that are most suitable for their needs.

55. The financial supervisory agencies should ensure that useful comparative information is made available for consumers. The AFN could require that financial institutions publish their fees, charges and commissions in a manner that allows consumers to easily compare the costs charged for the same service by different financial institutions. Publication of comparable offers could be made by the financial supervisor, as is done by the Financial Regulator of Ireland and some other countries. On a periodic basis, the Irish Financial Regulator compiles offers by different financial institutions and then issues its comparative tariff survey with a press release. Alternatively one of the consumer advocacy organizations could compile comparable prices and publish the survey. Publication of the comparable prices by different financial institutions would allow consumers to do accurate cost comparisons.

56. Publication of comparable offers on standard consumer financial services would likely reduce interest rates on consumer loans and improve quality of service. Provision of comparable information for financial consumers has been shown to be effective in increasing competition among financial service providers. The Banking, Insurance and Pension Funds

Supervisory Agency of Peru, for example, found that online publication of consumer loan rates reduced the average consumer lending rate by 1000 basis points (or ten percentage points) at a time of stable interest rates.¹²

57. Some consumer associations already publish the prevailing interest rates and charges for various products across the banking system. They obtain the information from the banks periodically and publish it on their website. Consumers can be urged to look at this information before deciding on the products and services. One of the consumer organizations, such as the National Consumer League, or even a leading newspaper could conduct weekly surveys of offers by financial institutions and publish them.

58. Standardized contracts—or at least standard provisions of contracts—would also be helpful. Such an approach would help consumers by offering them standard contract provisions that have been reviewed by AFN to ensure that the provisions are fair and balanced in both protecting the interests of both financial institutions and their retail customers. Standardized contracts could be developed by the professional associations, such as the Financial Institutions' Association of Kazakhstan (FIAK) and the Association of Microfinance Organizations (AMFOK), which would recommend these contracts for use by all institutions that are members of the association. 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 reference benchmarks such as LIBOR or the refinancing rate of the National Bank of Kazakhstan. While it is recognized that financial institutions will undoubtedly need to tailor-make specific contracts for sophisticated investors involved in large-scale transactions, standardized contracts would be an effective measure for the protection of most, if not all, individual consumers.

59. A glossary of key terms would also be helpful. Financial services are characterized by complex and proprietary terms, developed by financial institutions, to differentiate their services from those of their competitors. Preparation of a glossary of key terms and conditions would help consumers understand the nature of the financial service being purchased. Standardized terminology would also help organizations preparing comparative surveys of services offered by financial institutions. Glossaries of key terms have been developed by financial regulators in several countries.

60. Simple and easy-to-read key facts statements for all retail financial products and services would be useful. Consideration could be given to measures that allow consumers easily to identify and understand the terms and conditions of the financial products or services they wish to purchase. International practice requires financial institutions to give each consumer a one-page Key Facts Statement (sometimes called a “passport”) that summarizes—in easy-to-read print and plain language—the key terms and conditions for the financial product or service on offer. A Key Facts Statement would neither replace nor be a part of the terms and conditions for a financial product or service. The Key Facts Statement would be given to the consumer as a separate, additional document that would help the consumer understand all essential terms and conditions. The Key Facts Statement should also indicate what mechanisms for recourse are available to the borrower or investor in the event of a complaint.

¹² See www.sbs.gob.pe

61. Providers of financial products and services should be encouraged by their professional associations to give consumers a Key Facts Statement or other standardized report at the point of sale of the contract. Some banks have already developed 1-page documents that summarize contracts of financial products or services offered to customers. However consumer associations claim that such documents are as confusing and hard to understand as the full contracts. 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 by all 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 has no incorrect information. The approach of a Key Facts Statement was developed in the United Kingdom and should be kept in mind for possible application at a future date in Kazakhstan.

62. If a Key Facts Statement were developed for consumer credit, it should cover the most important terms and conditions. The Statement should follow a simple clear format that summarizes all the essential terms and conditions, which are provided in a separate document. 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, and some banks provide summary documents to their customers, there is no clear standard format used by all 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 industry associations which should recommend its use to the financial institutions that are members of the associations.

63. Key Facts Statements could be developed for all basic retail financial products and 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 products and services.

64. It would be useful to also conduct surveys of consumers to see how they understand the current consumer disclosure. Banks are obliged to disclose to customers the annual percentage rate of charge (APR) for loans and deposits and the list of commissions and charges that would affect the APR. However the APR concept might be difficult for the typical consumer to understand and there are concerns that this term has not been clearly disclosed and explained by retail sales officers. Recent experience in the United States has shown that consumers often do not clearly understand or know how to use interest rate disclosure. The US Federal Reserve has conducted extensive surveys of financial consumers (while visiting shopping malls). The surveys were used to see how consumers understand the terminology used in credit cards and revise interest rate disclosure requirements.

65. Detailed regulations on advertising by securities intermediaries, investment management companies and pension funds would be helpful. The Law on Advertising provides a basic legal framework on advertising that is also applicable to financial services. Article 6 stipulates that all advertisements should be reliable and easy to understand by the average population, whereas Article 7 defines and prohibits improper advertising. Article 14 explicitly covers financial services and products, and lists practices that are explicitly prohibited, such as the forecast or guarantee of future returns or profits (including increase in market value of securities), or the omission of material terms and conditions. However, the provisions of this law are general in nature and more specific guidance would be helpful, especially to securities intermediaries, investment management companies, insurers and pension funds. For insurers and pension funds the law should explicitly state that they entities are legally responsible for all statements that are made in marketing and sales materials. 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 capacity of AFN should be strengthened in order to ensure close monitoring of advertising in the securities, insurance and private pension sectors.

66. Specific rules on disclosure and account handling for insurance customers should be issued. The insurance legislation should specify that traditional life insurance savings contract policyholders shall receive statements of value at least annually (possibly after the first two years), and shall have mechanisms to dispute the accuracy of the statement. The law should also require insurers to notify policyholders about the need to renew policies that are due to expire, and to provide a renewal notice to that effect. In addition, more explicit requirements should be imposed on insurance companies to disclose commissions on non-mandatory insurance policies to the customer.

67. There should also be specific disclosure requirements for private pension funds. The Law on Pensions Systems (LPS) requires the pension fund to establish procedures for the notification of the status of the pension savings to the contributor. However the LPS does not regulate the content of such disclosure. Regarding transfer of funds, there are no explicit provisions that require agents to disclose information on the implications of applying for transfer of funds from one pension fund to another. In general, the LPS is silent on what occurs at the point of sale other than the conclusion of a contract. Information at the point of sale will be particularly important once pension funds and investment management companies are authorized to introduce riskier portfolios within the pension funds (starting from January 2012). However there seems no requirement on disclosure of fees for pillar III pension products or any changes thereto. The AFN should also make sure that information on portfolio performance of pension funds is published on time, using clear and comparable formats. In particular, stringent risk disclosures should be required concerning the volatility of pension fund (and other securities) investments as well as the risks related to investing in corporate bonds.

68. Consumers should be clearly informed about their rights to dispute entries into their credit records. The Law on Loan Offices and Formation of Credit Histories includes comprehensive rules on the functioning of credit bureaus, use of credit information, disclosure of information, privacy and protection of security of data. The law requires credit institutions to obtain the consent of the credit history subject to share his or her information with the credit bureau. However it is not clear if in practice credit institutions explicitly inform customers that

they are agreeing to allow the institution to share their credit history. It is also unclear whether banks tell the customers about their right to obtain a credit report.

69. It should be easier for consumers to correct mistakes in their credit records. Not many customers know that they can dispute the accuracy of the reports in their credit record and how to go about it. Anecdotal evidence suggests that not many consumers understand fully or realize the implication of failure to pay on time and the impact of a bad credit record. Either AFN or FIAK should provide additional information to consumers about the need to have an accurate credit report. At the point of purchase of a financial service, consumers should receive an easy-to-read key information brochure. The 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 go about correcting reports and resolving complaints. Consumers should also be able to obtain online access to verify information in the credit bureau.

70. Improvements could be made in the practices related to sharing of personal information with third parties in the securities sector. Securities legislation should specifically require market participants to inform investors of the sharing of their personal information and allow investors to opt out of information sharing.

71. It may also be helpful to use mystery shoppers to learn how retail customers are treated by financial institutions. Mystery shoppers (hired by AFN or a consumer organization) could visit banks, insurance companies, broker-dealers and private pension funds to see what information is provided to them when they walk into the offices of the financial institution. Reports by mystery shoppers could help AFN see what additional changes may be needed in regulations and guidance for financial institutions.

Business Practices

72. Nonprofit organizations point out weaknesses in the common business practices of credit institutions. Speaking on behalf of entrepreneurs and other self-employed consumers, the National Economic Chamber Atameken highlighted different types of problems encountered in dealing with banks and other credit institutions. Atameken complained about: (i) unilateral and seemingly arbitrary changes in interest rates in loan contracts, (ii) loans disbursed in local currency but with repayment calculated based on a foreign currency-local currency exchange rate, (iii) penalties for early repayment not clearly specified, (iv) debt collectors that “violated human rights” and often acted as corporate raiders. Other consumer associations pointed out other types of weaknesses such as: loan officers being unable to explain the terms and conditions of consumer credits, the value of collateral being determined by a valuation agent chosen by the bank, banks failing to release collateral when additional property was provided to back up a loan, requirement to use the insurance company chosen by (and often affiliated with) the bank providing the loan to the consumer.

73. Consumer associations have also pointed out weaknesses in business practices of insurers and pension funds. Such practices include cases where insureds cannot obtain payment under legitimate claims for car insurance or where a pension beneficiary finds that the investment fund has been changed without the approval of the beneficiary—or even without formal notification to the beneficiary.

74. Unfair and abusive business practices should be explicitly prohibited. Close watch should specially be made of debt collection practices to ensure that they are not abusive. The contract agreements between banks and their customers usually include a clause which stipulates that the bank can provide information to external collection agencies. However the contract does not provide details on the person or entity that would collect the debt or the debt collection procedure. The reason given for not providing such details is the fear of restricting ability to recover debts. In the absence of accessible and affordable mechanisms to redress abuse, it is necessary to monitor practices in this area. AFN should have more information on the practices of credit institutions and obtain feedback from consumer associations on consumers' view and actual experiences on debt collection. It is also important that a regulation on debt collection practices be issued to provide guidance in this area. This regulation would have to balance the right of borrowers to fair and reasonable collection methods with the right of lenders to enforce contractual rights in a cost-effective and speedy manner.

75. Cooling-off periods should be set for all consumer financial contracts except securities and investment funds. Once a product or service has been bought, a consumer 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 unsatisfactory to him or to her. Currently there is no cooling-off period for any financial product or service. 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. Cooling-off periods should apply to all contracts for financial products and services, except securities and investment funds. (For traded securities and funds, rapid changes in market prices 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.

76. Tied selling of financial products and services should also be discouraged. As seen in many rapidly expanding financial markets, as consumer credit becomes an increasingly competitive sector, financial institutions seek to appear competitive while maintaining high profit margins. One practice is to require that contracts for certain financial products or services, such as insurance, be obtained in order for the borrower to receive a loan (mortgage or auto loans). 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.

77. Tying and bundling of financial products and services should be explicitly discouraged. The consumer should always be free to choose the provider of a financial product or service. From a competition point of view, bundling and tying practices may weaken competition by: (1) raising costs and therefore reducing customer mobility, (2) discouraging the entry of new players and growth of smaller players because customers are bound into buying several services from the same financial institution, (3) reducing price transparency and comparability among providers given that additional and perhaps unnecessary services are introduced in a transaction.

78. A frequent tying practice in Kazakhstan 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 meet 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.

79. Regarding consumer choice in the selection of insurance and appraisal companies, a balance is needed. On the one hand, consumers should have the right to shop around and find the most suitable providers of insurance and appraisal services. Furthermore consumers should not be obliged to use the services of insurance or appraisal companies that are affiliated with the credit institution. Where different financial services are provided by different members of the same financial group, a risk arises that one service is used to subsidize other services. On the other hand, financial institutions are in the business of taking risk. Not all licensed insurance companies are equally financial strong and capable of paying claims. Similarly different property appraisers take different views of the market value of property. Working with a limited number of well-managed insurance companies and conservative property appraisers is an important element of risk management for any credit institution. Rather than providing consumers the choice of selecting any licensed insurance company or property appraiser, it would be better if banks were obliged to present a list of at least three qualified (and independent) insurance and insurance companies that would be acceptable to the bank. In this way, consumers could still shop around for the best pricing and quality of service but banks could also manage the risk of consumer loans.

80. Legislation could regulate the practice of bundling financial products and 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. Bundling practices should be regulated for all types of financial products and services.

81. For private pensions, the pension funds should be responsible for the activities of their agents. Marketing of private pension products is done through a free agent system (the same agents who distribute mandatory insurance products). The AFN has enacted a law that would come into force in 2011 that requires pension funds to be responsible agents to be liable for their misconduct. Adopting the same approach for securities as for banks, the AFN's regulatory rules under the risk management policy requires the pension funds to be responsible for complying with market conduct rules.

82. 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. A suitability rule that establishes the due diligence responsibility of the securities market participant should be incorporated in the securities regulation.

83. The financial industry associations should develop codes of business practice for all parts of the financial sector. Codes of conduct should be developed for banking, insurance, securities, pensions and other parts of the financial sector. Once the codes have been approved by the financial industry associations, members should be asked 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, AFN could review if the institution was following its own internal regulation regarding the code of business practice. Where the institution was failing to do so, AFN could make recommendations on ways in which the institution could improve its compliance. While such recommendations would not be binding for the financial institution, those 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 association, which should also establish sanctions for misconduct or violations of the code.

84. 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. 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.

85. Special training should be established for those officers in financial institutions who deal with retail customers. AFN is requiring some certification starting in 2012. As a starting point, regulations (or legislation) should explicitly define the concept of “those who work with the public and sell financial products and services to consumers”. Then, the financial supervisory agency and financial sector associations should collaborate to set competency requirements for staff of financial institutions who work with retail customers. In the securities sector, the law and regulations already 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 in the banking, insurance and pensions sectors. Competency standards should be improved. The AFN and the professional industry associations should work together in order to establish minimum competency requirements for any staff member of a financial institution who: (1) deals directly with consumers, (2) prepares any Key Fact Statement or any advertisement for the institution, or (3) markets the financial institution’s services. For example, 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 products and 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 AFN.

86. In addition, FIAK should play an active role in strengthening the business practices of financial institutions in Kazakhstan. FIAK was established in 1999 in accordance with Congress I Resolution of Kazakhstan Financiers. The founders of FIAK are the five largest second-tier banks and one leading insurer. The funding sources of FIAK include the founders’

contributions, admission and annual membership fees and sponsor support. FIAK's objective is to represent the industry in governmental and other bodies, express and advocate the financial industry's common interests, participate in Government efforts to improve financial sector legislation and liaise with governmental bodies. However FIAK has no established permanent working groups or committees on banking, capital markets, insurance and pension. Many countries such as China (Hong Kong), Canada, US, UK, South Africa have adopted codes of conduct, maintain comprehensive consumer websites of important information on products and services, and issue brochures and educational material in addition to the information on their website. In the absence of bankers training institute, FIAK should take steps to strengthen the level of skills in the banking industry in order to improve the banking practices in the country and consumer confidence. In this way, consumer protection can be driven by the market instead of by regulatory directives.

87. 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, as is required under the AFN Law. 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.

88. The issue of "shared construction" of apartments has given rise to a number of lawsuits, both in the criminal and civil courts. The Prosecutor's Office notes that, between its office and that of the financial police, as of October 2010 law enforcement agencies had filed criminal cases against 55 construction companies in Kazakhstan. It is estimated that 16,000 residential real estate investors lost KZT 99 billion (or \$670 million). Civil lawsuits are still more numerous. An estimated 85 lawsuits have been filed on behalf of 6,500 real estate investors, with estimated damages of over KZT 40 billion (or \$270 million).

89. The AFN should play an active role in dealing with financial pyramids. In the case of a pyramid that is selling a security without a license, the AFN could use the securities legislation 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. Indeed the financial frauds concerning "shared construction" were Ponzi schemes to solicit funds from the public, promising apartments at half the market price. The pyramid schemes that do not fit clearly into the strict definition of a security are turned over to the Financial Police or Prosecutor's Office to be dealt with as criminal matters. However, the law enforcement bodies are not financial expert agencies, although they are able to call upon experts from the AFN. It would be better if the AFN 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. Criminal referrals to the Financial Police should be made after the AFN has finished its investigation. In addition, the AFN should have the legal authority to freeze assets of the scheme (as can the Financial Police) as needed to protect investors' assets. If a court action is needed before the assets of pyramids can be frozen, the assets will likely be dissipated long before.

90. 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.

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)

91. Disclosure of supervisory arrangements can also help in cracking down on financial frauds. In their advertising, financial institutions should be obliged to state publicly that they are regulated—and to indicate which financial supervisory agency oversees them. In so doing, financial firms separate themselves in their advertising from financial pyramids and other frauds and help consumers decide which institutions are safe and reliable for purposes of entrusting their finances.

92. 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 AFN and the Financial Police 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 a named company is not licensed to provide investments for the public—and care should therefore be taken in any dealings with it. However, careful consideration should be given to designing legislation that avoids overregulation while effectively fighting financial frauds.

Dispute Resolution Mechanisms

93. 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 products or 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. Consumers also need a mechanism that is fast, efficient and cost-effective in addressing their problems.

94. There are no legal requirements for banks, insurance companies or pension funds to establish complaints procedures for effective resolution of complaints and disputes. Although several financial institutions have developed internal procedures to handle consumer complaints, there is no uniform practice in this area. Information on procedures and contact persons within the financial institutions are not necessarily disclosed to consumers when entering into a financial contract. According to consumer associations, financial institutions are generally slow to respond to consumer complaints

95. As a starting point, financial institutions should establish detailed internal procedures to deal with consumer complaints. The professional associations should develop recommendations on complaints' handling procedures for their member institutions. However, in general, all financial institutions should: (1) have a written procedure for handling consumer complaints and include a summary of this procedure in the financial institution's general terms and conditions that are part of any agreement with customers; (2) provide the customer with detailed information of the department or person appointed by the financial institution to deal with any complaints; (3) provide the complainant with a regular written update on the progress of the investigation of his or her 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 financial institution's responses and other relevant documents, including in respect of the action taken to resolve the complaint, whether resolution was achieved and, if so, on what basis; and (8) make these records available for review by the competent authorities.

96. AFN has an active complaints handling process. AFN has a department dedicated to consumer protection in the financial system. AFN has a complaints mechanism whereby consumers can lodge complaints either through letters, e-mail or telephone. AFN investigates the complaint by asking for an explanation from the financial institution and makes a decision on the complaint. It also ensures that the staff carrying out on-site supervision looks into the issues surrounding the complaints. In 2009, AFN received a total of 3,913 complaints (almost twice the number of 2008). 2,083 complaints referred to banks and other credit institutions (See Table 2).

Table 2: Number of complaints received by AFN

Financial Segment	2003	2004	2005	2006	2007	2008	2009
Banking and NBF1	185	234	233	441	866	953	2,083
Insurance	111	205	275	250	253	443	529
Securities	56	89	53	73	315	321	279
Pension Services	371	149	201	250	361	301	344
Other Issues	n.a.	n.a.	n.a.	14	392	135	678
Total	723	677	762	863	2,187	2,153	3,913

Source: AFN

97. In addition, a statutory ombudsman has already been established for compulsory motor third party liability insurance. Although 95 percent of the cases by the ombudsman are determined in favor of the insured, popular perception is that the insurance ombudsman represents—and favors—the insurance industry.

98. Similarly, the draft legislation on financial consumer protection presents an important step forward in providing for a statutory ombudsman for consumers of residential mortgages. Countries such as Germany, United Kingdom and Ireland have found that establishing financial ombudsmen helps build confidence by consumers that any problems with financial institutions can be addressed quickly and efficiently. The work of the ombudsman also helps financial institutions deal with specific consumer complaints. In addition, a financial ombudsman is well-positioned to see trends in financial consumer complaints and propose ways of encouraging improved business practices by financial institutions.

99. Still, a financial ombudsman covering all financial services is needed. As a first step, the work of the banking ombudsman should relate to all banking services and not just residential mortgages. While mortgages may represent a particularly sensitive area, financial consumers are likely to have difficulties in all banking services. Similarly consideration could be given to extending the work of the insurance ombudsman from just motor third-party liability (MTPL) to all insurance services. The post-crisis concept adopted by Presidential Decree in February 2010 envisages the creation (by 2012) of a financial ombudsman to cover all consumer financial services in Kazakhstan. It may be worthwhile to include in the draft financial consumer protection legislation a provision (effective in 2012) to create a financial ombudsman for all financial services.

100. Consideration should also be given to increasing the authority of the ombudsman. International best practice calls for financial ombudsmen to have the authority to take decisions on small amounts of money where the decisions are binding for the financial institution (although the consumer can still take the case to court.) In Germany, for example, the banking ombudsman

can take decisions on cases up to Euro 5,000. For Kazakhstan, it may be useful to set a lower threshold, say KZT 20,000 (or \$1,370). The amount should be set high enough that it covers 90 percent of financial consumer complaints but low enough that financial institutions prefer to pay the penalty than spend the administrative time and trouble dealing with the complaint.

101. As financial products and services that are aimed at consumers continue to expand, the number of complaints is expected to increase dramatically. Based on the experience of other countries (such as the United Kingdom and Ireland) where consumers have confidence that their claims will be resolved quickly and fairly, the number of complaints is expected to increase at least ten-fold.

102. International experience shows that most communications from consumers are inquiries rather than complaints. For example, a study conducted in 2006 in Romania regarding so-called “complaints” regarding financial products and services found that many of them were in fact inquiries. However, both disputes and inquiries provide valuable early warning signals to the institution’s executive management and to the supervisory service regarding possible future problems.

103. In addition, it may be helpful to strengthen the system of consumer organizations. A system of consumer organizations is needed throughout Kazakhstan’s regions to serve low-income, as well as heavily-indebted, households. The number of voluntary organization and consumer protection agencies has dwindled from 100 over in 1991 to four or give today. The National Consumer League is a strong institution with more than 7000 members and 125 institutional members however its outreach is limited to the city of Almaty. Except for the National Consumer League, there are few organizations that focus on financial services. The organizations suffer from lack of membership, funding and collaboration with government, industry and regulators. Most are very small operating with volunteers and fewer than 10 members. One of the associations only had four members. Nevertheless, these grass root organizations are one of the few accessible points for the poor and socially disadvantaged citizens. However one complaint from consumer associations is that AFN does not actively seek and use their input which is based on the need and experience of consumers. Accessing the input of the consumers’ organizations could strengthen AFN’s work in consumer protection.

104. The 2010 Consumer Protection Law provides a useful framework for the creation of active consumer advocacy organizations. Under Article 7 of the Law, consumers have the right to establish public associations of consumers. Article 20 provides that consumers are entitled to join on a voluntary basis in voluntary associations of consumers. Article 41 provides a wide mandate to these associations. They can: (1) make proposals for improving the legislation concerning consumer rights; (2) seek assistance of state agencies to monitor compliance, evaluate goods and services and conduct public polls on quality of goods and services; (3) receive applications and complaints; and (4) address state bodies in order to evaluate the quality of goods and services in the case of income statements and consumer complaints. They can also represent consumer interests in government and in other public associations. Also they can sue in court for the benefit of consumers, including class action; investigate and disseminate information on issues and consumer rights in the media and implement social programs. The new law places a large mandate on voluntary organization and huge expectation in the public. It is hoped that sufficient resources and effective plans are put in place to realize the goals of the new law. The new law when implemented will pave the path for better funding, activities, sustainability of consumer associations and improved consumer protection in Kazakhstan.

Financial Education

105. In the long-run, one of the most effective forms of consumer protection is ensuring high levels of financial literacy. Indeed, development of the market economy followed by the emergence of new financial services has escalated personal liability in financial decisions of Kazakh citizens for the sake of their present and future financial wellbeing. A financially literate consumer is best able to understand own rights and responsibilities, financial disclosures and weigh the risks and rewards of each type of available financial product and service. Strengthening financial literacy requires a long-term investment in financial education.

106. The Regional Financial Centre of Almaty (RFCA) is the leading institution promoting financial literacy in Kazakhstan. RFCA was established as the administrator of the Program on enhancement of investment culture and financial literacy in September 2008. Its mandate on financial literacy has been extended till 2011. Among other things, its program objectives are to create a public system of informing citizens of the possibilities of using various financial instruments and services, educate the public on managing personal budget, and inform the public on proper use of financial products and services existing in the market and on how to assess the risk associated with them. RFCA currently runs centers for information and education in 16 provinces, open to the public. Nearly 280,000 people all over the country have interacted with these centers. RFCA also runs a free hot line to answer consumers' inquiries on financial services. Its website (www.fingramota.kz) provides an interactive learning platform to the public on the use of financial instruments and personal budgeting.

107. AFN has also undertaken several initiatives to improve financial literacy in Kazakhstan. AFN is an active supporter of the 2007-2011 Program for increasing the investment culture and financial literacy of the population. Under this program, AFN has undertaken activities measures such as posting articles in mass media (e.g. AFN's website, newspapers and magazines), participating in TV programmes, organizing training courses, participating in conferences and seminars. In addition, AFN places on its website information containing key indicators of activities of financial institutions, statistics on complaints received by financial institutions, as well as applied sanctions. AFN has also published brochures on financial products and services, and concepts like the APR. Unfortunately, consumers complained that the brochures were too legalistic and asked consumer associations for help to understand the contents of the brochures. AFN has worked closely with RFCA in several financial literacy initiatives, but there is little evidence of collaboration between AFN and consumer associations.

108. The National Consumer League collaborates with the business community, mass media and other associations to carry out consumer awareness programs including weekly financial seminars at \$20. About 12-15 people attend the program weekly. The association also provides telephone lines in public places for consumers to seek information and assistance. There is a weekly program for seven minutes on the State TV channel that deals with consumer issues including financial services.

109. It may be helpful to find ways to coordinate the initiatives of government entities, consumer associations and private institutions. For example, an umbrella-type organization could receive information from all the existing initiatives and make the information available to

the public. Such an umbrella organization would help encourage synergies in the individual programs prepared by different organizations and dissemination of best practices. Consumers would benefit from having access to a single source of reliable, comprehensive and clear information, which is especially designed to address their needs. Gateways are needed to a wide range of information resources: consumer protection legislation and regulation, educational materials, training courses, counseling and advice, comparative tables of the costs of financial products and services, and financial planning tools, etc.

110. For designing financial education policies and programs, 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 needed by a well-equipped and prepared consumer. According to this framework, a consumer with advanced capabilities should: (1) know about the different sources of generic financial advice, including financial advisers; (2) know about the different sources of advice and the differences between generic and personal advice; (3) be able to assess and compare different sources of financial advice and information; (4) understand there are different rights and responsibilities in relation to different financial products and services; and (5) understand how to identify if it is appropriate to comment or complain and be able to access the complaint procedures.¹³ A similar learning framework is needed for Kazakhstan. 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 Kazakh context, considering legislation and regulations, level of financial deepening, general culture of consumption and tradition of dealing with personal finance, etc.

111. Financial education programs should be based on life-cycle planning approach. Evidence from current international experience shows that rigid academic educational programs aimed at providing audiences with fundamental knowledge about financial products and services and institutions are less efficient in affecting actual behavior of consumers than programs designed in the context of the human life cycle. People are more responsive to education which directly addresses the issues they face in the 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.

112. Financial literacy programs should be differentiated between those that provide broad financial education and those that give targeted consumer information. Broadly-based financial education, delivered through the educational system gives individuals the essential life-skills to understand the need for personal long-term financial planning and risk-reward trade-offs. 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 products and 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 an adequate level of functional financial literacy of Kazakh consumers.

¹³ The Basic Skills Agency and the Financial Services Authority, *Adult Financial Capability Framework*, Second Edition, March 2006.

113. Financial education programs should be designed and delivered by professional educators (e.g. university and school staff), as well as 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 will necessarily vary depending on the type and topic of the educational program. A major role of educators would be to ensure appropriate design and quality of instruction, while financial sector experts would contribute their knowledge of recent legislation, financial products and services, general trends of the financial marketplace, and so on. Therefore, educators are likely to play a greater role in programs for audiences seeking to improve their general financial competences and for future consumers (i.e. the youth of Kazakhstan). At the same time, financial sector technical experts will likely be best at leading programs for individuals who seek advice regarding particular personal finance-related products or services.

114. Schools provide a natural entry point for financial education, but expectations of the actual impact of these programs should be modest.

Some years ago financial education was introduced in the school curriculum for tertiary education. In addition the 2010 Consumer Protection Act requires that consumer protection be included in the school curriculum. General schools should equip boys and girls with basic financial knowledge and skills so as to prepare them for future activities in the financial marketplace. Basic principles of course-of-life planning and financial literacy (such as personal budgeting, consumer credit as a form of debt, risk-return tradeoffs, etc.) along with understanding of basic financial services (such as current and savings accounts, credit cards and personal loans) 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 secondary schools. However,

115. capacity of the education sector in the area of financial literacy development shall also be evaluated. Initiatives that identify efficient ways to provide financial education in schools should be supported.

Surveys and Evaluation

116. Evaluation of the effectiveness of financial education programs is needed.

International experience in financial education demonstrates that increasing the number of financial education programs and initiatives does not automatically lead to increases in the level of financial literacy or positive change in the behavior of consumers who have participated in these programs. It is important to introduce the practice of evaluating the results of educational programs so as to identify the ones that are most beneficial. Controlled trials provide an effective means 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 most beneficial should receive wide support and be widely publicized.

117. Testing and surveys are critical tools in the evaluation of financial education programs and consumer protection initiatives.

It is important that a well designed broad-based nationwide household survey on financial literacy be undertaken every 3-5 years to measure the impact of financial literacy initiatives and evaluate whether financial education programs and consumer protection initiatives are working—or need to be revised further.

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ANNEX I: LEGAL AND INSTITUTIONAL FRAMEWORK

LEGAL FRAMEWORK

The legal system of Kazakhstan owes its origin to the Continental (Roman-German) legal family. The Constitution, respective normative legal acts, international treaties, as well as the normative resolutions of the Constitutional Council, and Supreme Court of Kazakhstan constitute the law in Kazakhstan. The international treaties ratified by Kazakhstan generally have priority over its laws and, such treaties can either apply directly or automatically, or, after the adoption of a law where the treaty itself provides that, for its application, a law must be adopted. Kazakh legislation is codified. A strict hierarchy of the sources of law includes the Constitution at the top, constitutional norms and laws, codes and ordinary laws and other state obligations, normative decrees. A new Constitution was adopted by 1995, placing the judiciary under the president and the executive branch. The Constitution establishes a seven-member Constitutional Council to determine the constitutionality of laws adopted by the legislature. It also rules on challenges to elections and referendums and interprets the constitution. The president appoints three of its members, including the chair.

General Laws

Constitution of the Republic of Kazakhstan

Civil Code of Kazakhstan

Administrative Code of Kazakhstan

Law on State Regulation and Supervision of Financial Markets and Financial Organizations (Law No. 474 –July 4, 2003)

Law on Consumer Protection (Law No. 274 –August, 2010)

Law on Advertising (Law No. 508-II –December 19, 2003)

Law concerning Competition and Restriction of Monopoly Activities (Law No. 144 - January 19, 2001)

Law on Private Entrepreneurial Activity (Law No. 124-III –January 31, 2006)

Informatization Law (Law No. 217-III – January 11, 2007)

Law on Counteracting Legalization (Laundering) of Ill-gotten Proceeds and Terrorist Financing (September 2009)

Banking

Law on Banks and Banking Activity (Law No. 2444 –August 31, 1995)

Law on Loan Offices and Credit History (Law No. 573 –July 6, 2004)

Law on amendments to some legislative acts on matters of the enhancement of legislation on payments and money transfers, accounting and financial reporting of financial organizations, banking activity, and activity of the National Bank ” (2009 Amendments)

Law on introducing amendments and addenda to some legislative acts on mortgage lending and consumer protection, financial services and investment (Draft Law/2010)

Law on the Obligatory Insurance of Deposits placed in the Second Tier Banks (Law No. XXX/2006)

Rules of calculating interest rates when spreading information about values of interest for financial services (Resolution No. 215 – September 23, 2006)

Securities

Law on Securities Market (Law No. 461-II –July 2, 2003)
 Law on Investment Funds (Law No. 576-II –July 7, 2004)
 Law on Joint-Stock Companies (Law No. 415-II –May 13, 2003)
 Rules on Performing Broker-dealers Activities in the Securities Market (AFN Resolution No. 317 –August 27, 2005)
 Regulation and Supervision of Financial Market and Financial Institutions including risk management rules (AFN Resolution No. 209 –September 26, 2009).
 Regulation on investment portfolio management operations (NBK Resolution No. 137 –April 21, 2003)

Insurance

Civil Code (Articles on insurance)
 Law on Insurance Activities (Law No. 126 of 18th December 2000)
 Law on Mandatory Insurance of Civil Liability of Third Party Motor Vehicles (Law No. 444 – July 1, 2003)
 Law on Mutual Insurance (Law No. 164 –July 5, 2006)
 Law on Joint Stock Companies (Law No. 415-II –May 13, 2003)
 Law on Accounting and Financial Reporting (Law No. 235 –Feb 28, 2007)
 Law on Licensing and Consolidated Supervision (Law No. 222 –Jan 12, 2007)
 Law on the Fund of Guaranteed Insurance Benefit (Law No. 423-June 3, 2003)
 Law on Obligatory type of Insurance (Law No. 244 –May 7, 2007)
 Regulation on Activity of Insurance Ombudsman (AFN Resolution –August 23, 2007)

Private Pensions

Law on Pensions System (Law 136-I –June 20, 1997)
 Regulation on the operation of the insurance annuity for pensions (NBK Resolution No. 249 – July 25, 2003)
 Regulation on the rules for transferring pension savings from accumulation pension funds (AFN Resolution 240 –December 28, 2009)
 Regulation on maintaining records of the pension accruals on the individual pension account of depositors in pension funds (AFN Resolution 153 –June 12, 2004)
 Regulation on carrying out activities of investment management of pensions assets and pensions savings funds (Decree AFN No. 189 –August 5, 2009)
 Regulation on charter capital of pension funds (NBK Decree No. 96 –March 21, 2003)
 Regulation on issuance of the consent to state registration of the pensions saving fund (AFN Decree No. 123 –April 30, 2007)
 Regulation on carrying out pensions payments from pension savings (AFN Decree No. 661 –July 4, 2003)

INSTITUTIONAL FRAMEWORK

The **Agency on Regulation and Supervision of Financial Market and Financial Organizations (AFN)** is the main regulator of the financial services including banking, securities, insurance and accumulation pensions fund sector. Its supervisory objectives are broadly "to ensure financial stability of the financial market and financial organizations, and

maintain confidence in the financial system in general; to ensure appropriate level of protection of interests of financial services consumers; and to level off the field for operations of financial organizations with the aim to maintain bona-fide competition in the financial market.” The Consumer Protection Department of the AFN is responsible for implementing, collecting, analyzing and dealing with complaints from users of financial services and products

The **Agency for Competition Protection (ACP)** oversees the Law on Competition, which identifies the violation of consumers’ rights as a source of unfair competition. In addition, ACP monitors business practices by financial institutions, especially those related to advertising of financial services. For the new Law on Consumer Protection (Law No 274 of 2010), ACP is expected to be assigned the role of enforcement agency for competition purposes, although the Consumer Protection Law specifically exempts financial services from the scope of the legislation.

The **Regional Financial Centre of Almaty (RFCA)** is an agency set up by statute to promote financial literacy in Kazakhstan. Since September 2008, RFCA is the administrator of the Program on enhancement of investment culture and financial literacy. Its mandate on financial literacy has been extended till 2011.

The **Financial Institutions’ Association of Kazakhstan (FIAK)** was established in May 1999 in accordance with Congress I Resolution of Kazakhstan Financiers. The founders of FIAK are the five largest second-tier banks and one leading insurer. The funding sources of FIAK include the founders’ contributions, admission and calendar membership fees and sponsor support.

Kazakhstan First Credit Bureau is a private company owned largely by banks (81.6%) and started operation in 2004. All banks are members of the bureau and non banks are also members.

The **Kazakhstan Stock Exchange (KASE)** was established in 1993 and is now a demutualized stock exchange that operates an organized market for foreign currency, government securities, corporate bonds and shares and derivatives. Although KASE has substantial trade volume, most of the trade volume is in repos and foreign exchange. Securities market activity is dominated by debt issuances, mainly government and banking securities.

The **National Consumer League of Kazakhstan** is uniquely a strong institution with more than 7000 members and 125 institutional members. It collaborates closely with the business community and carries out activities to improve awareness and literacy amongst consumers.

The **Ministry of Labor and Social Protection** oversees the policy framework of pensions in Kazakhstan, the public pensions system and the operations of the SPPC. The Ministry has two departments operating for protection of pensioners: the Department of Social Provision and Social Insurance and the Department of Social Assistance and Social Services Provision.

The **court system** is a three-tier system composed of **regional courts, district courts and the Supreme Court** as the highest judicial body. The regional courts are of common jurisdiction and try most cases in the first instance. The judgments of regional courts may be appealed to the district courts, while decisions of district courts may be appealed to the Supreme Court. There are also specialized courts including the recently created economic courts. Cases that are in the competence of the specialized courts are judged in the first instance in the relevant specialized court.

ANNEX II: LIST OF RECOMMENDATIONS

BANKING SECTOR

Short-term

- Establish and expand the scope of Ombudsman under AFN's proposed law to all banking matters.
- AFN needs to take steps to reduce high fees and charges in the banking system through improved competition by studying the dynamics of the market and behavior of banks and also learning from other regulators.
- AFN ought to require FIAK to play a more relevant role in consumer literacy.
- AFN needs to introduce cooling off period even if it is 3 or 5 working days in the beginning especially for mortgages and other financial contracts that have long term impact on the financial standing of customers.
- FIAK needs to start work on Code of Conduct and standard terms and glossary and issues them soonest possible.
- Improve collaboration of industry, regulator with civil society and mass media in the delivery of financial information and consumer literacy.
- Credit bureau ought to enable verification of information on line.

Long Term

- AFN ought to devise a long term plan on its mandate on consumer protection with a view of getting the industry participants to play more active proactive roles.
- AFN needs to compile and analyze legal action brought against banks to fully understand the impact of the court as a credible institution to uphold consumer rights.
- AFN needs to also look into the disclosure, sales practices, affordability test and customer account and handling procedures used by banks with a view of protecting, in particular unsophisticated consumers.
- Improve AFN's capacity to handle consumer protection through exchange program and additional resources.
- FIAK should take the following steps to improve the banking practices in the country and consumer confidence so that consumer protection can be driven by the market instead of regulatory directives:
 - Have standardized rules on in-house redressal or complaints mechanism and ensure disclosure and publication of the procedures on the website of banks.
 - Carry out concerted effort on consumer protection, participate with voluntary organizations and consumer protection associations in financial literacy activity, accredit or carry out certification of specialized skills, provide information to consumers on financial products or services to customers.
 - Adopt a voluntary code of conduct and publish it on its website
 - Provide comprehensive information on its website that that helps or promotes consumer literacy on financial products and services.
 - Establish permanent working groups or committees on banking, capital markets, insurance and pension.

- Take steps to improve the banking practices of its members.
- Issue brochures and educational material in addition to the information on their website.
- Improve level of skills in the banking industry through a banking institute
- RFCA ought to in the long run shift the duty and responsibility of educating and building consumer confidence in financial institutions from government to private sector.
- RFCA needs to carry out impact assessment of the training and outreach activities to better align resources to achieve the goals of better informed consumers.
- Competition Authority must monitor the banking sector closely and encourage better competition in the industry. It needs to also publish the assessment it carries out of the banking system and its practices including the evaluation of the fees and charges.
- State funding ought to be provided to consumer protection associations to improve their scope, outreach and sustainability.

SECURITIES SECTOR

Short-term

- A financial ombudsman should be set up to provide a speedy, efficient and cost effective avenue for dispute resolution between the securities intermediaries and their customers. To ensure a high level of accountability and transparency, the ombudsman should be obliged to publish an annual report describing decisions taken by the ombudsman so that investors can identify the nature of the disputes referred to the ombudsman and assess the results of the ombudsman's actions.
- The law should be reviewed to introduce more detailed regulations to standardize the rights and duties of the securities brokers and investors across the industry. In addition, there should be more specific provisions in the regulatory framework relating to account transfers or the procedures for closing an account.
- A standard industry-wide examination for determining the competency of individual sales persons in the securities industry should be required. In this regard, a “tiered” approach towards accreditation may be considered where different levels of complexity of financial products are required for different products.
- A KYC rule should be required for the securities industry.
- A suitability rule that establishes the due diligence responsibility of the securities intermediary should be required.
- More detailed sales practice rules should be required for the securities industry as the current law appears to contain mostly general provisions relating to misrepresentation and misleading advertisements.
- The law should be reviewed to require more detailed requirements on the contents of the contract note on an industry-wide basis for securities.
- The law should be reviewed to require more specific regulations on the procedure for contesting the accuracy of statements by the client of the securities intermediary.
- The law should be reviewed to introduce clear provisions that require broker/dealers and management companies to immediately pay the customers any cash balances in their accounts and proceeds from sales when the payment is received by them.

Long Term

- A principles-based code of conduct should be developed for all participants in the securities industry and adopted by all industry participants. The code of conduct should be published and be part of the application form that is provided to investors. The FIAK should monitor its compliance by broker-dealers and impose fines in case of violations to the code of conduct. Consumer associations should also be encouraged to monitor the compliance with the code and highlight cases where insurers fail to comply.
- Increased involvement of consumer organizations should be encouraged by providing them funding and resources, and by AFN engaging with them in its policy formulation responsibilities.
- As activities by unauthorized entities such as investment scams and unauthorized pyramid schemes can pose a serious threat to investor confidence in the capital market, the AFN should play a key role in alerting investors to illegal or fraudulent investment products. One useful approach would be to set up a “Consumer Affairs” section on the home page of its website that links to investor alerts, thus making it easy for investors (and their advocates) to identify possible scams and schemes from unauthorized entities —with regular distribution of press releases to the media. In addition, the law should be reviewed to empower the AFN to freeze assets of unauthorized activities that fall within its mandate so as to be able to prevent the dissipation of investors’ assets.
- The AFN should educate other governmental agencies and investors as to its functions and responsibilities so that investors are clear as to whom they should send their complaints particularly in regard to fraudulent investment schemes and pyramid schemes. In this regard, a high level coordinating committee between relevant agencies and AFN would be useful to ensure effective enforcement against investment scams and illegal pyramid schemes.
- The AFN should specifically require that securities intermediaries provide information to their clients on how to seek a remedy, including redress, for problems arising out of interactions with the securities intermediaries. For example, the websites of such intermediaries should have clearly identified portals for customer complaints and the intermediaries should also be required to prepare an annual report of compliance with their dispute-resolution policy.
- The FIAK should carry out concerted effort on consumer protection, participate with other voluntary organizations in financial literacy activities; accredit or carry out certification of specialized skills and provide information to consumers on financial products or services.
- A coordination mechanism should be set up between the Competitions Authority and the AFN to ensure effective enforcement against mis-selling of financial products and misleading advertisements by entities not supervised by the AFN. In addition, more capacity within AFN should be built to closely monitor advertising by securities intermediaries for securities products to ensure that they are not misleading or untrue.
- The media and the industry associations should be encouraged to promote consumer awareness of issues relating to consumer protection.
- A broad-based survey should be undertaken to measure the effectiveness of financial education and awareness initiatives in the financial sector.

INSURANCE SECTOR

Short Term

- Establish specific provisions in the law that governs all insurance contracts which deals with consumer protection issues in a comprehensive manner. This would include the need to ensure that insurance contracts are presented to the consumer in plain language and mandating disclosures that are clear, accurate and comprehensive about products and services that customers are purchasing and with whom the consumers are entering into contract with, before the consumer makes a decision to conclude an insurance contract.
- The law should be reviewed to require credit providers to inform consumers about their right to freely choose any insurance product. This could be done in the form of an acknowledgment statement that has the consumer's signature. More disclosures should be required including the relationship between the bank or credit provider and the selected insurance provider; the benefits which the bank or credit provider will derive from the arrangement and a comparison of the costs to the consumer with the costs of a number of other alternatives. In addition, tariffs on credit insurance should be presented to customers of standard loan types.
- More explicit requirements should be imposed on insurance companies to disclose commissions to the customer for non-mandatory insurance policies.
- A "KYC" rule should be incorporated into the regulatory framework.
- A cooling-off period should be introduced especially in respect of voluntary insurance products such as investment-style life insurance products so that consumers would have an opportunity to rethink their decisions in the face of high-pressure sales tactics. Typically these apply for up to 14 days after the contract becomes effective or a shorter period after the insurance contract is sent out (note – this need to be verified and recommendation to be removed if the cooling off regulatory requirement can be identified).
- The insurance industry working with the FIAK should develop key facts statements in plain language for each class of life and non-life insurance products and agree on the content of the Key facts statements with the AFN. Insurance companies, brokers and agents should ensure that a key facts statement forms part of the information that is given to applicants when an offer of insurance is made and when insurance contracts are finalized.
- The regulatory framework should be reviewed to require an insurance company to provide information to their clients at the point of sale on how to seek a remedy, including redress, for problems arising out of interactions with the agents or insurance company. In addition, the website of such insurance company should have clearly identified portals for customer complaints.
- Greater publicity should be given to the Ombudsman for compulsory insurance for civil liability for vehicle owners as it is a cost-effective, speedy and effective dispute resolution. The ombudsman system should be extended to all other types of insurance products in the insurance sector.

Long Term

- A principles-based code of conduct be developed for all participants in the insurance industry and adopted by all industry participants. The code of conduct should be published and be part of the application form that is provided to consumers. The FIAK should monitor its compliance by insurance companies and impose fines in case of violations to the code of conduct. Consumer associations should also be encouraged to monitor the compliance with the code and highlight cases where insurers fail to comply.
- More capacity within AFN should be built to closely monitor advertising by insurance companies for insurance products to ensure that they are not misleading or untrue. In addition, there should be regulatory limits on investment returns used in life insurance value

projections for advertising and sales materials. More should be done in utilizing ongoing market intelligence at a local level to monitor market practices of agents and insurance companies.

- More specific guidance can be provided by AFN in the form of policy explanatory notes to the insurance industry on what may constitute legitimate advertising by insurance companies and what is meant by the “unreliable and misleading” advertisement rule.
- The law should make it explicit that insurers must be legally responsible for all statements that are made in marketing and sales materials
- The AFN should consider requiring insurance companies to provide simplified financial statements that will allow consumers without a technical background to make assessments about the financial viability of insurance companies.
- The law should be reviewed to specify that for savings-type life insurance policies, policy holders should be entitled to receive statements of value at least annually. The Law should be reviewed to ensure that insurers are required to notify insured persons about the need to renew policies that are due to expire and to provide a renewal notice to that effect.
- Increased involvement of consumer organizations should be encouraged by providing them funding and resources and engagement with them by the AFN in its policy formulation responsibilities. Consumer organizations should be strongly encouraged and supported by the Government and the competent authority for consumer protection to deliver financial education awareness programs throughout Kazakhstan.
- A follow-up survey assessment should be conducted to better identify the segment of the population that require particular attention, measuring the effectiveness of financial education and determine education needs.

PENSIONS SECTOR

Short Term

- Sales and business practices of APFs and pension fund managers should also be strengthened. Agents should be appropriately trained if they are selling individual voluntary pension products. As the pensions services market develops in Kazakhstan that make demand for different levels of skills and competence, a standard industry-wide examination for determining the competency of individual sales persons should be required.
- The pension fund industry working with the AFN should develop key facts statements in plain language and agree on the content of the Key facts statements. The key facts statement should be a one- or two-page simple document that is made available to contributors when they are considering entering into a contract, and which will also allow prospective contributors to compare different offers more easily.
- There should be a reasonable cooling-off period associated with any traditional investment or long term life savings contract, after the policy information is delivered, to deal with possible high pressure selling and mis-selling. Consumers should be able to easily compare offers by different APFs and pension fund managers.
- A KYC rule should be required for the pension fund industry.
- A financial ombudsman similar to the ombudsman structure in the insurance industry for mandatory motor vehicle insurance should be considered.

Long Term

- A code of conduct should be developed for providers of third pillar pension products.

- The laws should provide specifically that the provider is legally responsible for the information that it provides to consumers in its marketing and sales materials rather than rely on the broad risk management policy issued by AFN that holds the management of the APFs and pension fund managers responsible for the conduct of their agents/employees.
- More capacity within AFN should be built to closely monitor advertising by the aforementioned entities to ensure that they are not misleading or untrue.
- The content should be prescribed in regard to disclosures that must be made to the contributor regarding the status of his pension savings.
- The AFN should have explicit requirements for APFs and IMPAs to establish complaints handling. In addition, the AFN should specifically require that APF and IMPA provide information to their clients on how to seek a remedy, including redress, for problems arising out of interactions with the agents or APF and IMPA. For example, the websites of such companies should have clearly identified portals for customer complaints and these companies should also be required to prepare an annual report of compliance with their complaints handling policy to be publicized on its website.
- Financial education should be a prioritized in pensions. Total privately managed assets in the voluntary pension sector are still modest but they have the potential to grow rapidly if the population is properly educated. The education should include information regarding the risks and reward available and clear understanding that voluntary pension fund products are an investment tool rather than a guaranteed savings vehicle.
- There is a need to ensure voluntary consumer protection organizations are more effective in the financial sector including the pension's services sector particularly in providing them with sufficient resources and funding. There may be scope to encourage, one, or several of the current organizations to specialize in financial issues in recognition of the fact that this is a highly specialized field of activity.