

SLOVAKIA

Technical Note on Consumer Protection in Financial Services

Volume I Main Report

July 2007



THE WORLD BANK

Private and Financial Sector Development Department
Europe and Central Asia Region
Washington, DC

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This Technical Note is a product of the staff of the International Bank for Reconstruction and Development/ The World Bank. The findings, interpretations, and conclusions expressed herein do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent.

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Abbreviations

AOSP	Association of Installment Sales Companies
APR	Annual Percentage Rate of Charge
BSE	Bratislava Stock Exchange
DPF	Deposit Protection Fund
ESIS	European Standardized Information Sheet
EC	European Commission
EU	European Union
NAV	Net Asset Value
NBS	National Bank of Slovakia
OECD	Organisation for Economic Co-operation and Development
OPDP	Office for Personal Data Protection
PFMC	Pension Fund Management Company
SBA	Slovak Bank Association
SPAMC	Specialized Pension Asset Management Company
SRO	Self-Regulatory Organization
STI	Slovak Trade Inspectorate Office

\$1 = 25.393 SKK (End May 2007)

Foreword

Consumer protection in financial services lies at the heart of 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. Consumers should have access to recourse mechanisms that are efficient and cost-effective. And consumers should have the right to education that allows them to become financially literate so that they can make informed decisions.

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

We are pleased to provide this pilot Technical Note on Consumer Protection in Financial Services in Slovakia and we would like to thank the Slovak authorities for their valuable cooperation and collaboration in the preparation of the report. The report not only looks at financial services in Slovakia but also attempts to develop an initial set of good practices or benchmarks that can be used in reviewing consumer protection in financial services. This program is expected to be helpful to the international community as well as those in the European Union who are looking to establish common ground for minimum good practices in financial consumer protection.

Acknowledgments

This review was prepared by a team led by Sue Rutledge (Regional Corporate Governance Coordinator and Senior Private Sector Development Specialist). The project team consisted of Rodney Lester (Senior Adviser), Nagavalli Annamalai (Lead Counsel), Richard Symonds (Senior Counsel) and Greg Brunner. All are officials of the World Bank.

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Executive Summary

As financial markets develop and deepen, one of the key issues for a fair, open and efficient market is effective consumer protection in financial services. Financial consumers should have: (1) access to sufficient information to make informed decisions about their financial choices, (2) recourse to cost-effective mechanisms to resolve any dispute and (3) available programs of consumer education and financial literacy to assist them in understanding their financial rights and obligations.

Protection of financial consumers is part of the objective of the European Union (EU) in developing a single market for financial services, as well as part of the Slovak Government's agenda. With 27 different types of national consumer protection frameworks, financial service providers are obliged to work with panoply of national regulations for retail financial services. As a result, few cross-border financial services are sold. A background study prepared for the European Commission (EC) found that 26 percent of European consumers purchased financial services from a national "distance" provider by telephone or through the internet in 2006. However, only one percent purchased financial services on a cross-border basis. The need to strengthen financial consumer protection was also highlighted in the EU's Green Paper on Retail Financial Services in a Single Market released in April 2007.

Despite a strong framework for the financial sector, consumer protection in Slovakia is not as effective as it should be. The EC's Eurobarometer surveys found that consumer protection in financial services in Slovakia is generally more robust than in the other nine 2004 New Member States, but not as strong as in the other EU-15 countries. For the Technical Note, a detailed analysis was conducted of five parts of the financial sector—banking, commercial credit, securities, insurance, and private pensions. The Note found that although financial consumer protection was relatively strong, it could be further improved throughout the financial sector. However, particular weaknesses lie with the consumer finance companies that are subject to the commercial credit legislation but receive little effective oversight from the government supervisory agencies. The sector consists of over 70 consumer finance companies, some of which specialize in installment finance of large consumer items (such as appliances) at high but reasonable interest rates while others provide unsecured personal credit at rates as high as 200 percent per annum. Other abusive marketing and collection practices are also seen, particularly in the small commercial credit companies. The issue of high interest rates particularly affects low-income households living outside of major urban areas. Such families pay proportionately more of their income in debt service than do other parts of the Slovak population and generally have lower levels of financial literacy than other parts of the society.

All providers of financial services in Slovakia should be licensed. All corporations that provide consumer credit, including commercial credit companies, should be subject to specific authorization. A minimum level of supervision would require that basic information on the companies be made available to the public, including annual audited financial statements, the names of the key directors and the beneficial owners of the companies. Licensing of commercial credit companies will also help the public differentiate between legitimate providers of consumer finance and those that operate illegally.

It would be preferable if supervision of commercial credit companies were conducted by the National Bank of Slovakia (NBS) rather than a separate agency. Since the NBS is an integrated supervisory agency for the financial sector, an efficient use of resources in a small country such as Slovakia suggests that all financial supervision should be conducted by one agency. However this does pose some challenges. Consumer finance companies should be

supervised on the basis of market conduct rather than on the basis of prudential regulations. Combining the two responsibilities in one organization can create some conflicts of interest. However the experience of countries, such as Ireland, which uses a combined financial regulator indicates that the benefits of information gained from consumer protection supervision exceed the issues created by the conflicts of interest.

The law should prohibit abusive and deceptive practices and require minimum information for consumers. The Slovak legislation should explicitly prohibit abusive and deceptive practices related to all investment services, including selling of loans and investments and collection of past-due debts. A standardized form of "key facts" for all financial services would give retail consumers the information they need to compare one financial product to another, as will be required under the EC's proposed Directives for the financial sector. The standard information should also disclose any risks, including the possible loss of personal housing in the event of non-payment of loans or the possible increase in the loan amounts in credits which have been extended in foreign currencies. Standard assumptions need also to be set to ensure that all sellers of loans calculate the Annual Percentage Rate (APR) in the same way. Sellers of loans and investment products should also be obliged to ensure that the products are suitable for the purchaser, based on his/her age, financial experience and savings goals.

A tiered system for training and qualifications for sellers of financial products would be helpful. Those who sell simple products such as bank savings accounts need only limited training that could be provided by the financial institution itself. However, those who distribute complex financial products such as life insurance and private pensions should be obliged to have extensive training conducted under the aegis of the supervisory agency. Such sellers should also be obliged to meet high levels of business integrity and follow a strict code of ethics.

The mechanisms for dispute resolution should also be strengthened. All financial institutions should be required to maintain in-house dispute resolution departments, or internal ombudsmen. A central registry should also be established for all customer complaints from the financial sector with published statistics on the number and type of complaints and the eventual resolution of the complaints. The registry could be maintained by a consumer protection department within the NBS, or a separate institution. In addition, a financial sector ombudsman should be created to settle disputes that have not been resolved by the financial institutions themselves. The services of the financial ombudsman should be available to consumers at no charge in order to encourage presentation of customer complaints. Also, to encourage transparency by the ombudsman, the office should be obliged to publish an annual report of its activities. In addition, the industry association should develop sector-specific codes of conduct and be prepared to negotiate with member institutions when needed to resolve cases of unfairness.

Consumer protection and programs of financial literacy should also be improved. The ultimate tool in favor of financial consumer protection lies with a well-educated financial public. To increase awareness of consumers' financial rights and obligations, banks and other financial institutions should be encouraged to develop programs to teach consumers how to manage their money and invest wisely. The NBS should also open a consumer affairs webpage on its website and periodically issue consumer alerts, when unlicensed firms are known to provide financial services in the Slovak market. In addition, a special consumer protection institute should be established to focus on financial consumers with surveys and financial IQ quizzes to determine the level of financial literacy among the public. Consumer protection organizations should also play a key role in highlighting abusive financial practices. In addition the national education system should provide financial training for students.

Introduction

As financial markets develop and deepen, one of the key issues for the fair, open and efficient operation of the markets is the protection of consumers' rights in financial services. Be they bank depositors or borrowers or investors in insurance policies, securities or investment or pension funds, financial consumers need the ability to accurately understand the terms and conditions of their contracts—and take action if the terms of contracts have been violated.

The Note is the second report in a pilot program to analyze consumer protection in financial services.¹ The objectives of the Note are three-fold, to: (1) present a set of draft good practices for assessing consumer protection in financial services; (2) conduct a review of the existing rules and practices in Slovakia compared to the draft practices; and (3) provide recommendations on ways to improve consumer protection in financial services in Slovakia. The Technical Note was prepared at the request of the Slovak Ministry of Finance, with the valuable support of the National Bank of Slovakia and other government agencies, ministries, and non-government organizations.² In the past the World Bank has also prepared governance reviews of the Slovak financial sector for banking and private pension funds.

Few guidelines are available for consumer protection in financial services. Consumer protection in financial services remains a new and developing area for which no consensus has developed on the broad parameters against which a specific country might be analyzed. This Note relied on the EU Directives related to consumer protection and the reports of European financial regulatory and supervisory agencies. Other sources were also used. In the United States, the Federal Trade Commission, the Securities and Exchange Commission and other state, federal and self-regulatory agencies have developed laws, rules and guidelines to protect financial consumers. In addition, the 2003 OECD Guidelines for Protecting Consumers from Fraudulent and Deceptive Commercial Practices across Borders and the 1999 United Nations Guidelines for Consumer Protection served as useful reference points for general consumer protection not related to the financial sector.

The recommendations in the Note go beyond the provisions of the EU Directives currently in force. As described in the EU Consumer Protection strategy announced in March 2007 and the April 2007 Green Paper on Retail Financial Services, European financial consumers would benefit from stronger legal and institutional protections than are currently in place. Both in Europe and elsewhere, contemporary thinking on consumer protection is rapidly evolving. The Technical Note takes into account the international discussion on financial consumer protection and evolving good practices in financial consumer protection. Thus, the Note presents recommendations that are applicable to the Slovak financial sector, but in some cases go beyond the minimum requirements set by EU legislation.

¹ The full set of reports for Slovakia and other countries can be downloaded at www.worldbank.org/. The first report on consumer protection in financial services was prepared for the Czech Republic.

² The mission to Slovakia was conducted February 5-15, 2007 and met with officials from the Ministry of Finance, Ministry of Economy, National Bank of Slovakia, Antimonopoly Office, Trade Inspection Office, Office of the General Prosecutor, Office for Personal Data Protection, Guarantee Deposit Fund and Guarantee Fund of Investments. The mission also spoke with the associations for banking, banking cards, insurance, securities dealers, supplementary pension companies, asset management companies and installment sales companies. In addition, the mission talked to the Bratislava Stock Exchange, Central Securities Depository, Českoslovancká obchodní banka, a.s., Slovenská sporiteľňa, a.s., Allianz Pension Fund Management Company, the Center for Legal Aid and other members of the financial and legal community in Slovakia.

A draft set of good practices was assembled for the Slovakia Note. It was against the good practices that the Slovak legal and regulatory framework—and common practices—for financial consumer protection were reviewed. The assessment is not exhaustive and has not captured all prevailing services, products and practices of the financial sector. Furthermore, the Technical Note remains a “work in progress” and is subject to further revision based on future work done in other countries, as well as international discussion of the Note’s findings and recommendations.

It is hoped that the publication of the Technical Note will help further development in financial consumer protection. In particular, it is hoped that the publication of the draft good practices, and their application in a middle-income country such as Slovakia, will contribute to the international policy dialog on the key components to financial consumer protection—and may assist in the development of benchmarks applicable for consumer protection in financial services.

The Technical Note analyzes five important parts of the Slovak financial sector—banking, consumer credit companies, securities markets participants, insurance companies and private pension funds. For each, the issues have been grouped into seven key areas. They are: (1) consumer protection laws and institutions; (2) disclosure and sales practices; (3) customer account handling and maintenance; (4) privacy and data protection; (5) guarantees and compensation funds; (6) dispute resolution mechanisms; and (7) consumer education and financial literacy.

The Note is presented in two volumes. Volume I presents the importance of consumer protection in financial services, statistics on the size and growth of the retail financial sector in Slovakia, and the key findings and recommendations of the Note. The Annex provides a list of all the recommendations in the Technical Note from both volumes. The recommendations are based on effective practices in economies with strong consumer protection and in some cases, reflect current proposals under preparation by the EC. Volume II provides a detailed analysis of the key consumer protection issues for each of the five sub-sectors —banking, commercial credit companies, insurance, securities and private pensions. Volume II also presents the draft good practices and the assessment of Slovakia compared to the draft practices. It also provides a description of the key EU Directives related to consumer protection in financial services.

Importance of Consumer Protection in Financial Services

Strong consumer protection in financial services is needed to build and maintain public confidence in the financial sector—and encourage borrowers and investors to use financial services. Due to the uneven bargaining position of individual consumers *vis-à-vis* financial institutions, effective consumer protection regimes are needed to ensure that the public has confidence in the financial system and is willing to use it. The participation of retail consumers benefits the financial system by increasing the liquidity of the system, deepening the sector, and increasing the ability of the sector to provide financial intermediation as needed for a modern vibrant economy. Financial inclusion—and broad access to credit—for all households are important objectives for any program on financial consumer protection.

Effective financial consumer protection can also provide a valuable line of defense against possible corrupt behavior in emerging markets. Particularly in transition and developing markets, where government supervision of the financial sector remains insufficiently developed, strong consumer protection regimes can empower consumers by giving them legal rights to clear and transparent information about their accounts with financial institutions. The regimes also provide a cost-effective mechanism for consumers to take action if the financial institution has engaged in deceptive or abusive practices.

Consumer protection is also needed in developed markets. In industrialized countries, abusive retail practices have obliged financial regulators to issue regulations on accurate and full disclosure of consumer fees and charges, particularly for credit cards and collective investment funds. For example, a 2006 study in the US found that of the consumers using alternative financial providers, such as check-cashing centers, 58 percent had either a checking or savings account but preferred not to use either. The main concern of these consumers, who are often low-income earners, is that they cannot trust the system given the lack of transparency in bank fees and their own weak level of education in financial matters. Also in the Czech Republic, the Consumers' Defense Association (SOS) found that when consumers tried to pay off loans earlier than originally planned, the borrowers discovered that their contracts included hidden prepayment penalties equal to 100 percent of the original amount of the loan.

Consumer protection is characterized by light interventions and a focus on supervision of market conduct practices. This stands in contrast to the relatively heavy prudential supervision aimed at guarding the soundness and stability of the financial system. Public confidence may be eroded by unethical market participants when an individual firm attempts to take advantage of the relative ignorance of customers to gain a free ride on the reputation set by ethical firms. Supervision of business conduct practices is needed to prevent such unethical actions. Consumer protection is not without cost but it is a sound investment to build consumer confidence in the financial sector—and thus ensure that the sector plays its full role of financial intermediation.

The focus of consumer protection is on the relationship and interaction between a retail customer and a financial institution (or its agent or other intermediary).³ Distinguishing between unsophisticated retail and highly sophisticated professional customers is important when designing successful consumer protection provisions. Transactions between professional parties are not subject to many of the problems that could harm retail consumers. Furthermore, the constraints needed to protect retail customers often limit the ability of professionals to enter into efficient financial products.

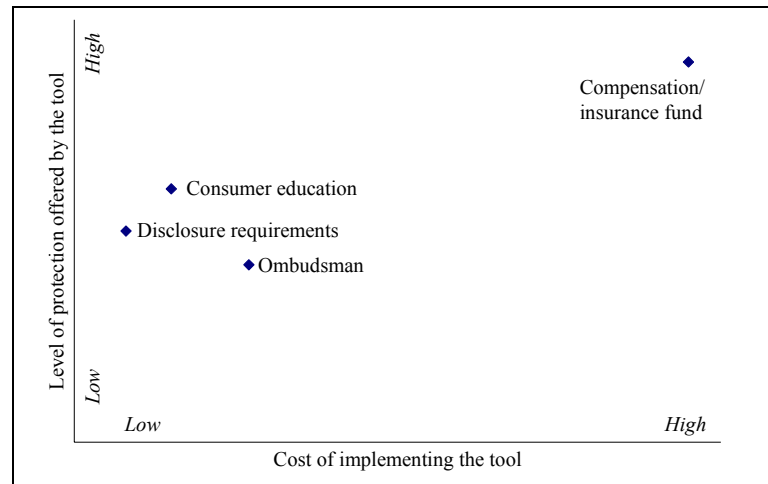
The need for interventions to protect consumer interests arises when the markets for financial services fail to protect retail customers. The academic literature identifies six potential market failures that may affect financial services:

- 1) *Inadequate information for consumers.* Information may be costly or difficult for the individual consumer to obtain.
- 2) *Consumers' inability to assess the quality of financial products.* Complex financial products can be difficult to assess, even when all relevant information is disclosed.
- 3) *Asymmetric information and the "lemon problem."* Consumers recognize that financial institutions understand their products better than they do. Out of fear of poor quality products, some consumers may exit the market.
- 4) *Differing risk appetites in managing accounts.* A financial institution managing an investor's funds has an incentive to take excessive risk since the investor participates in the downside risk but the financial institution enjoys the upside potential.
- 5) *Conflicts of interest.* A financial institution may have an incentive to place an investor's assets in investments that benefit the institution to the detriment of the investor.
- 6) *Need for monitoring of providers.* If supervisory agencies are not active, consumer groups are needed to monitor the quality of financial services provided to the public.

³ The Note uses the definition of retail market employed by the European Commission in its Consumer Policy strategy. That definition is that the retail market covers economic transactions made between economic operators and final consumers (consumers operating outside their professional life). This is sometimes called the business-to-consumer (or B2C) market. Thus, the definition does not include businesses--however small--in their role as purchasers of financial services.

An effective consumer protection framework incorporates numerous tools. Chart 1 provides a summary of the conceptual trade-off between the costs of implementing different consumer protection "tools" versus the benefits to each tool. Note that the chart is meant to illustrate the trade-off between costs and benefits—rather than identify the values for each.

Chart 1: Consumer Protection Tools Offer Different Levels of Protection at Different Costs



Source: World Bank staff

EU and Slovak Strategies on Financial Consumer Protection

No pan-European single market exists for retail financial services. With 27 different types of national consumer protection frameworks, financial service providers are obliged to work with panoply of national regulations for retail financial services. As a result, few cross-border financial services are sold. A background study prepared for the EU Consumer Protection strategy found that 26 percent of European consumers purchased financial services from a national "distance" provider by telephone or through the internet in 2006. However, only one percent purchased financial services on a cross-border basis.⁴ Three types of financial abuses are of concern: (1) incompetent performance, i.e. low quality of services; (2) misinformation or overselling, i.e. sale of inappropriate financial products due to low financial literacy by consumers or misinformation or abusive selling practices by providers; and (3) rogue traders, i.e. abuse and outright fraud by financial service providers.

The EU Consumer Policy strategy 2007-2013⁵ will strengthen consumer protection in financial services. The strategy has three objectives, to: (1) empower consumers by ensuring that they have real choices, accurate information, market transparency, and the confidence that comes from effective protection and solid rights; (2) enhance consumers' welfare regarding price, choice, quality, diversity, affordability and safety of products; and (3) protect consumers from the serious risks and threats that they cannot tackle as individuals. Key steps for the implementation of the strategy include the development of benchmarks for national consumer policies, including consumer policy for the financial sector. The program would involve the collection of service quality data and complaint statistics.

⁴ See Special Eurobarometer No. 252 *Consumer protection in the Internal Market*, available at http://ec.europa.eu/consumers/topics/eurobarometer_09-2006_en.pdf

⁵ See *EU Consumer Policy strategy 2007-2013* COM (2007) 99 final. A copy is available at http://ec.europa.eu/consumers/overview/cons_policy/EN%2099.pdf

The EC is also revising its consumer credit legislation and establishing a consultative group. The Commission plans to revise the 1987 Commercial Credit Directive, for which two proposals have been submitted but not yet approved. In April 2007, the Commission released a Green Paper on retail financial services and is preparing a White Paper on mortgage credit. In addition, to help prepare financial consumer legislation, in 2006 the EC created the Financial Services Consumer Group as a subgroup of the Commission's European Consumer Consultative Group.

Financial consumer protection is also part of the current agenda for the Slovak Government. The Government Manifesto of August 2006⁶ stated that,

The Government wants to continue in the creation of conditions to **eliminate unfair practices in the financial market**, for the struggle against legalization of income from criminal activities, as well as the conditions supporting free economic competition in the financial market. The Government will re-evaluate and systematically **modify the manner of mediation of financial and investment services**, as well as the rules of providing financial consulting. The Government will **safeguard adequate protection of participants in the financial market**, stressing the corresponding protection and non-professional investors and depositors from the possible failure of financial market entities and it shall strengthen prevention in this field. The Government will thus propose measures through which equality of position of those clients should be achieved and their **better access to information about the products**, as well as fees connected with them. The Government will devote in this connection special attention to the **support of the long-term financial education of the public at large**. The Government will also support rationalizing the system of compensation for misguided investment deposits and the investment assets of the clients.

Market for Retail Consumer Financial Services

Over the last five years, Slovakia has seen a substantial growth in consumer credit. As indicated in Table 1, consumer credit in Slovakia has grown rapidly with more than a three-fold increase from 2002 to 2006. The strongest growth is seen in a 255 percent increase in unsecured bank loans to households, although residential mortgages have also grown rapidly, particularly those provided by building societies (which are partially subsidized by the State Fund of Housing Development in combination with household savings). Table 1 includes only SKK-denominated loans and not those denominated in foreign currencies. However at the end of 2005, foreign currency loans in Slovakia were estimated to be less than one percent of all household loans (vs. 28 and 29 percent in Hungary and Poland respectively.)⁷

Table 1: Estimated Consumer Credit Provided to Households

Total Assets (mil. SKK)	2002	2003	2004	2005	2006
Unsecured bank loans	61,235	85,282	116,861	166,604	217,237
Residential mortgages by building societies	32,784	33,998	42,902	62,504	80,626
Residential mortgages by banks	11,249	24,764	39,024	53,757	67,119
Bank credit cards	n.a.	n.a.	n.a.	2,121	3,181
Loans by commercial credit companies	n.a.	8,000	10,000	17,658	n.a.
Total	105,268	152,044	208,787	302,644	368,163

Sources: Data collected by Slovak Ministry of Finance for World Bank mission. Data on commercial credit companies was provided by NBS.

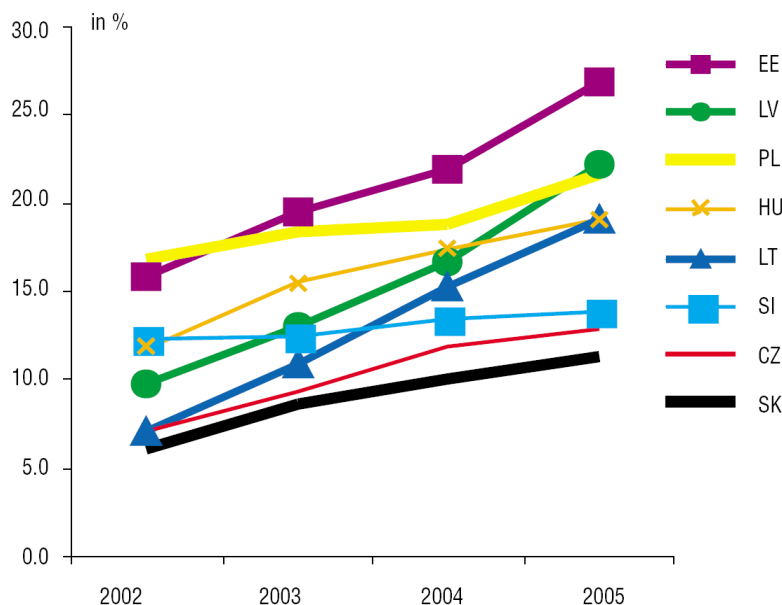
Notes: 2006 data is as of November. n.a.: not available

⁶ A copy of the Government manifesto is available at <http://www-8.vlada.gov.sk/data/files/1902.pdf>

⁷ FitchRatings, *Foreign Currency Lending*. Available at http://www.doingbusiness.ro/investment/pdf/Fitch_Ratings_Tim_Beck.pdf

While total debt to GDP has increased in Slovakia in recent years, it remains lower than in many of the other EU member states. This is seen in Figure 1.

Figure 1: Growth in Consumer Credit vs. GDP



Source: National Bank of Slovakia, calculated from data prepared by the NBS and the European Central Bank.

At the same time, household investments in financial instruments have increased. The largest rate of increase has been seen in private pension funds (see Table 2).

Table 2: Estimated Financial Investments by Households

Total Assets (mil. SKK)	2002	2003	2004	2005	2006
Bank deposits	389,730	375,954	360,335	360,016	417,247
Holdings in collective investment funds	16,173	35,701	55,615	91,139	84,374
Premiums for life and non-life insurance policies	36,164	42,416	48,087	51,685	53,757
Holdings in supplementary pension funds	n.a.	n.a.	14,455	27,069	42,000
Total	425,894	418,370	478,492	529,909	582,287

Sources: Data collected by Slovak Ministry of Finance for World Bank mission.

Notes: Holdings in funds and insurance premiums relate only to those provided by funds/companies serving the household sector. Pension funds refer to second and third pillar program with estimates for one fund (DDP Stabilita). 2006 data is as of November. n.a.: not available

Key Laws & Institutions for Financial Consumer Protection

- 1) Act No. **258/2001** Coll. on Consumer Credits, of 14 June 2001
- 2) Act No. **483/2001** Coll. on Banks, dated 5 October 2001, as amended
- 3) Act No. **566/2001** Coll. on Securities and Investment Services, as amended
- 4) Act No. **95/2002** Coll. on Insurance and on amendments to certain laws, as amended
- 5) Act No. **594/2003** Coll. on Collective Investment, as amended
- 6) Act No. **43/2004** Coll. on Retirement Pension Saving, as amended
- 7) Act No. **266/2005** Coll. on the Consumer Protection in Connection with the Distance Financial Services
- 8) Act No. **340/2005** Coll. on Insurance Mediation and Reinsurance Mediation
- 9) Act No. **650/2004** Coll. on Supplementary Pension Saving
- 10) Act No. **428/2002** Coll. on Protection of Personal Data, as amended
- 11) Act No. **747/2004** Coll. on Supervision of the Financial Market
- 12) Act No. **510/2002** Coll. on the Payment System, of 19 August 2002
- 13) Act No. **7/2005** Coll. on Bankruptcy and Restructuring, supplemented by the Decree on Insolvency and Excessive Indebtedness, came into effect on January 1, 2006
- 14) Civil Code
- 15) Commercial Code

In 1992, the Consumer Protection Act was enacted and implementation was assigned to the **Ministry of Economy**. The **Slovak Trade Inspection (STI)**, which is subordinated to the Ministry, was given the primary responsibility for conducting the inspections or “controls” of suppliers of goods and services to see that they met the legal requirements. Most of the activity of the STI relates to the quality of consumer goods provided in Slovakia.

The **Ministry of Finance** has the responsibility of preparing legislation for the finance sector and has assumed the duties of the STI in the area of consumer protection for the financial Sector.

The National Bank of Slovakia (NBS) was established by the Act on the National Bank of Slovakia of 1992. In 2006, the NBS became the integrated supervisory agency for the financial sector and assumed the responsibilities of the **Financial Market Authority** for securities markets and the insurance sector. The Ministry of Finance remains the regulatory agency for the financial sector, with responsibility for preparing primary legislation for the sector.

The Arbitration Court of the Slovak Bank Association was created in 2003 under the Act on the Payment System, for the narrow purpose of resolving disputes in the electronic payment system of banks. This mandate was later expanded to cover all customer disputes with banks.

The Office for Personal Data Protection of the Slovak Republic (**OPDP**) was established in 2002 under the Act on Protection of Personal Data. Under this Act, natural persons have a right to information about personal data collected regarding themselves, including how it was processed, the scope and nature of the information processed, the identity and location of who processed the data and the persons or organizations to whom the data has been transferred.

Consumer associations are present. There are about 30 consumer advocacy associations in Slovakia but most are under-funded and have little familiarity with financial issues.

The financial press also informs consumers about how the financial markets work and consumers’ legal rights.

Key Findings & Recommendations

An effective regime of financial consumer protection consists of three key rights for consumers. Consumers should have:

- 1) Access to sufficient information to make informed decisions as to whether or not they should enter into a contract with a financial institution—and whether they should maintain the contract;
- 2) Recourse to cost-effective mechanisms to redress any violations of the contract; and
- 3) Access to programs of financial education that empower them to understand the terms of the contracts with financial institutions and enforce their rights.

Giving consumers the three rights requires well-written laws, regulations and voluntary codes of conduct, as well as well-functioning government and private sector organizations aimed at protecting consumers of financial services.

Slovakia has taken considerable strides in the development of consumer protection, particularly in the area of goods and services, including financial services. Most EU Directives have been transposed into national legislation with only a few recent pieces of legislation in need of further review (see Table 4). In particular, the 1999-2001 legislation on banking, securities and collective investments specified that only entities licensed by the National Bank of Slovakia or the then Financial Market Authority (now part of the NBS) were authorized to accept or manage deposits or investments from the public.

However, consumer protection in financial services is still under development—as it is throughout Europe—and additional improvements could be made. Within the financial sector, the legal and regulatory framework is uneven with relatively strong consumer protection for consumers of banking services but weaker provisions for private pensions, insurance and collective investments. The weakest area relates to customers of commercial credit companies.

The need for further consumer protection in financial services in Slovakia (and the other 2004 New Member States) was confirmed by the Eurobarometer 2004 survey.⁸ While Slovakia's financial participation rates are higher than the average of the 2004 New Member States, they remain below those of the European average in all areas except purchase of life insurance. In Slovakia, only half of all consumers maintain a current checking account vs. 80 percent on average of those in the EU-15 countries (see Table 3). However as many as 43 percent have life insurance policies, which was slightly more than the EU-15 average. By contrast, fewer than 15 percent (vs. 23 percent in the EU-15) have private pensions and only two percent (vs. 13 percent in the EU-15) invest in collective investment funds.

Table 3: Financial Participation Rates

	Slovakia	2004 Member States	EU-15 Average
<i>Percentage of consumers that:</i>			
Maintain a current checking account	50%	45%	80%
Invest in collective investment funds	2%	3%	13%
Have a life insurance policy	43%	33%	39%
Invest in a private pension	14%	17%	23%

Source: Eurobarometer 2003.5

⁸ See Eurobarometer 2003.5, *Financial Services and Consumer Protection*, May 2004. The Full Report is available at http://ec.europa.eu/public_opinion/archives/cceb/2003/cceb2003_5.pdf

Consumer Protection Laws and Institutions

Revisions to the financial sector legislation in 1999-2001 resulted in the establishment of an effective legal and regulatory framework for the banking, securities, insurance and private pension sectors. Also in 2006, the NBS assumed supervisory responsibility for all four sectors. All institutions that accept funds from the public—be they banks that take retail deposits or asset management companies that offer investment funds—have strong legislation and supervisory structures with effective consumer protection, although some improvements should be made. Harmonization of legislation with the EU Directives has further strengthened consumer protection in financial services. However in areas where the EU Directives are silent, protection of financial consumers is not as strong.

One key weakness relates to regulation and supervision of the consumer finance sector. The primary legislation related to consumer credit, Act No. 258/2001 Coll. on Consumer Credits, requires the publication of the Annual Percentage Rate (APR) but has few other consumer protections. Responsibility for enforcing the consumer credit law lies with the Slovak Trade Inspection Office (STI). The Act No. 128/2002 Coll. on State Control of Internal Market in the Consumer Protection Matters, which covers general consumer protection of goods and services, authorized the STI to review contractual forms and conditions and creditor practices established under the Act on Consumer Credits. However the authority of the supervisory agencies is split. The STI supervises household lending by banks and commercial credit companies, but household investments in insurance policies and investments and pension funds fall under the supervision of the NBS. The STI reports to the Ministry of Economy on most activities, but to the Ministry of Finance on consumer lending. The STI does not specialize in the financial sector, focusing on other sectors such as food and apparel. In addition, the agency lacks both the technical expertise and the institutional capability to provide effective supervision for any part of the financial sector.

An increasing amount of household credit, particularly to subprime and other low-income borrowers is provided by commercial credit companies. While loans from commercial credit companies are far more expensive than bank loans, commercial credit companies provide financing to low-income households or those without collateral that might not otherwise be eligible for financing. Commercial credit companies generally finance the purchase of large household appliances and electronic goods but they also provide personal loans on an unsecured basis. The NBS estimates that the total assets of commercial credit companies by the end of 2005 is about SKK 19 billion, of which the members of the Association of Installment Sales Companies (AOSP) represent over 90 percent. While still only one-tenth the size of the banking sector, assets of the commercial credit companies have grown over 120 percent since 2003.

However, little public information is available concerning commercial credit companies. According to the business registry, 75 companies are registered to provide commercial credit. Of these, only 11 belong to the AOSP, which according to one of the member companies was established to differentiate their members from others that “engaged in illegal practices.”⁹ As non-licensed institutions, commercial credit companies are not required to file publicly their annual reports or provide other information to the public concerning their finances, operations or beneficial ownership. As of March 2007, only two of the 11 companies belonging to AOSP provided on the internet the audited annual financial statements of their Slovak operations.

⁹ As cited by Slovak Rating Agency in its report on Home Credit Services Slovakia. See http://www.homecredit.net/file/cms/en/credit-ratings/slovak-republic/HCS_2003_summary.pdf

Table 4: EU Directives on Consumer Protection in Financial Services and Applicable Slovak Laws

CELEX Reference	EU Directive	Supervisory Agency	Slovak Law
3 1987 L 0357	Directive on Consumer Credit, 1987/102/CEE	STI	Act No. 258/2001 Coll. on Consumer Credits
3 1998 L 0007	Directive On Consumer Credit, 1998/7/EC, amending Directive 87/102/EEC	STI	Act No. 258/2001 Coll. on Consumer Credits
3 1993 L 0013	Directive on Unfair Terms in Consumer Contracts, 1993/13/EEC	STI	Act No. 150/2004 Coll. amending the Civil Code
3 2005 L 0029	Directive concerning Unfair Business-to-Consumer Commercial Practices in the Internal Market, 2005/29/EC		Not yet implemented. To be part of new consumer protection law under preparation.
3 1998 L 0027	Directive No. 98/27/EC on Injunctions for the Protection of Consumer Interests	STI	Act No. 364/1992 Coll. on Consumer Protection
3 1994 L 0019	Directive on Deposit Guarantee Schemes, 1994/19/EC	DPF	Act No. 118/1996 Coll. on Protection of Bank Deposits, as amended
3 1997 L 0009	Directive on Investor Compensation Schemes, 1997/9/EC	NBS	Act No. 566/2001 Coll. on Securities and Investment Services, as amended
3 2002 L 0058	Directive Concerning Processing Personal Data and Protection of Privacy in the Electronic Communication Sector, 2002/58/EC	NBS	Act No. 510/2002 Coll. on the Payment System, as amended Act No. 483/2001 Coll. on Banks, as amended
3 1995 L 0046	Directive on the Protection of Individuals with regard to the Processing of Personal Data, 1995/46/EC	OPDP	Act No. 428/2002 Coll. on Protection of Personal Data
3 1997 L 0007	Directive on Protection of Consumers in Respect of Distance Contracts, 1997/7/EEC	STI	Act No. 108/2000 Coll. on Consumer Protection in Doorstep Selling and Distance Selling and amending Act No. 118/2006 Coll.
3 2002 L 0065	Directive on the Distance Marketing of Financial Services, 2002/65/EC	MOF	Act No. 266/2005 Coll. on Consumer Protection in Distance Financial Services
3 1997 L 0055	Directive On Comparative Advertising, 1997/55/EEC	STI	Act No. 147/2001 Coll. on Advertising
3 2006 L 0048	Directive on Capital Requirements for Credit Institutions 2006/48/EC	NBS	Act No. 483/2001 Coll. on Banks, as amended
3 1985 L 0611	Directive on UCITS 1985/611/EEC, as amended	NBS	Act No. 594/2003 Coll. on Collective Investments, as amended
3 2004 L 0109	Directive on Transparency, 2004/109/EC	NBS	Act No. 566/2001 Coll. on Securities and Investment Services, as amended
3 2004 L 0072	Directive on Market Abuse, 2004/72/EC		Act No. 209/2007 Coll. on Securities, as amended
3 2004 L 0039	Directive on Markets in Financial Instruments, 2004/39/EC (MiFID)	NBS	Act No. 566/2001 Coll. on Securities and Investment Services, as amended (Partially implemented. Additional amendments are in process.)
3 2002 L 0083	Directive on Life Insurance, 2002/83/EC	NBS	Act No. 95/2002 Coll. on Insurance
3 1992 L 0049	Directive on Non-Life Insurance, 1992/49/EEC		Act No. 747/2004 Coll. on Supervision of the Financial Market
3 2002 L 0092	Directive on Insurance Mediation 2002/92/EC	NBS	Act No. 340/2005 Coll. on Insurance Mediation and Reinsurance Mediation Act No. 95/2002 Coll. on Insurance

Source: Prepared by World Bank. Note that a description of the EU Directives on financial consumer protection is provided in Volume II.

Additional financial consumer protection provisions are found in the Commercial Code; Act No. 43/2004 Coll. on Retirement Pension Saving, as amended; Act No. 420/2004 Coll. on Mediation; Act No. 650/2004 Coll. on Supplementary Pension Saving, as amended; and Act No. 7/2005 Coll. on Bankruptcy and Restructuring.

All providers of financial services, including consumer finance companies, should be required to obtain authorization for their activities. If all institutions providing financial services were required to obtain authorization for their activities, it would be easy to identify unlicensed entities. The need for clear authorization would also help to differentiate legal and legitimate credit activities from those that are not legal. Lending on usurious terms is prohibited by Section 235 of the Criminal Code and needs to be prosecuted by the Office of the Prosecutor General. If the NBS were clearly responsible for all financial activities in Slovakia, the NBS would be able to monitor the financial markets in ways that would highlight usury and thus provide a case for referral to the criminal justice authorities.¹⁰

It would be preferable if supervision of commercial credit companies were conducted by the National Bank of Slovakia (NBS) rather than a separate agency. Since the NBS is an integrated supervisory agency for the financial sector, an efficient use of resources in a small country such as Slovakia suggests that all financial supervision should be conducted by one agency. However this does pose some challenges. Consumer finance companies should be supervised on the basis of market conduct rather than on the basis of prudential regulations. Combining the two responsibilities in one organization can create some conflicts of interest. However the experience of countries, such as Ireland, which uses a combined financial regulator, indicates that the benefits of information gained from consumer protection supervision exceed the issues created by the conflicts of interest.

One important advantage of having all authorizations in one agency is in communications with the public. If the NBS were responsible for authorizing all financial institutions, the NBS could release consumer alerts noting their responsibility and identifying financing entities that operate in Slovakia but are not authorized by the NBS. Such alerts would help to build consumer confidence in the Slovak financial sector, particularly after the activities of the unlicensed and unsupervised non-bank entities in the late 1990s.¹¹ It would also be helpful if the NBS (and any other agencies responsible for supervision of retail financial sector activities) include the objective of protecting financial consumers as part of their formal mandate.

For consumer finance companies, market-conduct supervision advocating market protection—rather than prudential supervision—should be applied. Consumer finance companies should not be required to maintain minimum capital adequacy levels or other measures needed for prudential conduct. However, consumer finance companies should be obliged to meet certain minimum standards such as disclosure of beneficial ownership and ultimate control of the entities and publication of annual audited financial statements. In addition, the law should establish fit and proper standards for significant owners and key directors of consumer finance companies. Such standards would include the absence of conviction for economic fraud. Also, the NBS should be authorized to use sanctions (such as levying of fines) where finance companies engage in unfair or deceptive practices.

¹⁰ The issue of usurious lending is one that particularly affects the Roma community. Once an individual borrows from money-lenders, the stranglehold of debt (and compounded interest) is virtually impossible to break. A 2005 report prepared by the Council of Europe noted that only 12 cases of usury had been prosecuted against the Roma community in nine municipalities. Financial profit from usury of the Romany community was estimated at SKK 8.9 million.

¹¹ The history of the Slovak financial sector also supports the need for mandatory licensing of all providers of financial services. As of 2000 and prior to the approval of new financial legislation, more than 50 non-licensed non-banking entities were receiving funds from the public, having collected more than SKK 12 billion. Of these, more than 10 companies were primarily engaged in providing credit. (See <http://www.ratingagency.sk/eng/analyses/pension/insurance.html>) Trials of fraud by four major non-licensed entities were continuing as of April 2007.

Disclosure and Sales Practices

The Eurobarometer Survey indicates that Slovak consumers felt that they understood the costs of borrowing. Almost half of Slovak consumers indicated that it was "easy" or "fairly easy" to know the cost of borrowing money before taking out a loan. This was the same level as for the EU-15 average, but higher than the rate (37 percent) for the 2004 Member States. Knowing in advance the cost of insurance coverage was again easy or fairly easy for almost half of Slovak consumers, but just slightly higher for 2004 Member States and the EU-15. Only 29 percent of Slovak consumers felt confident that they knew about the workings of residential mortgages and the risks involved—but was only slightly higher than the statistics for 2004 Member States and EU-15. (See Table 5)

Table 5: Confidence in Knowing the Costs and Risks of Financial Instruments

	Slovakia	2004 Member States	EU-15
<i>Percent of consumers that felt it was easy or fairly easy to:</i>			
Know the cost of borrowing	46%	37%	46%
Know the cost of insurance	46%	50%	51%
Understand the risks in mortgages	29%	24%	27%

Source: Eurobarometer 2003.5

Lending rates for consumer credit are transparent but vary widely. As of February 2007, bank loans to households were approximately at 8 to 10 percent per annum, with the lower end of the range applying to loans secured by real property. However, financing from commercial credit companies varied. According to the industry association AOSP, installment sales loans from commercial credit companies were generally between 12 to 14 percent per annum, where a loan is arranged at the "point of sale" of a retail distribution outlet and the loan is used to finance appliances, electronic equipment or other consumer goods. However, credit card loans from the same companies were higher. The Ministry of Finance estimated that credit card loans (revolving credits) were 23 to 26 percent per annum. Cash loans (i.e. unsecured personal loans) were offered by commercial credit companies at still higher rates. Estimated lending rates for cash loans were between 166 and 249 percent per annum for three large commercial credit companies. This was confirmed by company advertising and press reports.¹² Loans from commercial credit companies were generally small at under SKK 15,000 and for periods of less than one year but the financing charges were relatively high. Also the fees and charges were not reported in a format that allowed for easy comparison of the effective borrowing rates.

It is likely that it is the low-income households who are most vulnerable to high borrowing costs. According to a household survey conducted in 2005 by the Slovak Statistics Office, those without formal employment pay the highest percentage of their income in debt service. Families where the head of the household is self-employed pay 38 percent more of their gross household income in loan repayments (including mortgages) than do families where the head of the household has a steady job. Differences are also seen by level of urbanization. According to the 2005 survey, those living outside major cities pay 12 percent more of their income in loan repayments than do those living within the major metropolitan areas.¹³ While the methodology

¹² As of March 28, 2007, Kešovka (Telervis plus) was offering loans of up to six months and SKK 50,000 at an annual rate of 227 percent per annum, with weekly payments. See <http://openiazoch.zoznam.sk/produkty/hp/detail.asp?TID=HPTEL>

Note that loans from illegal "money-lenders" were still more expensive at 50 percent per month.

¹³ See Statistical Office of the Slovak Republic, *2005 Household Survey*. According to the survey, households where the head is an "employee" paid 4.68% of gross income in "refunded loans and credits"

for the household survey is still being refined, the conclusions confirm the experience of other countries. Low-income families tend to spend more of their income on debt payments than do high-income families. In Slovakia, low-income households are also associated with lack of formal employment, low levels of education and residence in depressed areas, notably the Eastern Slovakia and Banska Bystrica regions.

Few laws regulate lending practices. For licensed financial institutions, the NBS plays a *de facto* supervisory role in ensuring fair-lending and debt-collection practices. However, no such supervision applies to non-licensed consumer finance companies. The Commercial Code prohibits misleading advertising and the legislation on consumer protection generally prohibits practices that mislead consumers. However, Slovak legislation provides no explicit prohibition against abusive or deceptive practices for either lending or debt collection. Some of the commercial credit companies are known as “doorstep lenders” for their practice of selling (and collecting) loans door-to-door. No laws prohibit the use of such high-pressure sales tactics, such as going to customers' homes to sell (or collect) loans. In addition, at least one commercial credit company acknowledges that it uses “multi-level” distribution systems for its loans, which are often associated with very aggressive sales tactics. While the Act No. 108/2000 on Consumer Protection in Doorstep Selling and Distance Selling requires a seven-day cooling-off period for tele-marketing and doorstep selling of goods and services, a longer cooling-off period would be helpful.¹⁴

The law should prohibit abusive lending practices. The law should also specifically prohibit not only practices that are misleading but also those that are harassing, coercing and otherwise unduly influencing consumers in connections with transactions. A fourteen-day cooling-off period should apply to all credits and purchases of products with long-term components, including investments in private pension funds. The customer should have the right to withdraw from the contract without having to pay any expenses except for the initial transaction fee agreed at the time of the signing of the contract. In addition, it would be helpful to set up a “do-not-call” registry that allows consumers to avoid receiving unsolicited marketing calls for mortgages or other credits. Regulations will also be needed to ensure the implementation of the proposed laws (as well as the existing legislation prohibiting misleading advertising).

As a first step, disclosure and sales practices among licensed financial institutions should be improved by providing standardized key facts disclosures to consumers. All providers of financial services, particularly for complex financial products, should be required to give consumers a “Statement of Key Facts” or other standardized report at the point of sale of the contract. The key facts statement would include not just the Annual Percentage Rate (APR), as is currently required under the commercial credit legislation. The mandatory disclosure should also cover: (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 disclosure to consumers should also indicate what mechanisms for recourse are available to the borrower or investor. The format for key facts

versus 6.44% for self-employed heads of households. Households in regional cities paid 3.85% of gross income in loan repayments versus 4.30% for households in other cities.

¹⁴ For a description of cooling-off periods in several EU member states, see http://ec.europa.eu/consumers/cons_int/fina_serv/cons_directive/cons_cred1a_en.pdf

disclosure should allow consumers to easily and quickly identify the key terms and conditions for the financial products.

Special risks should also be disclosed to consumers. For mortgage loans and any other credits secured by real property (such as a house or apartment), the mandatory disclosure should note that in the case of default, the lender could seize the property. In addition, for loans denominated in a foreign currency (such as Japanese Yen, Swiss Francs or even Euros), the mandatory key facts disclosure should contain a warning that changes in exchange rates could increase the total amount of the debt.

Additional specialized disclosure should be required for investment products. For pension funds and other investment products, the consumer should also be advised of the percentage commission charged for each product. Regulations should be issued to set out in detail the disclosure requirements for prospectuses and simplified prospectuses of mutual funds, especially for calculating the net asset value (NAV) of real-estate funds. Regulations should also standardize the account-opening disclosures for brokerage accounts and collective investment funds.

A useful starting point would be the standardized information sheet provided by banks for mortgage loans. In January 2006, the Slovak Bank Association adopted a Voluntary Code of Conduct for Pre-contractual Information on Home Loans.¹⁵ Banks that comply with the Code must provide mortgage information to consumers in the format of the European Standardized Information Sheet (ESIS).¹⁶ The ESIS provides a transparent and comparable basis upon which consumers can make informed decisions about mortgage loans.

The supervisory agency should ensure that useful comparative information is made available for consumers. The NBS should publish information (or require that financial institutions publish data) to allow easy comparisons of fees, charges and commissions charged for the same service. For example, for life insurance the NBS could review the insurance rates by all the major insurance companies for similar types of life insurance using a standard reference, such as 30-year non-smoking male head of household. Publication of the different costs by each institution would allow consumers to do accurate cost comparisons. The result would be seen in informed consumers and an increasingly competitive financial sector. It would also be helpful if the NBS were to require that all licensed financial service companies publish annual audited financial statements and the names of the significant beneficial owners and directors of the companies. In addition, insurance companies should be obliged to publish reports showing the financial solvency of individual companies, based on each company's published financial statements. Where financial corporations have received debt ratings (or in the case of insurance companies, rating of claims-paying ability), the companies should be obliged to publish the ratings.

The proposed revised legislation on commercial credit also provides the opportunity to clarify the calculation of the APR. The experience of the United Kingdom indicates that APRs from different lenders may be difficult to compare because different credit institutions may use different assumptions in calculating their APRs.¹⁷ The proposed legislation should authorize the NBS to establish the assumptions to be used for APRs.

¹⁵ See <http://www.asocbank.sk/?id=474&lng=eng>

¹⁶ The European Financial Services Roundtable suggests the use of a compulsory Pan-European Info Box (PEIB), similar to the European Standardized Information Sheet (ESIS) in use for mortgages. See <http://www.efr.be/members/upload/news/23328EFRCPWP.pdf>

¹⁷ See U.K. Department of Trade and Industry, *Fair, Clear and Competitive: The Consumer Credit Market in the 21st Century*, December 2003. Available at <http://www.dti.gov.uk/files/file23663.pdf>

Another issue also relates to the sale of “tied” products. In a survey of 25 EU member states, the European Commission found that Slovakia was one of just three countries where bank deposit accounts were seen as fully tied to residential mortgages and consumer loans. As noted in Table 6, 100 percent of consumers responded that mortgages, consumer loans and small business loans were all tied to holding a current account with the bank. The NBS should specify in its regulations that banks disclose that a current account is not needed to receive financing from the bank. In addition, not all banks clearly identify the customer service counters for opening a bank savings account (guaranteed by deposit insurance) from those for opening an investment account in an investment fund (with no guarantee on the return of principal or interest). All banks should be required to establish separate service counters for bank deposit accounts and investment holdings.

Table 6: Tying of Products

	Slovakia	2004 Member States	EU-15
Mortgage + current account	100%	59%	42%
Consumer loan + current account	100%	53%	43%
Small business loan + current account	100%	83%	49%

Source: Commission services retail banking sector inquiry, 2005-2006

Notes: 2004 member states exclude Estonia and Latvia. EU-15 excludes Luxemburg.

On a related issue, Slovak consumers complained of exit charges. A 2007 EC Survey on the retail banking sector found that while the exit charges imposed by Slovak banks for closed accounts were in line with the average of the EU-25 countries, Slovakia was one of just eight countries that required exit charges to be paid.¹⁸ The NBS should work with the banks to reduce—and preferably eliminate—charges to be paid upon the closing of an account.

Financial institutions should be legally required to act responsibly. Lenders should be required to ensure that loans meet the needs of the borrower. Similarly, sellers of investment products should be obliged to verify that the products are suitable for the purchaser. At a minimum, a standard process should be set by law or regulation by which the lender (or seller of investment products) collects information about the client, particularly when selling complex products such as life insurance or private pensions or special collective investment funds. Creditors should be obliged to verify the age, financial experience, and business capacity of the client—and if the borrower is in poor health or otherwise unable to comprehend the costs or risks involved in the financial product. At the same time, borrowers and investors should be obliged to provide true and accurate information regarding their financial circumstances.

The Eurobarometer survey found that 70 percent of Slovak customers expected financial institutions to provide advice on financial products. This was higher than the 2004 Member States rate of 61 percent but lower than the EU-15 rate of 74 percent. However, the confidence of financial consumers is also relatively high. About 45 percent of Slovak consumers say that they trust the advice provided by financial institutions (versus only 32 percent in the 2004 Member States and 47 percent in the EU-15.) Such levels of trust place a premium on ensuring that financial intermediaries have received sufficient training to provide accurate expert advice.

The Ministry of Finance and the NBS are in the process of strengthening the qualifications required for financial advisors. It is expected that new legislation will be prepared that will

¹⁸ See European Commission, Directorate-General for Competition, *Report on the retail banking inquiry*, Commission Staff Working Document, SEC (2007) 106. Available at http://ec.europa.eu/comm/competition/antitrust/others/sector_inquiries/financial_services/sec_2007_106.pdf

create the institution of a certified financial advisor, that is, a professional person who has completed specialized financial training under a certified training program. Such a program would improve the expertise of those qualified to sell financial products.

A three-tiered system for the training and certification of intermediaries and other sellers of financial products would be useful. While not all EU member states differentiate among different levels of complexity of financial products—and the required training and certification for different products—a tiered system would be helpful in Slovakia. Tier 1 would apply to individuals who sold simple products, such as savings account. For selling of Tier 1 products, training and supervision from the financial institution would be sufficient. Tier 2 would relate to complex products, such as pension funds, collective investment funds or life insurance that included a savings component. For this, training and certification could be done by the industry association under guidelines set by the supervisory agency. Tier 3 would be the highest level covering certified financial advisors (or planners). For Tier 3 certification, individuals would be obliged to complete extensive training conducted by the supervisory agency, or a program under the direct review by the supervisory agency. Tier 3 individuals would be able to sell any and all products offered by any financial institution. Tier 3 financial advisors would also be obliged to meet high levels of business integrity. They would be obliged to follow a strict code of ethics. All three tiers should require registration with the NBS of all individuals selling financial products.

Consideration should also be given to the commission structure for brokers, particularly those in the insurance market. The Slovak legislation applying the EU Directive on Mediation prohibits insurance brokers licensed in the Slovak Republic from accepting commissions from customers—a common business practice particularly for the reinsurance market. Insurance brokers play a valuable role by ensuring the integrity of the insurance sector, increasing competition among reinsurers, and making detailed risks analyses available to reinsurers. Rather than prohibiting local brokers from receiving commissions from insurance companies, the law should require public disclosure of the fees paid to the brokers.

Customer Account Handling and Maintenance

The key issue for account handling and maintenance relates to relatively high fees for bank charges and unclear liability of unauthorized credit card charges. The EC study on the European retail banking sector noted that Slovak banks charged relatively high maintenance expenses for bank accounts. Of particular concern were charges for closing accounts. A regulation should also be issued requiring the prompt payment or transfer of customer assets to ensure that the customer—rather than the financial institution—benefits from the "float" of unused cash deposits. In addition, Slovak consumers should be clearly absolved of any liability for credit card charges that were not authorized by the consumer. A statement under oath on unauthorized credit card transactions ought to absolve the customer of any liability for the unauthorized payment. It may also be helpful for the NBS (or the SBA) to conduct a survey of customer service quality to identify any concerns by consumers in the handling or maintenance of their accounts with financial institutions.

Improved information for ongoing customers would also be useful. A regulation should be issued requiring the issuance to customers of periodic and confirmation statements, the minimal contents for the statements and the procedures for customers to correct the statements. Banks and other lenders should be required to indicate in the customer statements the amount paid towards principal and interest for any loans outstanding.

Abusive debt-collection practices should be prohibited. Anecdotal evidence suggests that some unscrupulous lenders take advantage of loop-holes in the legal system, requiring borrowers to pre-sign legal agreements that transfer property (such as housing) to a lender in the event of

non-payment of installments. All transactions transferring residential real estate should require authorization by a court order. The consumer credit legislation should also prohibit lenders from making false statements or using unfair practices when collecting debts. Giving false information to others should also be explicitly prohibited. In addition, the financial institutions that hire debt collectors should be required to ensure that their debt collectors are contractually obliged to comply with the law. Also, regulations should set permissible times for contact with borrowers so that borrowers cannot be harassed in the late evening or early morning by debt-collection agents.

Lenders who engage in illegal practices should be prosecuted. According to the National Center for Legal Aid, some lenders evict borrowers, without first obtaining a court order. Other lenders request that employers garnish wages—again without first obtaining a court order to garnish such income. Such cases should be presented to the Office of the Prosecutor General and prosecuted through the court system.

Privacy and Data Protection

The Eurobarometer Survey indicated that almost half of Slovak consumers were confident of sufficient data protection. Over 45 percent said that their confidential information was being protected. While relatively low, the confidence level for Slovak consumers was higher than the average of the 2004 Members (at 42 percent) but not as high as the EU-15 average of 51 percent.

Most provisions on privacy and data protection of financial matters are adequate. Under the 2002 Act on the Protection of Personal Data, natural persons have a right to information about personal data collected, including how it was processed, the scope and nature of the information processed, the identity and location of who processed the data and the persons or organizations to whom the data has been transferred. However financial conglomerates generally share consumer information among their subsidiaries. One approach to strengthening privacy would be to allow consumers to “opt out” of having their personal financial information being shared with other companies within the financial group or conglomerate.

On the other hand, consumer finance companies need reliable data on which they evaluate lending risks. One key role of the consumer finance sector is to provide affordable financing for low-income households and other "subprime" borrowers. However, in order to establish a competitive consumer finance sector, the companies need reliable credit data on borrowers. Efficient lenders need to be able to conduct stress tests on their portfolios and measure their value at risk in multiple economic scenarios.¹⁹ For consumer finance companies, success in risk management requires that credit decisions and pricing be based on comprehensive consumer credit scoring data and automated tools of analysis. In particular, competitive finance companies need to maintain risk databases that allow them to compare expected risk ratings on risk portfolios to the actual loss experience—and then identify measures to refine the accuracy of evaluations of credit risk.²⁰ High quality credit information would thus allow consumer finance providers to use risk-based pricing, thus reducing the interest charges for low-income borrowers with strong credit records of timely payments.

A systematic credit scoring system for retail customers should be set up. Slovakia is among the central European countries where little reliable consumer credit data is available to consumer

¹⁹ See for example, PricewaterhouseCoopers, *Consumer Finance Update*, Winter 2006 (available at <http://www.pwc.com/consumerfinance>)

²⁰ See AT Kearney, *Consumer Finance in Central & Eastern Europe*, Discussion Document presented at the Institute of International Finance: Annual Meeting of Central European Bank Chief Executives, 2006. Available at http://www.atkearney.at/content/misc/wrapper.php/name/file_pdf_final_-_cf_conference_1161939492d164_1169114808f4df.pdf

finance companies. Particularly for subprime borrowers, credit data is sketchy. The members of the AOSP industry association give “negative” information to a credit bureau for non-bank financial institutions. However, banks maintain a separate credit bureau with access only for banks and information between the two bureaus is not shared. A system of credit scores for individuals should be set up and cover delinquencies in the payments of all credits, both to financial institutions and sellers of other goods and services.

Guarantees and Compensation Funds

The Bankruptcy Act should be amended to ensure that bank deposits (and insurance policy holders) have a high ranking. The system of guarantees and compensation funds provides for adequate protection for consumers. However bank deposits not covered by the Deposit Protection Fund are ranked *pari passu* with general creditors. A similar issue exists for insurance policy-holders. However, to build additional consumer confidence in the financial sector, bank deposits (and insurance policy holders) should be ranked higher than the claims of general creditors of the financial institution. For this, an amendment will be needed to the Bankruptcy Act.

Dispute Resolution Mechanisms

In Slovakia, public confidence in the national consumer protection institutions is lower than in the average of the EU-25 countries. In its 2006 report, Eurobarometer found low rates of confidence in both the Slovak public authorities and the Slovak private sector organizations supporting consumer protection (see Table 7). By contrast, the Slovak public had a heightened level of awareness of EU organizations related to consumer protection. The high interest in EU organizations suggests that once the Slovak institutions are fully effective, Slovak consumers will turn to them for assistance for protection of their financial rights.

Table 7: Public Confidence in Consumer Protection Institutions

	Slovakia	EU-25
<i>Consumers:</i>		
Feel existing national consumer protection institutions are adequate	36%	54%
Trust public authorities to protect consumer rights	42%	57%
Trust independent organizations to protect consumer rights	43%	66%
Are aware of EU organizations for consumer protection	53%	29%

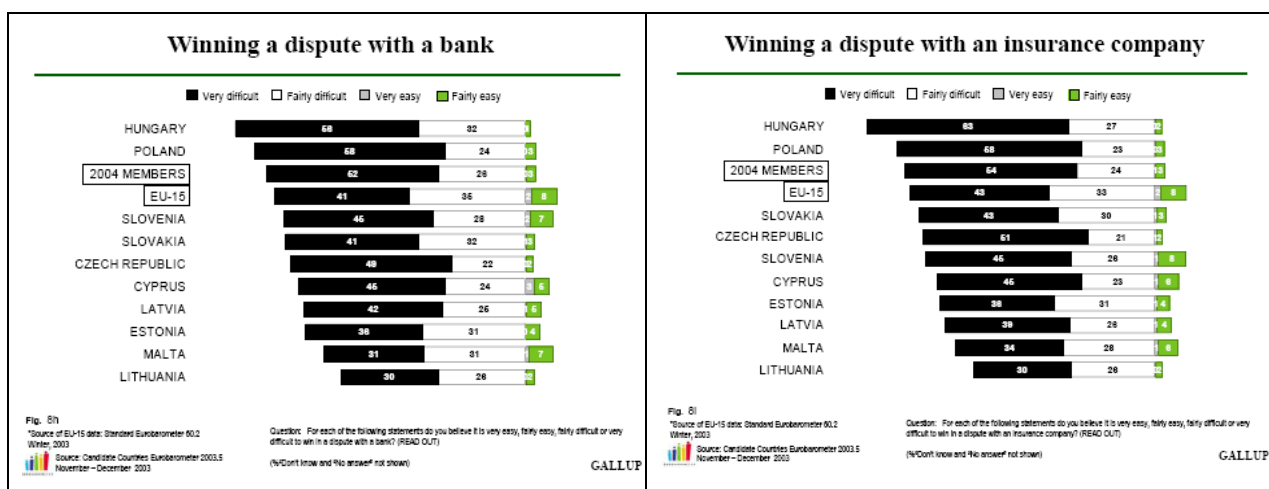
Source: Special Eurobarometer No. 252, September 2006

Eurobarometer 2003 found that the Slovak dispute resolution mechanisms were generally weak in dealing with financial institutions. Fewer than five percent of respondents said that it would be “easy” or “fairly easy” to win a dispute against a bank or insurance company as seen in Chart 2. The rest were more pessimistic. This was similar as the level for other 2004 Member States but lower than the eight percent rate for EU-15 countries. However, settling a dispute was more difficult.

Several mechanisms are in place for customers to lodge complaints but none is sufficiently effective. All banks are required to have in place a system to receive customer complaints. The complaints are lodged in a register maintained by the bank and reviewed by the bank’s internal auditors and also by the NBS supervisors when they conduct their inspections. Some financial institutions, such as Slovenska Sporitelna, also maintain an internal ombudsman to whom customers can submit their complaints. The ombudsman acts as the representative of customers and has the authority to make recommendations directly to the chief executive officer of the bank. However not all financial institutions—or even banks—have similar ombudsmen. In addition,

complaint statistics are not published, either for individual banks or in aggregate for the banking sector. Nor are the statistics easily accessible, as evidenced by the inability of the World Bank mission to obtain complaint statistics for any part of the financial sector.

Chart 2: Consumer Disputes with Financial Institutions



For consumers, complaining outside of the financial institution is also difficult. By law, the NBS is not permitted to become engaged in commercial disputes between banks (or insurance companies) and customers, although the NBS does review disputes in order to identify any possible systematic issues. To try to cover the void, the Slovak Bank Association (SBA) has established an Arbitration Court. The Court's authority was initially limited to financial payments among institutions but has since been expanded to cover any dispute between a bank and a customer. However, the Arbitration Court suffers from the same weaknesses of time and expense related to the Civil Court. A mediation process has also been established by law but it has only rarely been used. The STI also has some authority over disputes related to financial services but the expertise and capacity of the STI are limited, as noted above.

Access to the courts is a slow and expensive option for financial consumers. On average, a year and a half is required to resolve commercial disputes and the cost may be as high as 16 percent of the amount involved as seen in Table 8. In most countries, the large majority of financial disputes are for small amounts of money and less than the cost of initiating a court case. However, the absence of any cost-effective recourse mechanism undermines the public's confidence that their interests are adequately protected.

Table 8: Court Process for Addressing Complaints

	Slovakia	Region	OECD
Procedures (number)	27	31.5	22.2
Time (days)	565	408.8	351.2
Cost (% of debt)	15.7	15.0	11.2

Source: Doing Business: Economy Rankings 2007 ²¹

Similarly the non-government organizations are able to provide little help. The National Center for Legal Aid which is financially supported by the Ministry of Justice has only recently

²¹ The full report is available at <http://www.doingbusiness.org/EconomyRankings/>

been established and lacks sufficient staff or capacity to be effective. Furthermore, its audience is limited to those in material financial need. The 30 consumer advocacy organizations in Slovakia are similarly lacking in funding and capability to assist individual consumers in dispute with a financial institution. While the press attempts to highlight cases of abuse, their impact is limited and their reports are not subject to independent confirmation or review.

To establish an effective dispute resolution mechanism, several functions need to be fulfilled. They are:

- 1) Ensure that financial institutions are in compliance with the consumer provisions which apply to them;
- 2) Promote the adoption by financial institutions of policies and procedures which they need in order to implement their consumer provision obligations;
- 3) Provide a mechanism for dealing with customers that have complaints;
- 4) Provide a central registry and clearing house for consumer complaints; and
- 5) Promote consumer education and awareness, including about the obligations of financial institutions to fulfill their consumer protection obligations.

As a starting point, detailed data should be collected on the current status of customer complaints and consumer awareness of the existing mechanisms to resolve disputes. A survey could be conducted of the views of both consumers and financial institutions regarding four main issues related to customer complaints across the financial sector. They are: (1) the nature of complaint, (2) the numbers of complaints for each type of complaint, (3) the time required to resolve each complaint, and (4) the final resolution to each complaint. The data collected from the survey would provide useful information on the number of internal ombudsmen, the current consumer awareness of the existing system, efficiency of the current system, and the system's effectiveness in achieving monetary compensation for aggrieved customers. The survey could be initiated for the banking sector and then extended to the other parts of the financial sector, including insurance, collective investment funds, private pensions and eventually consumer finance companies. As recommended by FIN-USE, it would be helpful to receive comments directly from consumers, for example through surveys conducted by the consumer protection organizations.²² In addition, the complaint statistics should be published so that consumers can readily access the information of which institutions have received the most customer complaints.

The NBS should also ensure that all financial institutions have in-house dispute resolution mechanisms. All financial institutions should be obliged to set clear procedures for dealing with customer complaints with a system of time-bound resolution and a formal mechanism for dispute resolution. All financial institutions should be required to prepare a policy on internal dispute resolution—and the policy should be subject to review by the NBS as part of its standard supervision procedures. The NBS should require that financial institutions provide information to consumers on how to seek a remedy, including redress, for problems arising out of interactions with the companies or their intermediaries. For example, the websites of financial institutions should have clearly identified portals for customer complaints. Financial institutions should also prepare an annual report of compliance with their dispute-resolution policy.

The NBS should create a Consumer Protection Department. The Consumer Protection Department would have responsibility for receiving copies of complaints submitted to the financial institutions. The legislation should be amended to allow the NBS to review individual consumer complaints with financial institutions and take action as necessary against the financial institution. The Consumer Protection Department should create a central registry where

²² FIN-USE is the expert forum assisting the EC in developing financial sector policies by including the perspective of users. See http://ec.europa.eu/internal_market/finservices-retail/finuse_en.htm

complaints are filed and reviewed by the NBS for systematic patterns of consumer abuse. The Consumer Protection Department should also have the authority to make recommendations to the Supervision Department about proposed changes in supervision practices or internal operations of banks, or if necessary, changes in laws or regulations. The Consumer Protection Department could be combined with the proposed department supervising consumer finance companies, or could be established separately.

A financial ombudsman should be established. It would be helpful for consumers to have an agency that provides a low-cost but effective alternative to the court system. As an out-of-court mechanism, an ombudsman can take a more flexible approach than the courts. For example, an ombudsman can decide a case not just on the basis of legal rules but also issues of equity and fairness as well as industry-accepted codes of conduct. The ombudsman for the Irish financial sector may provide a useful model (see Box 1), although other approaches may also be workable. The work of the Irish financial ombudsman helps support the effectiveness of the work of the supervisory agency, by reviewing individual cases and making recommendations to the supervisory agency. In Slovakia, the financial ombudsman would also assume the role of the financial arbiter now set up under Slovak law. Another approach would be to encourage the industry associations to set up their own ombudsman structures, as the banks have proposed to do through the banking association.²³ The industries ombudsmen would then operate under the supervision of a general financial sector ombudsman. The EC also provides some recommendations on ombudsmen, noting that they should follow the processes of transparency, due process, independence, legality and effectiveness.²⁴ 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 consumers can identify the nature of the disputes referred to the ombudsman and assess the results of the ombudsman's actions. The ombudsman for Slovakia should also be part of FIN-NET, which links across the EU the ombudsmen and other dispute resolution mechanisms. Establishment of an ombudsman, following the approach of other EU states, is currently under consideration by the Ministry of Finance and NBS.

Box 1: Financial Services Ombudsman of the Republic of Ireland

The Irish Financial Services Ombudsman²⁵ is an independent officer who deals with unresolved complaints from consumers about their individual dealings with all financial service providers. It was established under The Central Bank and Financial Services Authority of Ireland Act (2004).

The Ombudsman is empowered to make awards up to €250,000 and awards are binding on both parties, but available for appeal to the Irish High Court. Subject to the Ombudsman's office are banks, insurance companies, credit intermediaries, stockbrokers, pawnbrokers, money lenders, bureaux de change, and commercial credit companies. Application to the Ombudsman is a free service for consumers. Eligible consumers include all natural persons (i.e. individuals), limited companies with a turnover of €3 million or less, and unincorporated bodies, including clubs, charities, trusts, and partnerships.

The Ombudsman is also responsible for improving public understanding of issues related to consumer protection and complaints against regulated financial service providers.

In addition, the industry associations should be encouraged to develop codes of conduct. The voluntary code of the SBA regarding mortgage loans provides a useful first step. AOSP notes that it has an ethical code for the eleven commercial credit companies that are its members—although

²³ The voluntary approach follows that used in Germany, as described in Volume II.

²⁴ See Commission Recommendation on the principles applicable to the bodies responsible for out-of-court settlement of consumer disputes (98/257/EC). Available at http://europa.eu.int/eur-lex/pri/en/oj/dat/1998/l_115/l_11519980417en00310034.pdf

²⁵ Source: Financial Services Ombudsman's Bureau of the Republic of Ireland. <http://www.financialombudsman.ie/>

the code is not available on the internet. However, all providers of financial services should be covered by principle-based codes of practice covering areas that include responsible practices in lending, marketing and management of arrears and other forms of debt collection. The associations should also be encouraged to take action to mediate, and if possible resolve, disputes where a lender's practice violates the association's code of conduct. In addition, the codes should be disseminated to the public, not only by individual institutions but through the association and consumer interest groups. The associations should also adopt codes of ethics specific to each sector in order to establish ethical norms of conduct and improving professional standards and guidelines.

Consumer Education and Financial Literacy

The ultimate weapon for effective financial consumer protection is well-informed consumers. A broad-based program of financial education will provide the population with essential life skills to manage budgets, set aside sufficient funds to repay credits, and invest for major life events including establishing families and retirement. Consumers that are well informed and financially literate are able to make sound financial decisions for themselves and their families. They are able to increase their financial well-being and ensure economic security in times of financial crisis. Knowledgeable consumers are also at the heart of efficient retail financial markets. They are able to protect themselves from unscrupulous sellers of financial services and make it difficult for sellers to use unfair or deceptive practices. Consumers who are literate in financial matters are empowered consumers.

Subprime borrowers are generally the most vulnerable to abusive lending practices. Research in the U.S. indicates that in the residential mortgage market, predatory lending generally occurs in the "subprime" market where borrowers with weak access to credit use the collateral in their homes for debt consolidation or other consumer credit purposes. The research notes that predatory lending may also occur in the "prime" market but is deterred by high levels of competition among lenders and homogenous loan terms—and high levels of financial information (and financial literacy) by borrowers.²⁶

Subprime borrowers often have weak education. The U.S. report also found that, among other characteristics, subprime borrowers were less well-educated than prime borrowers. Sixty percent of prime borrowers had college education versus only 38 percent of subprime borrowers. In one survey, 12 percent of subprime borrowers were unfamiliar with basic financial concepts such as the definition of "principal" and "interest." One-third also claimed that they were not familiar with the different types of mortgage products available.

Surveys of financial consumers in the U.S. have found that the most effective form of financial education is through the media. In one survey, 71 percent of all consumers choose television, radio, magazines and newspapers as the most effective way to learn about personal finances. Information brochures and presentations at home were the next most effective method of acquiring financial expertise.²⁷

Other approaches have also been used. For example, in 2005-06 the EC funded the development of the DOLCETA program, which provides an online training tool for use by

²⁶ *Curbing Predatory Home Mortgage Lending* (June 2000) report of the Joint Task Force of the Department of Housing and Urban Development and Department of Treasury. Available at <http://www.huduser.org/publications/hsgfin/curbing.html>

²⁷ Sandra Braunstein and Carolyn Welch, "Financial Literacy: An Overview of Practice, Research, and Policy," *Federal Reserve Bulletin*, vol. 87 (November 2002). Available at <http://federalreserve.gov/pubs/bulletin/2002/1102lead.pdf>

teachers of adult education. In addition, in 2006 the EC funded a study of financial education initiatives throughout the EU. The objective was to exchange best practice models for improving the access to financial services for those suffering from poverty and social exclusion. Focus was placed on highly-indebted consumers.²⁸

Consideration should be given to Government support for programs that educate consumers and improve their financial literacy. The NBS should play a key role in alerting consumers to illegal practices. The NBS should put in place a system of consumer alerts to highlight to the press and public any consumer protection issue in the financial sector. One useful approach would be to set up a “Consumer Affairs” page on the home page of its website. The page could link to consumer and investor alerts, thus making it easy for consumers (and their advocates) to identify possible scams and schemes from unauthorized financial institutions—with regular distribution of press releases to the media. The planned adoption of the Euro as Slovakia’s currency will also generate opportunities for the financial agencies and consumer organizations to provide financial education for the public.

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

A specialized institution should be established for consumer education and financial literacy. The existing Slovak Institute of Banking Education may provide a useful base for such an institution, although its mandate would need to be changed from training of bankers and bank officials to training of the public. To be effective, the financial education institute should conduct a baseline assessment of the current level of financial literacy, using perhaps methods applied in other EU Member States. Several years later, a follow-up assessment should be conducted to see if the consumer education and financial literacy program was working or if it should be revised to improve its effectiveness and penetration. One approach would be to use a financial IQ quiz, administered through a consumer survey, to test consumers understanding of retail financial services.²⁹ Special consideration should also be given as to how to reach the low-income groups and advise them of their legal rights and institutions available to help them. The specialized institution should also help to set up a national education program through the universities and middle schools to develop programs of financial literacy for students of all ages.

Consumer protection organizations and the media could also play a helpful role. The Government might review the allocation of funding for consumer protection institutions with a view of providing targeted funding that supports the government’s strategy in consumer protection area. The voluntary consumer protection organizations need to have sufficient expertise and resources to deal with financial sector issues. It may be helpful to encourage one, or several, of the current organizations to specialize in financial issues. In addition, newspaper columns on financial issues should be encouraged. A regular column on financial matters for consumers would be very useful for the general readership who is generally retail investors and consumers.

²⁸ A comprehensive survey of financial literacy programs worldwide is provided by the OECD’s 2005 report, *Improving Financial Literacy: Analysis of Issues and Policies*.

²⁹ An example of a financial IQ test is given in Marianne A. Hilgert and Jeanne M. Hogarth, *Household Financial Management: The Connection between Knowledge and Behavior*, Federal Reserve Bulletin, July 2003. Available at <http://www.federalreserve.gov/pubs/bulletin/2003/0703lead.pdf>

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Annex: List of Recommendations

Consumer Protection Laws and Institutions

1. All providers of financial services, including consumer finance companies, should be required to obtain authorization for their activities. Priority: High
2. The NBS could release consumer alerts noting their responsibility and identifying financing entities that operate in Slovakia but are not authorized by the NBS. Priority: Medium
3. NBS (and any other agencies responsible for supervision of retail financial sector activities) should include the objective of protecting financial consumers as part of their formal mandate. Priority: High
4. Consumer finance companies should be obliged to meet certain minimum standards such as disclosure of beneficial ownership and ultimate control of the entities, and publication of annual audited financial statements. Priority: High
5. The law should establish fit and proper standards for significant owners and key directors of consumer finance companies. For example, individuals who have been convicted of economic fraud should not be permitted to be significant shareholders or directors in consumer finance companies. Priority: High
6. NBS should be authorized to use sanctions (such as levying of fines) where finance companies engage in unfair or deceptive practices. Priority: High

Disclosure and Sales Practices

1. The law should prohibit abusive lending practices, including practices that are misleading, harassing, coercing and otherwise unduly influencing consumers in connections with transactions. Priority: Medium
2. A 14 day cooling-off period should apply to all credits and purchases of products with long-term components, including investments in private pension funds. The customer should have the right to withdraw from the contract without having to pay any expenses except for the initial transaction fee agreed at the time of the signing of the contract. Priority: High
3. A “do-not-call” registry should be setup to allow consumers to avoid receiving unsolicited marketing calls for mortgages or other credits. Priority: Low
4. All providers of financial services, particularly for complex financial products, should be required to give consumers a “Statement of Key Facts” or other standardized report at the point of sale of the contract. Priority: High
5. For mortgage loans and any other credits secured by real property (such as a house or apartment), the mandatory disclosure should note that in the case of default, the lender could seize the property. Priority: High

6. For loans denominated in a foreign currency (such as Japanese Yen, Swiss Francs or even Euros), the mandatory key facts disclosure should contain a warning that changes in exchange rates could increase the total amount of the debt. Priority: Medium
7. Additional specialized disclosure should be required for investment products. For pension funds and other investment products, the consumer should be advised of the percentage commission charged for each product. Priority: Medium
8. Regulations should be issued to set out in detail the disclosure requirements for prospectuses and simplified prospectuses of mutual funds, especially for calculating the net asset value (NAV) of real-estate funds. Priority: High
9. Regulations should also standardize the account-opening disclosures for brokerage accounts and collective investment funds. Priority: Medium
10. Banks should be required to use a standardized information sheet provided for mortgage loans. Priority: High
11. NBS should publish—or require that financial institutions publish data for—comparisons of fees, charges and commissions charged for the same service. Priority: High
12. NBS should require that all licensed financial service companies publish annual audited financial statements and the names of the significant beneficial owners and directors of the companies. Priority: Medium
13. Insurance companies should be obliged to publish reports showing the financial solvency of individual companies, based on each company's published financial statements. Priority: High
14. Where financial corporations have received debt ratings (or in the case of insurance companies, rating of claims-paying ability), the companies should be obliged to publish the ratings. Priority: Medium
15. The new legislation should authorize the NBS to establish the assumptions to be used for APRs. Priority: Medium
16. The NBS should specify in its regulations that banks disclose that a current account is not needed to receive financing from the bank. Priority: Medium
17. All banks should be required to establish separate service counters for bank deposit accounts and investment holdings. Priority: Low
18. The NBS should work with the banks to reduce—and preferably eliminate—charges to be paid upon the closing of an account. Priority: Medium
19. Lenders should be required to ensure that loans meet the needs of the borrower. Similarly, sellers of investment products should be obliged to verify that the products are suitable for the purchaser. At a minimum, a standard process should be set by law or regulation by which the lender (or seller of investment products) collects information about the client, particularly when selling complex products such as life insurance or private pensions or special collective investment funds. Priority: Medium

20. Creditors should be obliged to verify the age, financial experience, and business capacity of the client—and if the borrower is in poor health or otherwise unable to comprehend the costs or risks involved in the financial product. At the same time, borrowers and investors should be obliged to provide true and accurate information regarding their financial circumstances. Priority: High
21. A three-tiered system for the training and certification of intermediaries and other sellers of financial products would be useful. Tier 1 would apply to individuals who sold simple products, such as savings account. Tier 2 would relate to complex products, such as pension funds, collective investment funds or life insurance that included a savings component. Tier 3 would be the highest level covering certified financial advisors (or planners). All three tiers should require registration with the NBS of all individuals selling financial products. Priority: High
22. The law should require public disclosure of the fees paid to the brokers. Priority: Medium

Customer Account Handling and Maintenance

1. A regulation should be issued requiring the issuance to customers of periodic and confirmation statements, the minimal contents for the statements and the procedures for customers to correct the statements. Priority: Medium
2. Banks and other lenders should be required to indicate in the customer statements the amount paid towards principal and interest for any loans outstanding. Priority: High
3. Abusive debt-collection practices should be prohibited. Priority: Medium
4. All transactions transferring residential real estate should require authorization by a court order. Priority: Medium
5. The consumer credit legislation should prohibit lenders from making false statements or using unfair practices when collecting debts. Priority: High
6. Financial institutions that hire debt collectors should be required to ensure that their debt collectors are contractually obliged to comply with the law. Priority: High
7. Regulations should set permissible times for contact with borrowers so that borrowers cannot be harassed in the late evening or early morning by debt-collection agents. Priority: Medium
8. Lenders who engage in illegal practices should be prosecuted. Priority: High

Privacy and Data Protection

1. Consumers should be allowed to “opt out” of having their personal financial information being shared with other companies within the financial group or conglomerate. Priority: Medium
2. A systematic credit scoring system for retail customers should be set up. Priority: High

Guarantees and Compensation Funds

1. Bank deposits (and insurance policy holders) should be ranked higher than the claims of general creditors of the financial institution. For this, an amendment will be needed to the Bankruptcy Act. Priority: High

Dispute Resolution Mechanisms

1. Detailed data should be collected on the current status of customer complaints and consumer awareness of the existing mechanisms to resolve disputes. The data should include (1) the nature of complaint, (2) the numbers of complaints for each type of complaint, (3) the time required to resolve each complaint, and (4) the final resolution to each complaint. Priority: High
2. The NBS should also ensure that all financial institutions have in-house dispute resolution mechanisms with a system of time-bound resolution and a formal mechanism for dispute resolution. Priority: Medium
3. All financial institutions should be required to prepare a policy on internal dispute resolution—and the policy should be subject to review by the NBS as part of its standard supervision procedures. Priority: High
4. The NBS should require that financial institutions provide information to consumers on how to seek a remedy, including redress, for problems arising out of interactions with the companies or their intermediaries. Priority: High
5. Financial institutions should also prepare an annual report of compliance with their dispute-resolution policy. Priority: Medium
6. The NBS should create a Consumer Protection Department which should create a central registry where complaints are filed and reviewed by the NBS for systematic patterns of consumer abuse. Priority: High
7. The Consumer Protection Department should also have the authority to make recommendations to the Supervision Department about proposed changes in supervision practices or internal operations of banks, or if necessary, changes in laws or regulations. Priority: Medium
8. A financial ombudsman should be established, and the industry associations should be encouraged to set up their own ombudsman structures. The industries ombudsmen would then operate under the supervision of a general financial sector ombudsman. Priority: High
9. The ombudsman should be obliged to publish an annual report describing decisions taken by the ombudsman and be part of FIN-NET. Priority: Medium
10. Industry associations should be encouraged to develop codes of conduct, including principle-based codes of practice covering areas that include responsible practices in lending, marketing and management of arrears. Priority: Medium
11. Associations should also be encouraged to take action to mediate, and if possible resolve, disputes where a lender's practice violates the association's code of conduct. Priority: Medium

12. The codes should be disseminated to the public. Priority: High

Consumer Education and Financial Literacy

1. Consideration should be given to Government support for programs that educate consumers and improve their financial literacy. Priority: High
2. The NBS should play a key role in alerting consumers to illegal practices. The NBS should put in place a system of consumer alerts to highlight to the press and public any consumer protection issue in the financial sector, such as a “Consumer Affairs” page on its website. Priority: High
3. Financial institutions should play a role in educating their customers. Priority: Medium
4. A specialized institution should be established for consumer education and financial literacy, and it should conduct a baseline assessment of the current level of financial literacy and follow-up assessments. Priority: Medium
5. The specialized institution should also help to set up a national education program through the universities and middle schools to develop programs of financial literacy for students of all ages. Priority: Medium



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