

FINANCIAL SERVICES CONSUMER PROTECTION IN UKRAINE: LEGAL ANALYSIS

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Roksolana Khanyk-Pospolitak*

Consultant to USAID Financial Sector Development Project (FINREP),
Head of Department of Applied Legal Studies of the National University of
"Kyiv-Mohyla Academy"

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Financial Sector Development Project (FINREP)

7/9 Yaroslavskyi Lane, 2nd Floor, 04071, Kyiv, Ukraine
www.finrep.kiev.ua

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ABBREVIATIONS

AMC	Asset Management Company
AMCU	Administrative Misdemeanor Code of Ukraine
CCU	Civil Code of Ukraine
CFF	Construction Finance Fund
CMU	Cabinet of Ministers of Ukraine
ComCPU	Commercial Procedural Code of Ukraine
ComCU	Commercial Code of Ukraine
CPCU	Civil Procedural Code of Ukraine
EU	European Union
FSR	State Financial Services Markets Regulation Commission of Ukraine
JII	Joint Investment Institution
LU-Ad	Law of Ukraine "On Advertising"
LU-BB	Law of Ukraine "On Banks and Banking"
LU-CRP	Law of Ukraine "On Consumer Rights Protection"
LU-CU	Law of Ukraine "On Credit Unions"
LU-FS	Law of Ukraine "On Financial Services and State Regulation of Financial Services Markets"
LU-JII	Law of Ukraine "On Joint Investment Institutions (Unit Investment Funds and Corporate Investment Funds)"
LU-NBU	Law of Ukraine "On the National Bank of Ukraine"
LU-NPP	Law of Ukraine "On Non-State Pension Provision"
LU-PSMT	Law of Ukraine "On Payment Systems and Money Transfers in Ukraine"
LU-SSMSC	Law of Ukraine "On State Regulation of the Securities Market in Ukraine"
NBFI	Non-Bank Financial Institutions
NBU	National Bank of Ukraine
NPF	Non-state Pension Fund
OECD	Organization for Economic Co-operation and Development
REF	Real-Estate Fund
SCRI	State Consumer Rights Protection Inspectorate of Ukraine
SSMSC	Securities and Stock Market State Commission
STRCPC	State Technical Regulation and Consumer Policy Committee of Ukraine
UIF	Unit Investment Fund
UK	United Kingdom

I. Introduction

Enhanced protection of consumer rights in financial services is needed in Ukraine for two fundamental reasons. First, financial literacy in Ukraine is weak and the population is vulnerable to unscrupulous schemes. The majority of adults between the ages 20 to 60 have little understanding of credit, mortgages, insurance, floating interest rates, investment funds, stock or bonds. Most Ukrainians are unable to correctly answer simple mathematical questions necessary to be able to manage one's own finances. While this is not uncommon (surveys find that even in highly developed economies most individuals have modest levels of financial literacy), in Ukraine the problem is compounded by very poor understanding of consumer rights in financial services.

The combination of these two factors – financial illiteracy and lack of trust – hinders greatly the development of robust and broad financial markets in Ukraine.

Second, Ukrainians do not trust the financial sector and this severely limits the stability of the financial system. There is perhaps as much money under mattresses as there

is in deposit accounts. Ukrainians use a very limited array of financial services, principally public utility payments, bank account plastic cards, ATM transactions and insurance of civil liability of car owners. One in four Ukrainians reports a bad experience with a financial transaction such as a bank deposit, consumer loan, or a credit card. Moreover, most Ukrainians believe that in a dispute between an individual and a financial institution, the financial institution will prevail.

The combination of these two factors – financial illiteracy and lack of trust – hinders greatly the development of robust and broad financial markets in Ukraine. The Organization for Economic Co-operation and Development (OECD) stresses that financial education for consumers is a requisite of smooth functioning capital markets and for growth of the economy as a whole. Likewise, the World Bank argues that financial literacy and empowering consumers is essential for efficient and transparent financial markets, particularly in countries like Ukraine moving from central planning to market economies. Remedies for Ukraine in these areas obviously include

greater financial education and improved transactional experiences with the financial sector. Yet, an equally important approach is to improve the legal and regulatory framework for consumer protection in financial services.

European Union Standards and Experience of Financial Services Consumer Protection

Although there is general agreement on the need for financial services consumer protection, a unified framework for protecting the interests of financial consumers is not yet in place on the international level. However, guidelines prepared by international organizations (World Bank, OECD, International Consumer Protection Group) are available and useful. Protection of financial consumers is part of the objective of the European Union (EU) in developing a single market for financial services, and a number of specific EU Directives relate to aspects of financial services and consumer protection.

The EU is actively engaged in an extensive program to further strengthen consumer protection in financial services, primarily because different, country-specific standards of consumer protection could undermine the integrity of the single market. The EU approach to an effective regime of financial services consumer protection is based on three fundamental principles. Consumers should have access to:

- 1) Sufficient information to make informed decisions on the purchase of financial services;
- 2) Cost-effective recourse mechanisms to redress violations of the financial service contract;
- 3) Programs of financial education.

These principles are covered in several EU Directives dealing with consumer protection. Their focus is on disclosure and advertising, sales practices, account handling, compensation and guarantee schemes, and the competence and financial strength of the service providers. New initiatives are in process with regard to mortgage lending.

Major European Union Directives

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- Directive 2008/48/EC of 23 April 2008 covers consumer credit loans from EUR 200 to EUR 75 000 and regulates advertising, pre-contractual and contractual information, creditworthiness assessments, adequate explanations, and disclosure requirements.
- Directive 2002/65/EC of 23 September 2002 concerning "distance marketing" of consumer financial services, which enhances consumer protection for services offered via Internet, telephone, or fax.
- Directive 2006/114/EC of 12 December 2006 concerning misleading and comparative advertising by securities traders, and Directive 2005/29/EC of 11 May 2005 concerning unfair business-to-consumer commercial practices by traders.
- Directive 93/13/EEC of 5 April 1993, which introduces the notion of 'good faith' in the relationship between consumers and sellers, and establishes general requirements for "fair" contract terms.
- Directive 2006/48/EC of 14 June 2006 relates to the licensing and supervision of credit institutions to the taking up and pursuit of the business of credit institutions.
- Other Directives: Directive 2009/48/EC on injunctions for consumer rights; Directive 94/19/EC on Deposit Guarantee Schemes; Directive 1997/9/EC on investor compensation schemes; and Directive 95/46/EC on personal data protection.

Recently, the EU Commission has undertaken a thorough review of EU mortgage markets, culminating in the White Paper on the integration of EU mortgage markets.¹ The underlying idea of greater integration and harmonization in the EU mortgage market is that an increase in cross-border activity and competition could increase consumer choice and reduce costs. The Commission also launched a public consultation to strengthen and deepen its understanding of the issues surrounding responsible lending and borrowing (for example, pre-contractual information,

¹ COMMISSION OF THE EUROPEAN COMMUNITIES, White Paper on the Integration of EU Mortgage Credit Markets (Brussels, 18.12.2007) // http://ec.europa.eu/internal_market/finances-retail/home-loans/integration_en.htm

advice, creditworthiness assessment, early repayment and credit intermediaries).

As a result, in March 2011, the Commission adopted the Proposal for a Directive on credit agreements relating to residential property.² This proposal aims at complementing the Consumer Credit Directive by creating a similar framework for mortgage credit. The proposal also takes into account the fact that some Member States are already applying certain provisions of the Consumer Credit Directive to mortgage credit.

EU countries can implement EU Directives on consumer financial protection in two ways. They can either 1) amend and supplement current generic laws (laws on consumer protection, on credit institutions) and/or 2) adopt new special laws on this issue.

Austria, Finland, France and Italy amended and supplemented their generic laws with provisions regarding financial services consumer protection. In Austria, provisions on consumer protection in banking (loan agreements, current account agreements, prices and advertising, banking secrecy) are part of the Federal Banking Act of 1993, while services in other financial areas are covered in other acts: the Insurance Act of 1958, Investment Funds Act of 1993, and Securities Supervision Act of 2007. In Finland, consumer credit provisions are part of the Consumer Protection Act of January 20, 1978 (No.38/1978) and the Act on Credit Institutions of 2007. France and Italy passed comprehensive laws: Consumer Codes that contain direct provisions regarding financial services.

Countries like Croatia, Czech Republic, Poland, Slovakia, and Bulgaria adopted special laws regarding consumer credits. In Croatia, for example, high-level provisions are part of the Act on Credit Institutions of September 26, 2008 (definition of a consumer, service agreements, disclosures, requirements for the content of agreements, notification of consumers, taking consumers' complaints and out-of-court settlement of disputes) and the Consumer Protection Act of 2003. Amendments to this Act in 2007 incorporated most of the provisions of the EU Directives on consumer

² Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on credit agreements relating to residential property // http://ec.europa.eu/internal_market/finances-retail/credit/mortgage_en.htm

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protection, including the provisions on unfair contracts and distance marketing of financial services. Provisions of the EU Directive on consumer credit are included in the Consumer Credit Act of June 19, 2009, which became effective on January 1, 2010. This Law sets out requirements for: consumer credit agreements and disclosures; rights concerning such agreements; access to databases; and consumer protection supervision. The mandate of supervisory authorities is set forth in the Act on the National Bank of Croatia of 2008 and the Act on the Croatian Financial Services Supervisory Agency of 2005.

Perhaps the most difficult issue for most countries in reforming the legal/regulatory framework for financial consumer protection is selecting the institutional and enforcement structure.

The Czech Republic put consumer credit provisions in the Act on Certain Conditions for the Conclusion of Consumer Loans of 2001 (No. 321/2001).

The regulatory framework and supervisory functions were codified in two acts: the Act on the Czech Trade Inspection of October 20, 1986, and in the Act on the Czech National Bank of December 17, 1992 (No. 6/1993). The financial arbiter status is established in the Financial Arbiter Act of 2002 (No. 229/2002). As in Croatia, there is a Consumer Protection Act of December 16, 1992 (No. 634/1992), which sets out general aspects: prohibition of unfair business practices, consumer rights, powers of governmental agencies, associations of consumers and other legal entities established to protect consumer rights.

Poland, Slovakia, and Bulgaria also have separate Consumer Credit Acts of July 20, 2001, March 9, 2010, and February 18, 2010, respectively.

Perhaps the most difficult issue for most countries in reforming the legal/regulatory framework for financial consumer protection is selecting the institutional and enforcement structure. In some EU countries, the financial supervisory agencies view consumer protection as part of their mandate for financial stability. In others, it is a general consumer protection agency that takes on the responsibility of dealing with financial services. Some countries

have used a third approach, creating a special purpose consumer financial protection agency.

For example, in Croatia, authority is shared among several financial agencies. The National Bank monitors the banking sector and whether credit institutions generally comply with good business practices, disclose general operating information, and conclude contracts with their clients that include consumer protection provisions. However, the National Bank does not address individual consumer complaints. If a consumer deems that a credit institution has not complied with the conditions of a contract, he/she may file a complaint with:

- A responsible unit of the credit institution itself;
- The internal audit unit of the credit institution;
- The consumer protection association;
- The competent regional office of the State Inspector's Office; or
- Other competent authorities.

If a consumer files a complaint, as mentioned above, the consumer may notify the National Bank. On receipt of such notification, the National Bank will require the credit institution to make a statement on the complaint. The statement will be delivered to the consumer by the National Bank.

The Croatian Financial Services Supervisory Authority supervises the stock market, investment funds, insurers, private pension, and leasing companies, and has direct investor education tasks. The State Inspector's Office is responsible for the enforcement of the Consumer Protection Act and, since 2010, the Consumer Credit Act (jointly with the National Bank). Thus, if the State Inspector's Office receives a consumer complaint about the failure of a credit institution, credit union, or payment agency to comply with the Act, it must forward the complaint to the National Bank for further action. Also, the Act on Credit Institutions establishes the Conciliation Center within the Chamber of Economy of Croatia to resolve disputes between financial services consumers and credit institutions. The decisions of this center are recognized as enforcement documents. The Consumer Credit Act contains a large list of offences punishable by fines of up to 200,000 kunas (about \$38,800) for legal

entities and up to 50,000 kunas (about \$9,700) for individually responsible persons.

In the Czech Republic, powers for supervision over consumer financial protection are divided between the Czech Trade Inspection and the National Bank. Compliance with the Act on Certain Conditions of Entering into Consumer Credit Agreements is supervised by the Czech Trade Inspection under the Ministry for Trade and Industry. This Law does not cover other retail banking products such as mortgages,

Ukraine's European contemporaries display diverse approaches to regulatory infrastructure and oversight.

credit cards, and saving products. The National Bank performs supervision of compliance with the obligations set out in the Civil Code,

including distant financial services agreements, prohibition of unfair business practices, and compliance with obligations upon concluding consumer credit agreements. This supervision is exercised over banks, credit unions, electronic money institutions, and payment institutions. Importantly, in 2006, the National Bank became the regulator for the entire financial sector and assumed the responsibilities of the Czech Securities Commission with respect to the stock market, and the responsibilities of the Ministry of Finance with respect to the insurance and pension sector. The National Bank of the Czech Republic was also registered as a relevant supervisory authority in accordance with the rules of Regulation (EC) No.2006/2004 on EU cooperation regarding consumer protection.

In Slovakia, compliance with the Act of Consumer Credits and Other Credits and Loans to Consumers is monitored by the Slovakian Trade Inspection, if not stipulated otherwise in special legislation. If the abovementioned Inspection finds shortcomings in the activities of the creditor or the financial agent, namely, breaching or evading the provisions of the Act, the Inspection is entitled, depending on the materiality, consequences, and nature of the shortcomings, to: a) require the creditor or the financial agent to rectify the shortcomings; b) impose a fine of up to €70,000, and in case of a repeated or major shortcoming – up to €140,000; c) decide to deregister the creditor's entry from the register of creditors.

In the United Kingdom (UK) and Ireland, the consumer financial protection powers are

exercised by the financial ombudsman. The UK Financial Ombudsman Service was established in 2000 by merging six ombudsmen services in different sectors of the financial market (banking, insurance, investments, etc.). Thus, the financial ombudsman obtained the mandate for the entire financial sector. The establishment of the Financial Ombudsman Service was provided for by the Financial Services and Markets Act of 2000, which introduced a unified regulator – the Financial Services Authority. The financial ombudsman is not a regulator but an out-of-court alternative way of settling disputes between financial institutions and their clients.

The Panorama for Consumer Protection in Ukraine

This paper focuses on the status of the laws on consumer protection for users of financial services in Ukraine. It examines the basic consumer protection and financial services laws of Ukraine governing various financial transactions, it surveys the institutional arrangement for regulating and enforcing these laws, and it looks at selected, important issues of consumer protection in bank and NBFIs (insurance companies, credit unions, non-state pension funds and joint investment funds). Other financial sector actors, such as pawn shops, real estate funds, trusts and credit societies, are discussed in an annex to the report.

This report offers a first step in understanding the legal environment for consumer protection in financial transactions in Ukraine. It advances four major arguments.

First, Ukraine's basic legislation on consumer protection is fragmented and inconsistent, and requires revision to clarify basic definitions and key provisions across several laws. In addition, some financial service institutions are unregulated and effectively outside the scope of state authority and supervision. This serves to undermine consumer financial protection generally.

Second, the capacity of the court system for adjudicating fairly and quickly disputes over the terms and condition of financial services

Areas of Concern Regarding Consumer Protection:

- 1) Legislation is fragmented
- 2) Inefficient dispute resolution
- 3) Weak regulation infrastructure
- 4) Poor disclosure practices

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provision is weak. There is an important need to clarify and consolidate judicial practice in this area, and to create space for alternative dispute resolution mechanisms (out-of-court resolution) between creditors and consumers.

Third, the institutional structure for consumer protection in Ukraine is fragmented and weak, requiring both rationalization and strengthening. The basic framework law for consumer protection inadequately addresses financial services, and therefore the authority of several regulators (NBU, SSMSC, FSR, etc.) is not clearly defined. There is seemingly little coordination among these government agencies, laws are not consistently formulated and applied to banks and non-bank financial institutions (NBFIs) equally, and enforcement powers are weak.

Fourth, because there is no clearly defined legal framework, no effective court system (or alternative dispute resolution), and little or no coordination by regulatory authorities, the issue of disclosure becomes all the more important. A critically important step is to enforce existing legislation on disclosure of terms and conditions of financial obligations, to take action to prohibit deceptive and unfair advertising of financial

services to consumers, and to encourage financial institutions and their professional associations to develop model template contracts and to police themselves on the fair treatment of consumers.

Much could be accomplished to enhance the protection of consumers of financial services by the creation of a task force to review and revise existing laws and regulations. Taking the EU Directives into consideration seriously would be a good starting point. The most pressing legal need is to provide clarification and consistency of existing basic provisions among the laws that pertain to consumers of financial services, rather than drafting a new comprehensive law. This task force should consist of representatives of all interested parties, and be charged with the mandate to achieve a balance between creditor and consumer rights in Ukraine's basic financial sector laws. The legal framework for protection of users of financial services should not be thought of as a zero-sum game, with consumers on one side and banks and NBFIs on the other. Benefits will flow to both if trust in financial institutions can be increased among the population.

II. Legal and Regulatory Environment of the Consumer Protection in Ukraine

A. General Overview of Financial Services Markets and the Status of the Consumer Protection

Providers of financial services in Ukraine can be divided into two sectors: the banking sector (banks) and the NBFIs (credit unions, pawn shops, insurance companies, non-state pension funds and other non-state pension provision entities, credit companies, trust companies, construction finance funds and real-estate funds), including the stock market (investment activities and trade in securities). Their activities are regulated by state authorities according to this distribution. The National Bank of Ukraine (NBU) regulates and supervises banks, the State Financial Services Markets Regulation Commission of Ukraine (FSR) regulates and supervises non-bank institutions, and the Securities and Stock Market State Commission regulates and supervises the stock market (Article 21 of the Law of Ukraine "On Financial Service").

There are many financial services, namely: issuance of payment documents, payment cards, traveller's checks and/or the servicing thereof, clearing, other forms of payment; fiduciary management of financial assets; currency exchange; borrowing of financial assets with the undertaking to repay the same; financial leasing; lending of funds, for instance, on terms and conditions of a financial loan; provision of guarantees and suretyship; money transfers; services in the field of insurance and accumulative pension provision; trade in securities; factoring; group buy schemes, and other transactions.

The level of trust in Ukraine's financial market is low due to insufficient financial literacy, the inadequate transparency and low level of consumer protection, and deceptive practices by financial services providers.

At the moment, some members of the financial services market, which provide financial services, are subject to licensing, while others are to be merely registered as a financial institution. For

instance, companies, which provide collection services by means of entry into factoring

contracts, are entered into the Financial Institutions Register but are not licensed. Business entities that grant loans are also not monitored.

Both legal entities and individuals are consumers of financial services in Ukraine. However, the Law of Ukraine "On Consumer Rights Protection" (LU-CRP) recognizes only individuals as consumers. It should be kept in mind that an individual procuring financial services is not identified as a "consumer" in various regulatory acts at all times.

The rights of consumers of financial services are protected by framework laws that are generally adequate. However, several key problems exist: the regulation of the protection of rights of financial services consumers is far from being perfect, regulation of the financial services markets is inadequate, and laws and other regulatory acts are uncoordinated and unclear.

The development of the financial services market in Ukraine depends on public trust in institutions of the financial market. This level of trust in Ukraine is low due to insufficient financial literacy, the inadequate transparency and low level of consumer protection, and deceptive practices by financial services providers. Consumers possess neither the necessary information about the financial products they are being sold, nor the required knowledge to understand them. They are unable to assess the level of risk and possible consequences of assuming additional financial liabilities, and they are unable to compare the conditions of the services being offered by various financial institutions.

Unfortunately, there is no comprehensive framework for the protection of rights of consumers of financial services at the national level in Ukraine. State authorities have developed some regulations to bridge identified gaps in the legislation and, by doing so, contributed to consumer protection, but the steps taken so far are inadequate for the provision of the proper level of protection. Any proposed systemic changes have remained a mere statement of intent.

For instance, a Non-banking Financial Services Consumer Protection Concept was approved with Instruction of the Cabinet of Ministers of

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Ukraine (CMU) No. 1026-r of September 3, 2009, and an action plan for its implementation was developed. The concept provides for improving the procedures and mechanisms of assurance of consumer protection, the institutional (administrative) capacity building of agencies in charge of the state regulation of financial services markets, improved transparency of activities of NBFIs, and better information-based protection of consumers. Most measures in the Concept are scheduled to start in 2011, but, so far, even the measures planned for year 2010 have not been implemented.

B. Fundamental Legislation

Many laws and regulations provide for the protection of the rights of consumers of financial services. The sheer number of regulations gives rise to issues from the point of view of consumer protection. Moreover, these regulations often protect consumer rights indirectly and do not specify the procedures for setting disputes.

The Law of Ukraine "On Consumer Rights Protection" focuses mainly on the protection of consumers of products, and regulation of financial services is limited only to consumer lending.

The LU-CRP is the overarching legal act which governs consumer protection. It sets out the fundamental principles of the consumer protection and establishes a dedicated state authority (currently,

the STRCPC³) in charge of consumer protection, and defines its powers. This basic Law is more than adequate for protecting consumer rights in many areas, but it is deficient in its treatment of financial services.

It is focused mainly on the protection of consumers of products, and scarcely regulates

financial services. In fact, the Law covers consumer lending only.

The definition of a "service" is provided in item 17 of Article 1 of the LU-CRP. A "service" is understood as an "activity of a contractor involving the provision (transfer) to the consumer with a certain tangible or intangible benefit defined by a contract that takes place on the basis of a custom order of the consumer for meeting the consumer's personal needs." In practice, however, this definition covers only the provision of services used in the course of consumption, while financial services rarely fit this definition.

The Law enumerates the following rights of consumers: to be protected by the state; to obtain necessary, accessible, true and timely information about a product, its quantity, quality and range, as well as the manufacturer (contractor, seller) thereof (*however, not the information about services — Author's note*); to apply to court of law and other authorized state authorities for the protection of violated rights; to establish civil-society consumer organizations (consumer associations), etc.

The Law does not contain direct provisions regarding the rights associated with financial services. The following articles treat the rights of consumers of financial services indirectly, via the rights of services consumers in general: Article 10 of the Law (the rights of a consumer in case of the violation of a works (services) contract); Article 15 (the consumer's right to obtain information); Article 18 ("onerous" terms and conditions in contracts with consumers); and Article 19 (prohibition of unfair business practices).

Article 11 of the LU-CRP refers to the protection of rights of financial services consumers directly, because it describes in detail the rights of a consumer if (s)he purchases products on credit. Item 23 of Article 1 of the Law defines a "consumer loan" as funds granted by a lender (a bank or another financial institution) to a consumer for the purchase of products.

References to the judicial practice of the examination of civil-law cases by the Supreme Court of Ukraine play an important role from the point of view of the practical application of this article and other articles of the Law. The Supreme Court of Ukraine specifies in its Plenum Resolution "On Practice of Examination of Civil-law Cases under Consumer Rights Protection Claims" No. 5 of April 12, 1996, that

³ Decree of the President of Ukraine "Issues of Optimization of the System of Central Executive Agencies" No. 370/2011 of April 6, 2011, provides for the establishment of the State Consumer Rights Protection Inspectorate of Ukraine. On April 13, 2011, the Charter of the State Consumer Rights Protection Inspectorate of Ukraine was approved with Decree of the President of Ukraine No. 465/2011. The STRCPC was transformed into the SCRI. Powers of the new agency are specified in item 6 of the Charter. For instance, the SCRI may generalize the legislation application practice and inspect business entities in the field of services, etc. The powers of the SCRI have not been expanded in comparison with provisions of the current laws. Hereinafter, the term "SCRI" will be used in lieu of "STRCPC".

"this Law" (*the LU-CRP – author's note*) applies to legal relations of insurance, contracts for the provision of financial and lending services for meeting individual household needs (including the provision loans, the opening and the maintenance of accounts, the performance of payment transactions, the acceptance and the safe custody of securities, the provision of consultancy services). This is the only reference to financial services in the Plenum Resolution of the Supreme Court of Ukraine.

In its Consolidation of the Judicial Practice of Examination of Civil-law Cases Arising from Credit-based Legal Relations (Years 2009 to 2010) of October 07, 2010, the Supreme Court of Ukraine concluded that the LU-CRP can be applied to disputes arising from credit-based legal relations if the issues pertain to consumer information about lending conditions (the types of interest rates, the foreign exchange risks, the procedure of the contract performance, etc.) and if they precede the entry into the contract.

Due to the above factors, there is no universal approach toward the application of consumer protection legislation regarding legal relations between consumers of financial services and financial institutions. It is for this reason that it

Given the current laws in Ukraine, there is no universal approach toward the application of consumer protection legislation regarding legal relations between consumers of financial services and financial institutions.

is necessary to clearly define consumers of financial services and their rights in the LU-CRP.

Article 23 of the LU-CRP allows for a penalty when a violation of the consumer protection legislation occurs.

This is an extremely positive clause, but it does not apply to the provision of services (other than amenity services in the field of retail trade and other types of amenity services), including financial services. Article 11 of the LU-CRP calls for the provision of the complete and true information before the entry into a consumer loan contract. However, penalties referred to in item 7 part 1 of Article 23 cannot be applied in the case of a violation of the requirements of Article 11, because this item can only be applied in cases that lack the necessary, accessible, true and timely information about products.

The Law of Ukraine "On Financial Services and State Regulation of Financial Service Markets" (LU-FS) refers to consumers in its definition of the notion of members of the financial services markets. According to the LU-FS, legal entities and sole proprietors, which are eligible to operate a financial services business, and the consumers of said services are members of the financial services markets. In fact, the above definition defines the range of parties to legal relations in this area. On the one hand, we have providers of financial services; on the other hand, we have consumers thereof. The Law defines clearly who may provide such services. However, it is not that specific about consumers. If one applies systemic construction of the law, one should rely on the definition provided in item 22 of part 1 of Article 2 of the LU-CRP. Thus, only individuals should be treated as consumers of financial services.

The LU-FS contains some provisions regarding consumer protections. Article 6 sets out general requirements for a financial services contract. Additional requirements may be specified by a dedicated agency, such as the FSR. The LU-FS has clearly prohibited financial institutions from unilaterally increasing an interest rate or other payments under the loan agreement or the debt repayment schedule, subject to specific situations specified in the law. In addition, financial institutions are prohibited from requiring an early repayment of the debt remaining under a loan and from voiding unilaterally the existing loan agreements in the case of a disagreement of the borrower with the suggestion of a financial institution to increase the interest rate or another payment called for by the loan agreement or the debt repayment schedule. Article 11 is very brief about the prohibition of the dissemination of advertising and other information containing false data on activities in the field of financial services in any form. The customer's right to information is specified in Article 12.

Other provisions of the LU-FS apply mainly to the regulation of the financial services market in Ukraine: the conditions of the establishment and the operation of financial institutions, licensing, capital requirements, and the powers of the authorized body. The LU-FS lacks provisions with respect to the liability of financial institutions for the violation of consumer rights.

Chapter 12 of the Administrative Misdemeanor Code of Ukraine (AMCU) sets out the penalties for administrative violations in the field of trade,

services, finance and entrepreneurship, and consumer protection. Specific articles contain direct references to consumer rights. For instance, Article 156-1 provides a penalty for the violation of consumer protection legislation; however, it only applies again to consumers of products, work and amenity services. Article 168-1 provides a penalty for the performance of work and the provision of services to consumers that do not meet required standards, policies and rules. Thus, it may only be applied after the appropriate state authorities develop standards for the provision of financial services.

It is a deficiency of the AMCU that it does not provide an administrative penalty for the violation of rights of consumers of financial services. The provisions of Chapter 12 of the AMCU should be expanded to the provision of any services (including financial ones) by making these provisions more specific.

The lack of specific penalty provisions results in issues with the application of the law. Article 244-4 of the AMCU provides that executive agencies in the field of consumer protection (in this case, the State Consumer

The lack of specific penalties for consumer protection violations makes official action against violators problematic.

Rights Protection Inspectorate of Ukraine, or SCRI) shall review administrative misdemeanor cases related to the violation of

legislation on the protection of rights of individual consumers set forth in Chapter 12 of the AMCU. Since Chapter 12 lacks a provision on administrative penalties for the violation of the legislation on the protection of rights of consumers of financial services, the SCRI may not review cases involving financial services and apply relevant sanctions.

Article 244-16 of the AMCU allows specifically authorized executive agency bodies that deal in the regulation of markets of financial services (in this case, the FSR) to review administrative misdemeanor cases related to the violation of the legislation that governs financial mechanisms of investment into housing construction (Article 166-13). In addition, it covers failure to comply with legitimate demands of officers of the specifically authorized executive agency in the field of the regulation of markets of financial services (Article 188-29). It is positive that the AMCU

contains the above articles. However, they provide for indirect consumer protection only and do not directly provide for sanctions in case a violation of rights of financial services consumers occurs.

The Criminal Code of Ukraine contains merely three articles that refer to consumer protection (225 to 227 – deception of purchasers and customers; falsification of measurement instruments; and poor-quality products). Only Article 225 refers to the deception of a customer during the provision of services. Unfortunately, no statistics are available about the criminal penalties involving cases of the provision of financial services. Thus, it is difficult to say whether this article has ever been applied to financial services. In addition, its application is very complicated in principle because it is problematic to prove intent in cases of the provision of services to a customer. The application of Article 190 of the Criminal Code of Ukraine (fraud) is more realistic for the purposes of punishment in the case of a violation of rights of financial services consumers. However, no statistics are available on the application of this article for the violation of consumer rights.

C. State Regulation

The legislation of Ukraine is not sufficiently specific about delimiting the powers of different state authorities regarding consumer protection for financial services. Likewise, legislation does not specifically enumerate the direct powers of state authorities in the field of consumer protection.

As previously mentioned, the responsibility areas of financial sector regulation are allocated in Ukraine as follows: the NBU supervises the banking sector; the Securities and Stock Market State Commission (SSMSC) is in charge of the stock market and its members; the FSR supervises the activities of the other non-bank financial sector. Additionally, the SCRI is in charge of consumer protection in general. Local self-governing bodies are also involved in this work. However, there is no clear segregation of duties among state authorities in this area and there is no regulation of mutual relations regarding the protection of rights of financial services consumers. This situation affects the

protection of rights of financial services consumers.

The SCRI is the central body in charge of consumer protection. Its powers are specified in Article 26 of the LU-CRP. However, it is clear under the provisions of the law that its powers apply to consumer protection with regards to goods manufacturers and the work of services contractors.

The SCRI does protect the rights of consumers of services in the field of amenity

Ukrainian Regulators

NBU – Banks
SSMSC – Stocks & Securities
FSR – Non-Bank Financial Institutes
SCRI – Consumer Rights Protection

services, but it protects rights in the field of the provision of financial services solely to the extent of control over consumer lending contracts (Letter of STRCPC No. 2408-7-5/18 of March 10, 2009). Consumer protection in the field of the provision of other financial services is included into the competence of other state authorities (Article 27 of the Law). In addition, the STRCPC mentioned in its Letter No. 4343-1-5/18 of May 6, 2008, that the provision of consumers with the necessary, accessible and true information about a product (service) is to be controlled by regional consumer protection agencies. The regional agencies review this data in the course of inspections for the conclusion of consumer lending contracts by banks and that appropriate measures are to be taken in accordance with the procedure specified by law if violations are detected.

Thus, the powers of the SCRI regarding providers of financial services are very limited. The SCRI may not apply any sanctions to parties that violate consumer protection legislation.

Regarding the three regulators of the financial services markets, the LU-CRP provides that the state authorities must protect the rights of consumers. However, no such powers are vested in them in the dedicated laws that define their respective competencies. The laws only specify the major objective or one of the goals of the activities of these agencies. In practice, neither the NBU, nor the FSR, nor the SSMSC is involved in consumer protection. State authorities do not apply appropriate tools at all times, even if they have such tools.

The Law of Ukraine "On the National Bank of Ukraine" (LU-NBU) does not contain specific

provisions on consumer protection by the NBU, and does not even list this protection among its tasks. The LU-CRP provides in its Article 27 that "other executive agencies shall exercise the state consumer protection within the scope of their competence". However, the NBU is Ukraine's central bank, a central state authority with a special status, in accordance with Article 2 of the LU-NBU. It is not an executive agency.

Powers of the NBU, which can indirectly contribute to consumer protection, include: the power to specify banking transaction performance, accounting and reporting, information disclosure, funds and property protection rules for banks; the power to regulate and supervise banks; keeping the State Banks Register; and licensing banking business and transactions in events specified by law (Article 7 of the LU-NBU).

According to the Law of Ukraine "On Banks and Banking" (LU-BB), the NBU monitors the compliance of banks or other entities with the requirements of banking legislation and regulations of the NBU. In the case of a violation of such requirements or the engagement of high-risk transactions that endanger interests of depositors or other creditors of a bank, the NBU applies sanctions commensurate to the committed violations in accordance with the procedure prescribed by the Policy of the Application of Sanctions by the NBU for the Violation of the Banking Legislation, approved by NBU Resolution No. 369 of August 28, 2001. Thus, issues not governed by the banking legislation are beyond the jurisdiction of the NBU.

The banking legislation directly related to consumer protection consists, perhaps, of only NBU Resolution No. 168 of May 10, 2007, "On Approval of Rules of the Provision of the Information to Consumers by Banks of Ukraine on Lending Conditions and the Aggregate Cost of the Loan". The NBU supervises the compliance with Resolution 168 (Letter of the NBU No. 40-115/616-1863 of February 18, 2008). The powers of the NBU do not include supervision of banks' compliance with the consumer protection legislation.

According to Article 54 of the LU-BB, banks are prohibited from disseminating advertising which contains false information about their activities in the field of banking services, in any form. The NBU may apply sanctions against banks and

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other parties that violate these prohibitions. The legislation does not specify the sanctions to be applied by the NBU in case of a violation of the advertising legislation. It is only possible to apply general sanctions called for by Resolution No. 369 of the Board of the NBU.

The FSR is a central executive agency with a special status in charge of the regulation of markets of financial services. The FSR is the major agency that should have ensured the protection of rights of consumers of non-bank financial services because it supervises and controls the bulk of participants in the financial services market.

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The powers of the FSR are enumerated in Article 28 of the LU-FS, other various laws, and the Charter of the State Financial Services Markets Regulation Commission of Ukraine approved with CMU Resolution No. 157 of February 3, 2010. These powers are related to the regulation of the market of financial services, including: the development of the relevant draft laws and other regulations in this area; the regulation and the supervision of activities of financial institutions; the registration of financial institutions and self-regulated organizations of members in the financial services markets; the issuance of appropriate permits and licenses to financial institutions; the approval of licensing conditions; and the specification of additional requirements for contracts for the provision of individuals with financial services, unless such requirements are otherwise specified by law.

The FSR does not have the specific power to protect rights of consumers of financial services. The FSR is only able to protect the rights of consumers through enforcement of the provisions referred to above. A conclusion can be drawn that most of the FSR powers are focused on securing the right of consumers to being informed and to ensure the proper quality of financial services. It is secured by means of granting the FSR the power to develop additional requirements for contracts and to endorse information to be provided to consumers. These powers are enumerated in both the overarching LU-FS and special laws. At the same time, the power to impose

sanctions, such as penalties for the violation of rights of financial services consumers, is either missing, or inadequate.

The FSR may not control advertising for most financial services. The Law of Ukraine "On Advertising" (LU-Ad) does not vest it with such authority and does not list the FSR among the eligible agencies. Some powers regarding advertising in the field of non-bank services are granted only with regard to non-state pension provision entities under the Law of Ukraine "On Non-state Pension Provision" (LU-NPP). The advertisement text must be submitted to the FSR ten days prior to its dissemination (Article 53 of the Law). There are sanctions for the violation of provisions of the Law, and the FSR may prohibit the dissemination of advertising materials with its decision or make a decision that advertising materials be amended. Other dedicated laws ("On Credit Unions", "On Insurance") do not contain such provisions. For this reason, it would be worthwhile to enumerate the powers of the FSR regarding the exercise of control over the dissemination of advertisements by NBFIs in Article 26 of the LU-Ad, and grant the FSR the power to levy penalties from parties violating the law.

The Law of Ukraine "On State Regulation of the Securities Market in Ukraine" (LU-SSMSC) is the fundamental law vesting the SSMSC with the power to regulate the stock market. There are other important laws: "On Securities and Stock Market", "On National Depository System and Specific Features of the Electronic Circulation of Securities in Ukraine", "On Joint Stock Companies", "On Corporations" and "On Joint Investment Institutions (Unit Investment Funds and Corporate Investment Funds)".

The LU-SSMSC does not contain specific provisions on the protection of rights of consumers by the Commission. The SSMSC does not have direct consumer protection powers. It may protect consumer rights by regulating activities of the stock market members.

Article 26 of the LU-Ad tasks the SSMSC with the duty to exercise control over advertising on the stock market. Penalties may be charged for the violation of requirements of the LU-Ad in amounts specified in the Procedure of Charging Penalties for the Violation of the Advertising Legislation approved with CMU Resolution No. 693 of May 26, 2004. However, the SSMSC

may not issue an order to terminate such advertising. It may only submit claims for the prohibition of the relevant advertising and the public refutation thereof to courts of law.

D. Judicial Practice

General Courts

The category of cases dealing with the protection of rights of consumers in the field of financial services falls within the jurisdiction of general courts. The activities of general courts are mainly governed by the Law of Ukraine "On Judicial System and the Status of Judges" and the Civil Procedural Code of Ukraine (CPCU).

The general rule of Article 157 of the CPCU provides that the examination of cases in court of first instance must not take longer than two months, but such deadlines are rarely met in practice. In addition, a decision by a court of first instance may be appealed in accordance with the procedure prescribed by the CPCU. In practice, the litigation can take years.

The state duty (the court fee) and the information/technical support fee must be paid upon referring a matter to court, according to the general rule. Consumers are exempted from paying state duty for this category of cases under item 10 of Article 4 of the CMU Decree "On State Duty" and part 3 of Article 22 of the LU-CRP. It should be noted that the Law of Ukraine "On The Court Fee" coming into effect on November 1, 2011, does not provide for exemption from paying the court fee for this category of cases. However, they are not exempted from paying the information/technical support fee, which is usually charged in the amount of UAH 120.

In practice, however, courts often do not consider claims unless the state duty for the claim submission has been paid, such as in cases of the invalidation of a loan agreement or a mortgage agreement. Courts consider these contracts to be contracts governed by civil law and, accordingly, outside the scope of the LU-CRP. For this reason, the above-mentioned provision is not applied to such legal proceedings.

Judicial practice has been consolidated and analyzed at the level of the highest judicial instances in only two documents: Plenum Resolution of the Supreme Court of Ukraine

"On Practice of Examination of Civil-law Cases under Consumer Rights Protection Claims" and the Consolidation of the Judicial Practice of Examination of Civil-law Cases Arising from Credit-based Legal Relations (Years 2009 to 2010) by the Supreme Court of Ukraine of October 07, 2010.

The Plenum Resolution contains a single reference to financial services. The Consolidation document mainly deals with lending relations, in which a bank is one of the parties, and, to a much lesser extent, with other financial institutions that may grant loans.

The Consolidation document covers the issues evident from the judicial practice in the matters of: the modification, the rescission and the invalidation of a loan agreement, a bank deposit agreement and a suretyship agreement; and the collection of the mortgaged or pledged property. There is a clarification on the application of provisions of the law prohibiting the unilateral increase in the interest rate on a loan; the collection of amounts from the debtor and sureties, such as in the case of the debtor's death; the performance of contractual duties during the operation of the provisional administration of a bank or the moratorium on the satisfaction of claims of creditors; as well as contentious procedural issues of the jurisdiction and cognizance over this category of cases.

The Practice Consolidation has the status of a recommendation for courts and makes it possible to avoid typical mistakes when solving such disputes. However, the Consolidation document does not cover all issues that exist and fails to eliminate conflicts in laws.

It must be kept in mind that there are no generalized statistics of court cases on the protection of rights of consumers of financial services. Some statistics are available only for specific sectors. According to the Universal State Register of Court Decisions, more than 51,000 disputes between consumers and banks have been resolved. There were more than 22,000 disputes in the field of insurance and about 1,000 disputes between consumers and credit unions, mainly regarding the repayment of deposits. Courts of general jurisdiction and appellate courts issued decisions and rulings on 8 cases based on claims by participants in non-state pension funds (NPF); there were just 4 disputes between consumers and joint investment institutions (JII) and 4 more between

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consumers and trust institutions (from 2007 to 2010).

The majority of disputes were between consumers and banks regarding loans. According to the statistics provided by appellate courts of Ukraine, local courts of first instance examined 197,600 civil-law disputes arising

Official statistics cite 197,600 legal claims made in 2009 arising from lending relations.

from lending relations in 2009. This was the reason for the consolidation of the judicial practices referred to above.

The typical cases included the invalidation of foreign-currency loan agreements, the invalidation of loan agreements to the extent of the modification of the interest rate by the bank and the invalidation of the bank's attempt to increase the interest rate, the recovery of the debt under non-performing loans by means of the declaration of bankruptcy of a borrower being a sole-proprietor.

For instance, a court of first instance dealing with the case based on a claim against OTP Bank public joint stock company made a conclusion that the bank was not allowed to grant a foreign-currency consumer loan without an individual license for this transaction; the mere possession of a banking license and a permit for transactions with foreign currency valuables issued by the NBU was not a proper ground for the performance of foreign-currency transactions by the bank. The court invalidated a consumer loan contract concluded between the bank and an individual defendant, and also invalidated a mortgage (property suretyship) contract concluded between the bank and an individual defendant who had pledged a two-bedroom apartment in order to secure the performance of liabilities under the loan agreement.

The appeal by OTP Bank PJSC was denied with a ruling of the Highest Specialized Court of Ukraine in Charge of Civil and Criminal Cases of December 17, 2010, and the decision of court of the first instance and the ruling of the appellate court was upheld.

With its Resolution of March 21, 2011, the Supreme Court of Ukraine reversed the ruling of the Highest Specialized Court of Ukraine in Charge of Civil and Criminal Cases of December 17, 2010, and sent the case to the appellate court for re-examination. The

Supreme Court established that the bank's possession of a general license for foreign-currency transactions had been a sufficient legal ground for the provision of foreign-currency loans by banks in accordance with the requirements of Article 5 of the CMU Decree, which would allow the transactions under consideration in the absence of the regulatory framework for the application of the individual licensing regime. Thus, the provision of foreign-currency loans does not contradict requirements of the current legislation of Ukraine if the bank is in possession of an appropriate general license (a permit granted by the NBU to engage into foreign-currency lending transactions).

Under similar circumstances, the Supreme Court of Ukraine reversed the decision of a court of first instance and a ruling of the appellate court on the basis of an appeal by "Sberbank of Russia Subsidiary Bank" PJSC, where counter-claims by borrowers had invalidated foreign-currency loan agreement, suretyship agreement and mortgage agreements. The Supreme Court handed over the case to court of the first instance for a new examination.

Eventually, the Highest Specialized Court of Ukraine in Charge of Civil and Criminal Cases also confirmed the stance that a bank may grant foreign currency loans on the basis of a banking license and an appropriate permit for transactions with foreign currency valuables, treated as a general license for foreign exchange transactions (with its Letter of April 13, 2011). The Letter covers other issues such as to the extent of surety's liability, a non-completed construction object as the object of mortgage, and the liability of a bank for the failure to meet its monetary liabilities.

The lack of legal claims involving non-bank financial services demonstrates that the market is in its early stages of development.

Judicial activity regarding NPFs was insignificant during the period of their operation from January 1, 2004, through March 1, 2011:

- Two claims of two NPF participants against the relevant fund and its administrator in respect of a lump-sum pension payment and a fee were satisfied. However, decisions of

courts of the first instance were reversed by the appellate courts;

- In a case dealing with the transfer of funds to another pension fund chosen by the NPF participant and the collection of a transfer fee, the court issued a ruling leaving the claim unconsidered because the claimant submitted an application to withdraw the claim;
- The claim of an NPF participant against the administrator of the fund for the collection of tax from the balance of funds on the individual pension account was rejected;
- Four claims related to the inheritance of funds of deceased NPF participants.

The judicial practice with the involvement of unit and corporate investment funds over the period of their operation was also insignificant as of March 1, 2011.

The lack of significant judicial practice demonstrates that the market for non-bank financial services is at the inception stage of its development. Additionally, referring a financial services matter to court and defending one's rights requires that the consumer be aware of details of the legislation. Obviously, a consumer is not on equal footing in this respect in comparison with financial institutions.

Problems with the enforcement of court decisions are systemic in nature. The new wording of the Law of Ukraine "On Enforcement Proceedings" has been in effect since March 9, 2011, but it is difficult to judge its efficiency yet. The following could be listed among major issues before the effective date of the said Law: the lack of interest in the enforcement of decisions on the part of state bailiffs; the long duration for the enforcement of decisions; the non-substantiated refusals to open enforcement proceedings; and the lack of control on the part of the claimant over activities of the state bailiff.

Arbitration Proceedings

Until February 2011, arbitration tribunals, which operated under the Law of Ukraine "On Arbitration Tribunals" had jurisdiction over consumer protection cases, including the protection of consumers of financial services. Their decisions were final and could not be disputed. Decisions of arbitration tribunals do not have to be disclosed. For this reason, it is not possible to analyze the judicial practices of the arbitration tribunals.

The Law of Ukraine "On Amendment of Article 6 of the Law of Ukraine "On Arbitration Tribunals" in Respect of the Jurisdiction of Arbitration Tribunals over Cases in the Field of the Consumer Rights Protection" of February 3, 2011, terminated the jurisdiction of arbitration tribunals over such cases. There are both positive and negative aspects to this decision. The positive aspect of the decision is due to the fact that most arbitration tribunals in Ukraine, which dealt with issues of the protection of rights of financial services consumers, were captives of the financial institutions. On the other hand, a positive aspect of a decision of an arbitration tribunal is that it is final and cannot be disputed. From the point of view of timing, the proceedings in arbitration tribunals are much faster.

Extrajudicial Settlement of Disputes

Other than referring a matter to court, individuals may submit complaints and statements to state authorities and legal entities in accordance with the Law of Ukraine "On Petitions of Individuals". Article 20 of this law specifies a one-month deadline for the review of a petition of an individual. In response to the petition, state authorities must specify measures taken against parties violating the law. No fee is charged for submitting petitions to state authorities. The receipt of a response to such a petition does not make an individual ineligible for referring the matter to court.

There is no special mechanism for the extrajudicial settlement of disputes between consumers and financial institutions in Ukraine. The institutions of mediation are in their inception stage. A draft law "On Mediation" has already been developed. It provides for mediation in the field of private law (legal relations governed by the civil law). In practice, some business entities are trying to make use of this mechanism in isolated cases, but not in their relations with consumers.

E. Proposed Legislation

Given the pressing problems protecting the rights of financial services consumers, steps are being taken gradually toward solving the problems by means of the development and the adoption of a number of laws. The draft laws deal with both the provision of financial services

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generally and with specific sectors. A brief overview of major bills is provided below.

Draft Law "On Amendment of Some Legislative Acts of Ukraine in Respect of the Regulation of Legal Relations between Creditors and Consumers of Financial Services" (registration number 7351)

This bill is focused mainly on defending the rights of creditors (for instance, banks). Regarding the protection of consumer rights, this bill contains a provision that "a lender may not make provisions in a consumer loan contract for any charges, interest, commissions and payments for actions, which are not a service for the purposes of this Law" and that a "contract must contain a detailed breakdown of the cost of a loan for a consumer taking into account the interest rate on the loan and the cost of all services (the registrar, the notary, the insurer, the appraiser, etc.) associated with the approval, the service and the repayment of the loan and the entry into the consumer loan contract." Other issues are included, such as debt restructuring and the opportunity for the early repayment of the loan with the recalculation of the interest.

Some of the suggested provisions are already in operation at the level of NBU regulations or even laws (on a provisional basis). Some of these provisions have poor wordings and effectively negate the good intentions of the legislature. In many instances, positive changes are insubstantial. They clarify some rules, but do not change the situation significantly. This bill requires refinement for the purposes of the introduction of clearer and more transparent mechanisms for the protection of rights of financial services consumers.

Draft Law "On Implementation of the Financial Ombudsman Service in Ukraine"

Developed by a UN project, this law establishes an agency or service for the protection of the rights of consumers of financial services. This bill covers a small number of cases because its intention is that a consumer may submit a complaint against actions and inaction of a supplier of financial services. The draft law effectively fails to specify efficient mechanisms of the operation of the Ombudsman services. The same functions can be performed by the existing state authorities (including Prosecutor's

Office of Ukraine), civil-society consumer protection organizations, Self-Regulatory Organizations of financial services market participants and mediators.

Draft Law "On Amendment of Article 11 of the Law of Ukraine "On Consumer Rights Protection" (in Respect of the Limitation of the Forfeit in Case of the Late Repayment of the Consumer Loan Amount by a Consumer)" (registration number 8242)

This is an important bill. It makes sense to limit the amount of liability by a consumer because it is set by agreement of the parties to the contract in accordance with current legislation. Sometimes, the liability can be in excess over the value of the actual debt under the loan, which becomes economically unjustified and onerous for the borrower. With the adoption of this bill, the liability is limited to 100 percent of the total debt amount. It will improve the situation of consumer loan borrowers who are unable to repay loans that would increase considerably due to the charged forfeit.

Draft Law "On Amendment of Some Laws of Ukraine in Respect of Advertising on the Securities Market" (registration number 8297)

It allows the SSMSC to endorse the contents of advertising. The endorsement must be requested by the advertiser. The SSMSC may also specify requirements for advertising on the stock market, and is vested with the right to apply sanctions for a violation of these requirements. Thus, this document is quite important from the point of view of consumer protection.

F. Conclusions and Recommendations

The following are major deficiencies and issues with regard to the protection of consumers of financial services under Ukraine's basic legislation:

1. The unclear delimitation of powers of state authorities in the field of consumer protection, and the lack of direct consumer protection powers vested in state authorities with the power of specific sanctions for a violation. Currently, there are no clear legislative

provisions defining the aspects of financial services consumer protection for which a particular state authority is responsible;

2. The imperfect judicial system and inadequate guarantees of the enforcement of court decisions. Lengthy and onerous court procedures, ambiguous construction of laws by courts and low chances of the enforcement of court decisions are not conducive to making courts an efficient tool for the consumer protection.

The following measures will be appropriate to improve the situation:

Ukraine should begin promoting consumer protection rights by clearly establishing that consumers of financial services are protected by the same laws that govern consumers of other goods and services.

1. A consumer of financial services should be defined more clearly in the LU-CRP in order to expand the scope of its application to the financial services markets. For instance, a phrase "service (including financial service) shall be understood as an activity..." should be added to the definition of a service provided in item 17 of Article 1 of the LU-CRP. It is necessary to state explicitly in the LU-FS that relationships between financial institutions or other entities providing financial services and consumers are subject to provisions of the LU-CRP.
2. It would be appropriate to clearly define and delimit the powers of state authorities in the field of consumer protection:
 - Charge the NBU with the duty to control compliance with consumer protection legislation in the field of banking by making an appropriate provision in the LU-NBU; apply sanctions against banks and their officers for violations; and expand the state protection of consumer rights to state authorities (and not merely executive agencies) in Article 27 of the LU-CRP;
 - Expand the scope of FSR powers regarding the prevention of violations of the rights of consumers of non-bank financial services; grant the FSR the power to apply sanctions

against NBFIs and their officers for violations of financial services consumer protection legislation in the LU-FS;

- Vest the SSMSC with the power to apply sanctions against members of the stock market and their officers for a violation of consumer protection legislation in the LU-SSMSC.
3. The liability of financial institutions for a violation of consumer protection legislation must provide for adequate penalties and the application of other sanctions up to the revocation of licenses.
 4. It would be worthwhile to expand the application of provisions of the AMCU and the Criminal Code of Ukraine regarding liability for a violation of the rights of consumers to the provision of any services (including those financial), and specify the components of the administrative misdemeanor (offences).
 5. The powers of regulators of the financial services markets should be recorded and expanded in the LU-Ad regarding the exercise of control over the dissemination of advertising by financial institutions. An opportunity should be provided for the termination of false or misleading advertising without the need to refer matter to court.
 6. It is necessary to consolidate judicial practice in cases concerning the protection of consumers of all financial services, and not only consumers of lending services. Such consolidation could be performed by the Highest Specialized Court of Ukraine in Charge of Civil and Criminal Cases. As a result, it could issue a practice consolidation document or a resolution clearly specifying deficiencies in the course of the settlement of financial service consumer protection cases, and offer unified approaches toward settling cases of similar categories.
 7. Develop a program of improving the financial literacy of consumers, in particular in the segment of financial services in order to enable them to better exercise their rights. This program should be designed by government bodies in cooperation with consumer protection Non-Governmental Organizations. The program should be

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developed from the perspective of expanding consumers' capabilities in order to provide consumers with information in a user friendly form which will allow them to compare proposals of various service providers.

8. Include Self-Regulatory Organizations of financial services market participants into the system of entities which protect financial consumers and grant them authority to inspect their members' operations and to take internal enforcement actions or to

appeal to respective state bodies to apply sanctions (up to license suspension or termination). These powers should be clearly prescribed in the LU-FS (Item 9, Part 1 of Article 1 and Article 16) and the Law of Ukraine "On Securities and Stock Market" (Article 48).

9. Amend the Law of Ukraine "On Court Fees" (Article 5) to provide for exemption from court fees for filing a consumer rights protection lawsuit with a court.

III. Banking Sector

A. Sector Overview, Fundamental Legislation

The banking sector is the largest segment of the domestic financial sector accounting for 93% of the total assets of financial institutions of Ukraine. As of April 2011, 176 banks in Ukraine were in possession of NBU banking licenses.⁴ Household deposits amounted to UAH 293.9 billion, including UAH 153.77 billion in domestic currency and UAH 140.13 billion in the foreign currency. Consumer loans amounted to UAH 125.25 billion and housing purchase, construction and rehabilitation loans granted to households amounted to UAH 77.96 billion.⁵

The provision of banking services to consumers is regulated by a large number of both laws and regulations. The following laws play a major role in this regulation: the Civil Code of Ukraine (CCU), the laws "On Banks and Banking", "On Mortgage", "On Payment Systems and Money Transfers in Ukraine", the CMU Decree "On Foreign Exchange Regulation and Foreign Exchange Control System", the NBU Resolution No. 368 of August 28, 2001, "On Approval of the Instruction on the Procedure of the Regulation of Activities of Banks in Ukraine", the NBU Resolution No. 168 of May 10, 2007, "On Approval of Rules of the Provision of the Information to Consumers by Banks of Ukraine on Lending Conditions and the Aggregate Cost of the Loan", et al.

Many issues on banking activity, which are related to consumer rights directly or indirectly, are detailed quite well in the legislation, such as: licensing, reporting, equity structure, requirements for bank managers, prudential supervision, provision of the information to consumers, etc.

Chapter 71 "Loan. Credit. Bank Deposit" is of fundamental importance in the CCU. It governs types of contracts, such as: loan contracts, credit contracts, and bank deposit contracts.

⁴ Аналітичний огляд банківської системи за I квартал 2011 року (*Analytical Review of the Banking Sector in Quarter 1, 2011*) // http://www.rurik.com.ua/documents/research/bank_system_1_kv_2011.pdf

⁵ Статистичний бюлетень НБУ (*NBU Statistical Bulletin*) // <http://bank.gov.ua/Statist/Electronic%20bulletin/data/stat.pdf>

The **Information Booklet for a Bank Borrower under a Consumer Loan** and the **Information Booklet for a Borrower Who Has Debt to a Bank under a Consumer Loan** are displayed on the NBU's official web site. After November 10, 2008, banks are required to display the first booklet in bank lobby areas where the bank performs consumer lending transactions, thus making it possible for borrowers to familiarize themselves with its contents. The Information must specify the name and address of the territorial directorate of the NBU that supervises the activities of the bank as a legal entity. Consumers are advised to notify the relevant territorial directorate of the NBU in case clarification of the required (exhaustive) terms and conditions of lending are not forthcoming by the bank.

The LU-BB is also a fundamental document containing important provisions on: requirements for participants of banks and holders of substantial interests (Article 14); licensing requirements (Article 19); the opening of branches and representative offices (Articles 23 to 25); and requirements for funds to be established by a bank, etc. LU-BB Chapter 9 "Bank's Customer Relations" (Articles 55 to 59) is important because it defines general conditions of the provision of services by banks to consumers.

NBU Resolution No. 168 makes it incumbent upon banks to provide a consumer with information on lending conditions in writing and the tentative aggregate value of the loan before entry into the loan agreement. The bank must obtain from the consumer a written confirmation of the familiarization with the lending conditions information.

Additional conditions to a loan contract are specified in Section 3 of NBU Resolution No. 168. These conditions may not be deemed essential for the contracts of this type, because they are set out in a regulation, which is not a law. Thus, their absence from a contract cannot result in the invalidation of the contract. However, the NBU may apply sanctions to a bank for the violation of banking legislation in case of the failure to comply with NBU Resolution No. 168.

B. Key Issues

The following key issues with financial services consumer protection in the field of banking can be identified on the basis of the analysis of regulations and judicial practice:

1. Provision of Information about a Loan to a Third Party (e.g., a Debt Collection Company) by Means of the Claim Assignment or Factoring, or on the Basis of an Agency Contract.

Item 1 of part 1 of Article 512 of the CCU provides that a creditor may assign its rights to another party; the assignment does not require the debtor's consent (part 1 of Article 516 of the CCU). In addition, banks may assign their monetary claim against a third party to a factoring agent (in fact, a debt collection company) under Article 1077 of the CCU.

When the mass-scale non-repayment of individual loans started during the financial crisis, the banks started assigning their claims under loan contracts to so-called debt collection companies. No law in Ukraine regulates their activities, although they are not directly prohibited. For this reason, these debt collection companies proceeded to act in quite an aggressive manner in practice.

The disclosure of information to a debt collection company is deemed legal if it has been carried out by way of factoring on the basis of Articles 1077 to 1086 of the CCU (i.e., if the claim is assigned to a factoring agent being a legal entity or an individual eligible for the performance of factoring transactions).

The provision of the information about the borrower to third parties is also legal if it is done in accordance with the Law of Ukraine "On Organizing the Compilation and Circulation of Credit Histories". The law specifies conditions for the disclosure of information to the Credit Histories Bureau regarding credit history information and the conditions of the provision of this information to users. However, it is necessary for the user to get written consent from an individual to access his/her credit history in order to obtain information from the Bureau.

The disclosure of information to a debt collection company by a bank can be deemed illegal in other cases because such a disclosure contradicts Article 302 of the CCU and

Article 11 of the Law of Ukraine "On Information". The adoption of the Law of Ukraine "On Personal Data Protection" (in effect since January 1, 2011) has been an important step in this area. It also prohibits information disclosure to third parties without the borrower's consent. For this reason, banks and other financial institutions include special clauses in their contracts under which the borrower grants consent to the disclosure of the information to third parties. Most consumers are not aware that financial institutions may not include such clauses.

According to FSR Instruction No. 231 of April 3, 2009, "On Categorizing Transactions with Financial Assets as Financial Services", the purchase of the assigned monetary claim (including a future claim) against business entity borrowers under a contract underlying such an assignment is deemed a financial service. But this treatment applies to the debt of business entities only, rather than the debt of individuals.

2. Violations in Case of Money Transfers

Money transfers are regulated by the Law of Ukraine "On Payment Systems and Money Transfers in Ukraine" (LU-PSMT). Article 8 of the LU-PSMT requires a bank to transfer funds during the operating hours of the bank on the date of receipt of funds or on the next day at the latest. Practice has demonstrated that banks often fail to transfer funds within the prescribed time frames, or do so with considerable delays. As a result, a debt under a loan agreement may arise on the part of the consumer and the bank starts accruing penalties. The law provides for sanctions in such cases (Article 32), but they are not applied because of the need to submit a court claim for the collection.

Article 31 of the LU-PSMT requires banks to repay transfer amounts to the initiator within three business days if the recipient does not receive the amount in question within 30 days. However, practice shows that banks delay such repayments. The LU-PSMT provides for sanctions in the form of fines (Article 32), but they are rarely used due to the need to refer the matter to court. The judicial practice demonstrates that the sanctions envisaged by the LU-PSMT have not been applied even in cases of the submission of a claim for the repayment of sanction funds to court.

3. Failure to Repay (Impossibility of the Obtainment of) a Deposit Upon Its Maturity from a "Problem Bank"⁶

Judicial involvement in Ukraine's financial markets has been plagued by the inefficiency of enforcing collections. Ukraine recently amended its law on the enforcement of proceedings to improve efficiency.

"Problem banks" often refuse to repay the whole amount of funds at once, contrary to Articles 526, 530 and 1060 of the CCU. They dole out payments in minuscule portions. Usually, contracts lack

provisions for special sanctions, such as the payment of forfeits. In this case, the general provisions of the CCU on the liability are applied (such as Article 625). When referring the matter to court, one can claim the accrual of interest at the rate of 3% p.a. for the entire period of delay. In practice, however, consumers rarely claim debt and 3% because it takes too much time.

Furthermore, there is another practical issue regarding the enforcement of the court decision. The new wording of the Law of Ukraine "On Enforcement Proceedings" has been in effect since March 9, 2011, but it is difficult to judge its efficiency yet.

4. Unilateral Reduction in the Interest Rate on Demand Deposits

Part 3 of Article 1061 of the CCU and Article 55 of the LU-BB provide that a bank may not change the interest rate on a term deposit unilaterally.

However, a bank may unilaterally change the interest on demand deposits under part 2 of Article 1061. The bank must notify the depositor and may accrue interest at new rates not earlier than one month after the notice. However, the method of the notification of a depositor of changes by the bank is specified in the contract, rather than in law. Often, the contract provides that the placement of the information on the bank's web site constitutes such a notice.

The interest rate is an essential term of contract. Since the contract is executed in

writing, any changes must also be executed in the same form as the execution of the contract (Article 654 of the CCU). A consumer may rescind the contract due to a change in an essential term of contract (Article 652 of the CCU). Hence, rights of consumers are violated.

5. Automatic Extension of a Deposit Contract

Often, there are provisions in deposit contracts for the automatic extension of such contracts for the validity period of the prior contract. This is permitted by law (part 4 of Article 1060 of the CCU). In practice, consumers are often unable to recover funds in these cases because banks indicate that the deadline for repayment is different. Such indications by bank employees contradict part 2 of Article 1060 of the CCU. It requires a bank to issue a full or partial deposit on the first demand by the depositor under a bank deposit contract regardless of the type. Furthermore, even if the bank agrees to repay funds, the bank may do so within 7 days of the consumer's demand (part 2 of Article 530 of the CCU). Additional commissions can also be charged for the early repayment of funds.

6. Issues with Banking Cards, Such As the Accrual of Considerable Debt Amounts for the Use of Banking Charge (and Credit) Cards, Hard Selling Other Cards

Some issues have been regulated. For instance, statements of card accounts are to be provided free of charge by the bank, rather than an ATM. Earlier, such statements had been issued for a fee. NBU Resolution No. 223 of April 30, 2010, On Performance of Transactions with Special Payment Instruments, provides that a monthly statement of payment transactions under a card account contract must be provided free of charge. The same resolution requires information to be provided to users of special payment instruments. According to item 2.6 of the resolution, "before the contract conclusion, the issuer shall be obliged to familiarize the customer with conditions of obtaining a special payment instrument, the list of necessary documents, the service tariff rates, and the special payment instrument use rules. This information must be presented in an

The lack of consumer awareness in Ukraine has been an invitation for banks and other financial institutions to draft contracts that include extra fees and services or that deliberately omit relevant information.

⁶ Currently, the legislation does not contain a definition of a "problem bank". However, such banks (e.g., Rodovid Bank and Nadra Bank) exist in practice.

accessible form and placed in a location accessible by customers in the bank and on the official web site of the issuer; it should also be issued in writing or in a digital format to customers upon their request".

However, not every customer has sufficient access to the Internet, and not all information is effectively provided.

Items 2.5 and 2.6 of Resolution No. 223 require the bank to specify principal terms of a payment card service contract, and the information is to be provided by a bank before entry into the contract.

Banks are entitled to issue additional payment cards to customers. For instance, item 2.8 of Resolution No. 223 grants banks the right to issue an additional special payment instrument to an individual. In practice, credit cards (under so-called debit/credit arrangements) are hard sold in addition to the so-called "salary cards" to consumers (employees of legal entities whose salary is transferred to card accounts). The bank charges fees for maintaining the account, even if a customer does not use the card. In practice, a consumer is not provided with the information about various charges under such cards, penalties, or even the text of the contract. However, item 3.12 of Resolution No. 223 specifies that a "provider of payment services must provide a user with the complete information about actual expenses and the commission for payment services".

The bank receives commissions for the transactions performed by users with special payment instruments, for which the accrual and payment procedures and the amount are specified in accordance with intra-bank rules.

7. Bank Service Provision Contract

The law only specifies principal terms to be covered in a contract. No model "template" contracts have been developed, and there is no standardization of contracts across loan products on an industry-wide basis. Further, each bank draws up a contract on its own. In practice, there can be two types of contracts:

➤ Small single-page contracts. In such a case, a customer is issued a contract referring to Comprehensive Banking Service Rules as an integral part of the contract. The legislation (for instance, the CCU) allows executing a contract in such a manner. The rules can be 10 to 15 pages long. Sometimes, the Rules

are not issued with a suggestion to find them on the bank's web site.

➤ Unwieldy contracts of 5 pages and more.

In practice, a consumer is unable to familiarize himself in detail with terms of the contract in either of these situations. Thus, customers very often sign contracts without being aware of potentially problematic details.

Additionally, there is a problem with the provision of complete information to a consumer.

8. Failure to Provide Complete and True Information

When entering into loan agreements, under the LU-CRP and NBU Resolution No. 168 of May 10, 2007, "On Approval of Rules of the Provision of the Information to Consumers by Banks of Ukraine on Lending Conditions and the Aggregate Cost of the Loan", a bank must provide a consumer with the information about the cost of all ancillary services of a bank associated with the obtaining loan, service and repayment. Additionally, a bank must obtain a written confirmation from the consumer regarding familiarization with the lending conditions. The same resolution provides a list of ancillary services that can be provided to a consumer by a bank when providing a consumer loan, which includes: opening a current/card account; the provision of cash and payment services; servicing the loan debt, such as the willingness of the borrower to obtain statements of the credit/card account; currency exchange transactions; and the provision of consultancy (including legal) services.

Since November 10, 2008, the banks are required to display the **Information Booklet for a Bank Borrower under a Consumer Loan** in areas where the bank performs consumer lending transactions, thus making it possible for borrowers to familiarize themselves with the information. The text of this document is provided in NBU Letter No. 40-511/4640-15577 of November 10, 2008. Heads of units of banks where consumer lending transactions take place are in charge of the placement of the Bank Borrower Information.

9. Unfair or Deceptive Advertising

Banks often advertise various services provided to individuals. They make references, for instance, to the provision of zero-commission or zero-interest

According to monitoring, only about 30% of advertising by banks is considered fair and accurate.

consumer loans. In these cases, banks actually deceive customers because the actual costs for the consumer are not mentioned. This

violates provisions of the LU-Ad. According to monitoring results, only about 30% of advertising is fair. The remaining 70% meets various unfairness criteria.

According to Article 54 of the LU-BB, banks are prohibited from producing advertising that contains false information about their activities in the field of banking services. However, they are not prohibited from disseminating deceptive advertising.

Article 24 of the LU-Ad sets out the requirements for services associated with raising funds from individuals, including the provision of banking services. Such a provision is positive, but it is quite generic. Moreover, the NBU is not authorized to control such advertising. No clear sanctions for the dissemination of such advertising are provided. The LU-BB (Article 54) merely states that the NBU may apply sanctions. According to the LU-Ad, a claim has to be submitted to court for this advertising to be terminated, which does not offer efficient protection.

10. Deposit Guarantee

A deposit guarantee system has been implemented in Ukraine for bank deposits only. Deposits are repaid in accordance with the Law of Ukraine "On Individual Deposit Guarantee Fund". The compensation ceiling is currently UAH 150,000 per depositor per bank.

Depositors of "problem banks" are unable to claim the compensation from the Fund until the liquidation of the said bank starts. Although depositors become entitled to guaranteed deposit compensations since the date of the deposit's inaccessibility, it is the liquidator who should provide the Deposit Guarantee Fund with the complete list of depositors. Therefore, a time gap exists between the moment of the deposit's inaccessibility and the beginning of the liquidation procedure, during which the funds lose value due to the inflation.

The fund does not compensate a depositor beyond the first UAH 150,000 of the deposit. For larger deposits, funds are repaid from the proceeds obtained in the course of the liquidation. It is possible for funds derived from sales of the bank's assets to be insufficient for meeting the claims of depositors.

Individuals with foreign currency deposits are paid funds in hryvnias.

C. Conclusions and Recommendations

The enhancement of protection for service consumers in the banking sector must take place on the basis of the adoption of a number of new legislative acts, the amendment of applicable laws and regulations.

1. The LU-CRP should clearly provide for a penalty in case a violation of rules for the disclosure of information to a consumer of financial services (including banking services). Additionally, the extent of the information to be provided to a consumer during the performance of specific banking transactions must be specified in the LU-BB (Article 56). In order to avoid any issues with the disclosure of the information to a consumer, it would be appropriate to provide for the obligatory notification of a consumer with a registered letter with delivery verification.
2. The requirements for advertising for banking services (the information to be provided) and sanctions to be applied for the violation of such provisions must be more clearly specified in the LU-Ad and Article 54 of the LU-BB. Civil-society organizations should be vested with the right to submit a claim to court in the interest of and on the general behalf of consumers for the termination of incomplete or false advertising by including appropriate provisions into the LU-CRP and LU-Ad.
3. It is necessary to regulate activities of debt collection companies by means of the adoption of a specific law. Before the adoption of this law, it would be appropriate to amend at least FSR Instruction No. 231 of April 3, 2009, "On Categorizing Transactions with Financial Assets as Financial Services" and expand its scope to legal relations with individuals.

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4. In view of inflationary processes, it would be appropriate to amend the LU "On Individual Deposits Guarantee Fund" by providing for the repayment of funds to a depositor taking into account the inflation index.
5. It would be appropriate to vest civil-society organizations with the right to initiate class action lawsuits in the interest of an indefinite group of individuals for the declaration of the bank's bankruptcy and the inaction of state authorities. This right should be vested in a number of laws, such as: "On Consumer Rights Protection"; "On Associations of Individuals"; and "On Restoring Debtor's Solvency or Declaring a Debtor Bankrupt".
6. The NBU should develop sample or model contracts in banking in order to avoid different approaches toward the contents of contracts concluded between a bank and a consumer. Any annexes to contracts must be issued to a consumer as a single copy for signature.
7. In the LU "On Payment Systems and Remittance in Ukraine", provide for protection of consumer rights for non-banking payment system participants who remit funds.

IV. Non-bank Sector

The non-bank financial sector of Ukraine was developing quite rapidly until the onset of the global financial crisis. The number of NBFIs, the value of assets, and consumers' demand for their services had been growing steadily. Changes in the environment, such as the global financial crisis phenomena, affected the Ukrainian non-bank financial sector negatively. This resulted in the reduction in the market value of financial instruments, such as those in possession of insurance companies and NPFs, and affected the profitability of these institutions and the level of their reserves held to cover future payments to customers.

As of December 31, 2010, there were 1,980 financial institutions in the State Financial Institutions Register, or 28 institutions fewer than in late 2009 (2,008 institutions). There were 456 insurance companies, 659 credit unions, 426 pawn shops, 221 financial companies, 101 NPFs, and 43 NPF administrators.

Assets of NBFIs regulated by the FSR are still dwarfed by the assets of commercial banks. For instance, the assets of commercial banks and NBFIs totaled UAH 1,012.0 billion as of December 31, 2010, with banks holding UAH 942.1 billion (93.1%) and NBFIs holding the remaining UAH 69.9 billion (6.9%).⁷

A. Insurance

The insurance market is the best-capitalized market among non-bank financial markets. Assets of insurers account for 65% of assets of NBFIs.

There were 456 insurance companies as of December 31, 2010, including 67 life insurance companies and 389 non-life insurance companies (as of December 31, 2009, there were 450 companies, including 72 life insurance companies and 378 non-life insurance companies). The insurance market

⁷ Огляд ринків фінансових послуг та підсумки діяльності небанківських фінансових установ, державне регулювання та нагляд за діяльністю яких здійснюється Держфінпослуг, за 2010 рік (Review of Financial Services Markets and Performance Results of Non-bank Financial Institutions Subject to the State Regulation and Supervision by the State Financial Services Markets Regulation Commission of Ukraine in year 2010) // <http://uainsur.com/wp-content/uploads/2010/01/OGLYAD2010.pdf>

has become somewhat more active in 2010, but the indicators are still below the pre-crisis levels. The gross insurance premiums received grew by UAH 2,639,600,000 (12.9%) in comparison with year 2009, while the value of net insurance premiums went up by UAH 669,700,000 (5.3%).⁸

In Ukraine, only financial institutions established in the form of joint-stock companies, unlimited and limited partnerships, or additional liability companies subject to the specifics defined by the Law of Ukraine "On Insurance", which have obtained an insurance license in accordance with the established procedure, are permitted to provide insurance services.

Activities of insurance companies in the field of the provision of financial services are governed by a number of regulatory acts: the CCU, the Commercial Code of Ukraine (ComCU), the Air Code of Ukraine, the Merchant Shipping Code of Ukraine, the LU-INS, the LU-FS, the Law of Ukraine "On Statutory Ground-based Vehicle Owner Third Party Liability Insurance", and a number of bylaw regulations issued by the FSR:

- FSR Instruction No. 741 of October 8, 2009, "On Approval of the Policy on Obligatory Criteria and Target Ratios of Adequacy, Diversification and Quality of Assets Representing Insurance Reserves for Insurance Other than Life Insurance";
- FSR Instruction No. 3178 of December 23, 2004, "On Approval of Licensing Conditions for the Statutory Ground-based Vehicle Owner Third Party Liability Insurance";
- FSR Instruction No. 3104 of December 17, 2004, "On Approval of Rules of Booking, Accounting for, and Placement of Insurance Reserves for Insurance Other than Life Insurance";
- FSR Instruction No. 2875 of November 26, 2004, "On Approval of Rules of the Placement of Life Insurance Reserves";
- FSR Instruction No. 913 of June 4, 2004, "On Approval of the Policy on Specific Features of the Succession under Concluded Insurance Contracts in Case of the Reorganization of Insurers";

⁸ Підсумки діяльності страхових компаній за 2010 рік (2010 Performance Results of Insurance Companies) // http://www.dfp.gov.ua/fileadmin/downloads/dpn/sk__2010.pdf

- FSR Instruction No. 40 of August 28, 2003, "On Approval of Licensing Conditions for the Exercise of Insurance Activities";
- FSR Instruction No. 42 of August 28, 2003, "On Approval of the Policy on Sanctions Applied by the State Financial Services Markets Regulation Commission of Ukraine".

A number of substantial issues prevent the insurance services market from developing rapidly, including: the imperfect regulation in the field of insurance; the underdeveloped market of life insurance and other types of personal insurance; the low solvency level of potential consumers of insurance services; the lack of trust by consumers in insurance as an institution; fraud and neglect of rights of

Obstacles to Rapid Development of Ukraine's Insurance Market

- Imperfect Legislation
- Lack of focus on personal insurance
- Lack of disposable income by consumers
- Lack of trust by consumers
- History of fraud and neglect

policyholders on the part of some insurers; the lack of information about activities of insurance companies and the services provided by them; the lack of effective mechanisms for the protection of consumers of insurance services; and the lack of a system of guarantees of the restitution of their violated interests. Thus, the following are the major problems of the protection of consumers of insurance services:

1. Compulsion to Enter into Insurance Contracts with Specific Insurance Companies

This issue is most often encountered during the entry into loan agreements. The requirement for the pledged object used as collateral under the loan agreement to be insured with an insurance company "recommended" by the bank (which is usually a financial appendage to the bank) is put forward as one of conditions for the provision of a loan.

The rights of the borrower under the loan agreement and the potential policyholder under the insurance contract are protected by the provision of item 2 of part 5 of Article 11 of the LU-CRP that contractual provisions making it incumbent upon a consumer to enter into an additional contract with a third party specified

by the creditor are treated as unfavorable and may be invalidated by court. In the field of insurance, this provision can be reinforced by the simultaneous application of Article 6 of the LU-INS prohibiting the use of voluntary insurance as an obligatory condition for the exercise of other legal relations. This problem was addressed in the Antimonopoly Committee Letter of April 29, 2010 No. 8-RK, but the situation did not change significantly.

As for a mortgage loan, insurance for the mortgage object is mandatory according to Article 7 of the LU-INS. However, a consumer usually does not have the possibility to choose an insurance company by himself, as banks impose specific insurers.

2. Violation of Time Frames for the Disbursement of the Insurance Indemnity

Failure to pay or delays in payment to policyholders with valid claims is a common practice of many insurance companies and seems to be considered "par for the course." Currently, part 3 of Article 16 of the LU-INS specifies the liability of each party for the non-performance or the improper performance of their duties as one of the essential terms and conditions of an insurance contract. However, insurance contracts are usually developed by insurance companies, difficult for the ordinary consumers to understand, and offered to consumers without giving them an opportunity for entering changes. Thus, the liability conditions, including those regarding late payment of the insurance indemnity, are formulated generally.

3. Use of Unreasonably Onerous Procedures or Unjustifiable Time Frames as a Condition for the Insurance Indemnity

Insurance contracts often contain conditions that either require a policyholder to give notice of an insured event and submit supporting documents within extremely confined time frames (on the order of several hours), the violation of which results in the waiver of the insurance indemnity, or grant the insurer a right to take various measures without time limits in order to verify circumstances of the insured event and make a decision to pay the indemnity. Such contractual terms result in the substantial violation of the rights of policyholders.

The above contractual terms are unfair in terms of their contents. For this reason, they can be

invalidated by court on grounds of Article 18 of the LU-CRP. In addition, the entry into contracts with the above mentioned conditions usually results from unfair entrepreneurial practices, which deceive a consumer (such as when the information required for the knowledgeable choice is not provided to the consumer at the time of the offering or is provided in an unclear, unintelligible, or ambiguous form) or are aggressive (e.g. when onerous or disproportionate extra-contractual obstacles are imposed to prevent the consumer from exercising his rights under the contract). Transactions entered into as a result of such actions may be invalidated by a court in accordance with part 6 of Article 19 of the LU-CRP.

Insurance contracts often contain conditions that make it difficult for the policyholder to give notice of an insured event and/or grant the insurance company the right to take measures without a clearly defined timeframe for resolution.

Often, consumers enter into insurance contracts with unfair conditions because of the non-disclosure of complete information or the concealment of the information about the insurance service and specific features of its provision. Such services may be provided in Ukraine by intermediaries—insurance brokers (for policyholders) and agents (for insurers). While activities of insurance brokers are regulated by the FSR and the brokers are entered into the state register of insurance brokers, the activities of insurance agents are scarcely regulated at all by state authorities. Their number is not known (there is no register of insurance agents). As a result, the legitimate rights of consumers, such as the right to obtain complete and true information, are often violated. Additionally, individuals who are not insurance agents often introduce themselves as such.

In order to correct this situation, it can be suggested: to strengthen requirements for all insurance intermediaries in terms of their compliance with requirements of the LU-INS; to implement licensing procedures for insurance agents, such as by renaming the Insurance Brokers Register into Insurance Intermediaries Register and by having insurance agents entered into the register as well; and to strengthen control by state authorities and to enforce these requirements by means of the more stringent sanctions, including removal

from the Insurance Intermediaries Register and the implementation of administrative and commercial penalties (under Chapter 27 of the ComCU) for insurance intermediaries.

4. Unilateral Increase in Insurance Premiums by the Insurance Company

Contractual conditions that vest an insurer with the right to unilaterally modify contractual features of the insurance service (with the insurance premiums amount being one of the elements), are unfair because the exercise thereof will result in the substantial imbalance between contractual rights and duties to the detriment of the consumer of insurance services. Part 5 of Article 18 of the LU-CRP offers a guarantee of the protection of the rights of consumers. Additionally, general standards of contractual law provide that a contract may only be changed by agreement of the parties, unless otherwise provided by the contract or law (part 1 of Article 651 of the CCU), and that the amendment must be executed in the same form as the contract being replaced (Article 654 of the CCU). Furthermore, the increase in question is prohibited by part 2 of Article 6 of the LU-FS. However, there is a contradiction. Part 3 of Article 6 of the LU-FS prohibits merely an increase in the interest rate under a loan agreement. This needs to be corrected.

Conclusions and Recommendations

The protection of consumers of financial services in the field of insurance can be improved by the introduction of changes and amendments into the current legislation of Ukraine.

1. Claim surveyors should be made legally and functionally independent from the insurance companies. To this end, it is necessary to regulate the activities of claim surveyors by law, setting more stringent qualifying requirements for persons, establishing their independence from parties to insurance legal relations, and creating conditions for their self-regulation. Provisions should be made for the licensing of claim surveyors and the introduction of clear mechanisms of depriving claim surveyors of the opportunity to exercise their profession in case of the violation of the said requirements.
2. An Insurance Contract Indemnity Disbursement Guarantee Fund should be established similarly to the Individual Deposit Guarantee Fund. To this end, the LU-INS

should be amended accordingly by requiring insurance companies to make certain allocations to the fund and specifying the procedure of the administration of allocations, the accumulation thereof, the grounds and procedure for the disbursement of payments from the fund to consumers, such as in cases of bankruptcy or liquidation of an insurance company.

3. There should be an automatic payment of penalties by an insurance company in cases of procrastination or refusal to execute an indemnity payment in the form of a fine to be specified by the parties to the contract and at the level of at least 0.1% of the amount to be paid per day of delay without the limitation of the accrual period, which should be introduced by means of an appropriate amendment of the LU-INS.
4. It is necessary to amend Article 6 of the LU-FS to prohibit unilateral increases in any payments by financial institutions on the basis of financial services provision contracts.
5. The possibility of the application of administrative commercial sanctions of an organizational nature for members of the insurance services market should be provided in addition to their liability under civil law before the service consumers (the reimbursement for the inflicted damage, the non-pecuniary damages, the payment of fines at a level not lower than specified by law for the entire period of non-payment) as follows: the restriction of the license validity or its suspension for a certain time, or, in case of the continuation of such practices, the revocation of the insurance license in case of the commitment of a certain number of groundless refusals by the insurance company to make insurance payments confirmed with court decisions, which have come into effect.

In order to ensure the efficiency of this mechanism, it would be appropriate to properly amend the procedural legislation of Ukraine (the CPCU, the ComCPU) simultaneously with the amendment of Article 38 of the LU-INS ("Licensing of Insurance Activities") to require courts to send the relevant information to the FSR after the effective date of a court decision establishing the groundless refusal to pay insurance indemnity for the consideration of such facts for the purposes of control over the insurance company's compliance with licensing

conditions and the application of the relevant administrative commercial sanctions.

B. Credit Unions

As of December 31, 2010, the State Financial Institutions Register contained information about 730 credit institutions, including: 659 credit unions; 42 other credit institutions; and 29 public entities. The number of credit institutions has decreased by about 10% since 2008.⁹ Most credit unions (346) had a relatively small number of members (up to 1,000 persons). However, many credit unions (239) have more than 1,000 members, making it complicated to hold a general meeting and to make timely management decisions.

The assets of credit unions as of December 31, 2010, totaled UAH 3,432,200,000 and dropped by 18.6% in comparison with the same period in 2009 (UAH 4,218,000,000 as of December 31, 2009). However, the major performance indicator development trends of credit unions had been positive throughout year 2010. More capital has been accumulated in Q4 2010 in comparison with Q1 2010 (71.8% or UAH 466,100,000 more) and the assets of credit unions grew by 14.7% (UAH 440,000,000).¹⁰

The Law of Ukraine "On Credit Unions" (LU-CU) is the major document which governs the activities of credit unions in Ukraine. There are also a number of bylaw regulatory acts issued by the FSR:

- FSR Instruction No. 685 of September 2, 2010, "On Publication of Information Letter of the FSR on Activities of Credit Unions during the Period Between the Expiry of the Current License and the Obtainment of the New License for the Exercise of Business of Raising of Contributions (Deposits) of Credit Union Members to Deposit Accounts" prohibiting credit unions from exercising activities related to raising contributions (deposits) of credit union members to deposit accounts during the period between the

⁹ Підсумки діяльності кредитних спілок, інших кредитних установ та юридичних осіб публічного права за 2010 рік (2010 Performance Results of Credit Unions, Other Credit Institutions and Public Entities) // http://www.dfp.gov.ua/fileadmin/downloads/dpn/ks_2010.pdf

¹⁰ Підсумки діяльності кредитних спілок, інших кредитних установ та юридичних осіб публічного права за 2010 рік (2010 Performance Results of Credit Unions, Other Credit Institutions and Public Entities) // http://www.dfp.gov.ua/fileadmin/downloads/dpn/ks_2010.pdf

expiration of the current license and the procurement of the new license. During this period, the credit union may not raise funds, but it must meet its liabilities under contracts that have been already concluded;

- Licensing Conditions for the Exercise of Financial Service Provision Activities by Credit Unions are approved with FSR Instruction No. 146 of December 2, 2003;
- Policy for the Entry of Information about Credit Unions into the State Financial Institutions Register is approved with FSR Instruction No. 1099 of June 22, 2004;
- Licensing Conditions for the Exercise of Financial Service Provision Activities by Credit Unions are approved with FSR Instruction No. 146 of December 2, 2003;
- The List of Internal Policies and Procedures of a Credit Union is approved with FSR Instruction No. 116 of November 11, 2003;
- The Policy of Financial Performance Target Ratios and Quality Criteria of the Management System of Credit Unions and Associated Credit Unions are approved with FSR Instruction No. 7 of January 16, 2004;
- Professional Requirements for Chief Executive Officers and Chief Accountants of Financial Institutions are set forth under FSR Instruction No. 1590 of July 13, 2004.

The non-repayment of deposits is the major issue with activities of credit unions. Judicial practice in most cases deals with this issue. The problem is caused by low capitalization and the unstable financial standing of some credit unions. Thus, the following can be stated on the basis of the analysis of regulatory acts and the practices:

1. Impossibility of the Declaration of Bankruptcy of a Credit Union

There are contradictions in the legislation regarding the possibility of declaring a credit union bankrupt. Article 9 of the LU-CU specifies conditions for the termination of activities of a credit union, including insolvency procedures. However, only a business entity may be declared bankrupt under part 3 of Article 209 of the ComCU. However, a credit union is not a business entity, but a not-for-profit organization (Article 1 of the LU-CU). The LU-FS provides that the FSR and a provisional administration appointed by the FSR are competent to solve issues of restoring solvency of an operating

credit union if it becomes insolvent. Thus, the solvency restoration procedures set out in the Law of Ukraine "On Restoring Debtor's Solvency or Declaring a Debtor Bankrupt" are not applied to operating credit unions that fail to meet their liabilities to creditors. No arbitration manager, who acts in bankruptcy cases on the basis of a license issued by the Ministry of Economic Development and Trade of Ukraine and manages property and the rehabilitation process, may be appointed for the exercise of such powers in case of an insolvent credit union.

As a result, there are no realistic mechanisms of declaring a credit union bankrupt and meeting claims of creditors as of today.

2. Deposit Guarantee

Unlike in the case of banks, there are no credit union deposit guarantee schemes at the legislative level. Some credit union associations (such as the National Association of Credit Unions of Ukraine) have implemented such mechanisms for their members.

The non-repayment of deposits is also associated with the non-repayment of loans. Thus, in order to reduce the non-repayment risk for credit unions, it can be suggested that the amount of a loan that can be granted by a union be limited by law depending on the value of its assets.

3. Non-refund of the Equity or Other Contributions

According to part 7 of Article 10 of the LU-CU, the entrance fee is not refunded in case of the termination of membership of an individual in a credit union. The obligatory equity contribution and contributions, other than the entrance contribution, are returned in accordance with the procedure specified by the charter of the credit union, but not later than within one month of the relevant decision made by the general meeting or the supervisory council of the credit union. However, in spite of this requirement, judicial practice has been characterized by refusals to refund equity contributions to members or by considerable delays with payment. The legislation does not provide direct sanctions for such violations.

4. Failure to Provide Complete and True Information

In case of entry into loan agreements under the LU-CRP, the consumer must be provided with

the information about the cost of all ancillary services associated with loan obtainment, service and repayment.

The LU-FS and the LU-CU do not detail the issue of information disclosure by credit unions. Thus, practice has demonstrated that the information is not provided in full.

5. Unfair or Deceptive Advertising

Credit unions do not advertise their services as frequently as banks, so the situation is not that pressing. However, they also provide deceptive information in their advertising, such as information on the interest rate of loans. In doing so, credit unions violate provisions of the LU-Ad.

Article 24 of the LU-Ad specifies the requirements for advertising for services associated with raising funds from individuals. The FSR is not authorized to control such advertising. No clear sanctions for the dissemination of such advertising are provided. According to the Law, a claim has to be submitted to court for this advertising to be terminated, which does not offer efficient protection.

6. Provision of Information to the Third Parties (Debt Collection Companies)

In practice, the assignment of claims by credit unions to the third parties (such as debt collection agencies) is rarely undertaken, unlike in the case of banks. However, if they do assign the claims, then violations of consumer rights described in the banking chapter become relevant.

Conclusions and Recommendations

The level of protection of consumers of services in their relations with credit unions must be enhanced by means of the amendment to legislation on credit unions (especially, the core law), and by strengthening the activities of the state regulator.

1. It is necessary to adopt a law to provide for the establishment of a dedicated Credit Union Members Deposit Guarantee Fund similar to the banking sector.
2. It is necessary to make provisions in the LU-CU for the accrual of fines for the non-repayment or delays with the repayment of contributions (deposits) to a credit union

member on a deposit account, equity and other contributions.

3. In view of the imperfect and contradictory legislation regarding the declaration of bankruptcy of a credit union, it is necessary to amend the LU-CU and the Law of Ukraine "On Restoring Debtor's Solvency or Declaring a Debtor Bankrupt" to define such a procedure.

C. Non-state Pension Funds and Other Non-state Pension Provision Entities

The non-state pension provision system is the third pillar of the pension system implemented with the LU-NPP of July 9, 2003. This system is based upon NPFs, of which the first was established in mid-2004.

As of December 31, 2010, the State Financial Institutions Register contained information about 101 NPFs and 43 NPF administrators. 36 Administrators are in possession of NPF administration licenses.

The assets of pension funds totaled UAH 1,144,300,000 as of December 31, 2010. In 2010, the NPF assets grew by 33.4% (or UAH 286,400,000). The net asset value of NPFs grew from UAH 854,700,000 to UAH 1,140,600,000 or 33.5% over 2010. The reduction in volumes of production of major industrial products and services during the financial and economic crisis has substantially worsened the conditions for investment activities, including those exercised by pension funds, and affected the yield of pension assets. Currently, assuring a yield for pension assets higher than the rate of inflation is a pressing issue for NPFs.¹¹

The LU-NPP is the core law that governs activities of NPFs and regulates relations between the NPFs and their participants. In addition, activities of asset management companies are regulated by provisions of the Law of Ukraine "On Securities and Stock Market" and the LU-SSMSC. There are also numerous regulations specifying requirements for activities of the NPF, administrators, asset management companies and custodians.

¹¹ Підсумки розвитку системи недержавного пенсійного забезпечення за 2010 рік (2010 Non-state Pension Provision System Development Results) // http://www.dfp.gov.ua/fileadmin/downloads/dpn/npf_2010.pdf

Major issues:

1. Complicated System of Legal Relations between an NPF and Its Service Entities

Ukraine's NPF system is characterized by its multi-level nature. In addition to the NPF, the entities providing services to the NPF and performing various functions play a major part in this system: the administrator, the asset management company (AMC) and the custodian bank. The LU-NPP provides that the administrator shall act on behalf of the NPF and effectively represent the NPF in its relations with depositors and participants. The administrator enters into pension contracts on behalf of the pension fund, keeps personalized records of participants, makes pension payments, and submits non-state pension provision reports (parts 4 and 6 of Article 21, part 1 of Article 55, part 1 of Article 57 of the LU-NPP). While the AMC acts in its own name, it invests the assets of the NPF (Article 38 of the LU-NPP) and administers the bank accounts of the NPF. The custodian opens and maintains accounts, and keeps custody of assets of the NPF (part 4 of Article 44 of the LU-NPP).

This unwieldy system of legal relations among NPF entities complicates and sometimes destroys opportunities for the protection of consumers of the NPF services. In a particular rights violation situation, it is difficult even for a relatively knowledgeable consumer to determine the entity which has committed the violation. However, the nomination of the defendant under the case, who will be held liable for any losses, will depend on such a determination.

2. Lack of the Property Autonomy of NPFs and the Independent Liability of NPFs

Provisions of the LU-NPP are formulated so as to rid an NPF of any property autonomy by not providing it with the statutory capital for the exercise of its activities. The funds of founders may not be used as the source for setting up the equity of an NPF in accordance with the LU-NPP. Thus, founders may establish an NPF without supplying capital required for operations. This situation makes it impossible to reimburse a participant for losses caused by the NPF, for instance, through the fault of a council member because of the lack of a source of funds for the reimbursement for such losses.

It demonstrates that an NPF is unable to be liable for its own liabilities because only the

equity of the NPF can underlie the liability in question. The administrator, the AMC and the custodian are separate legal entities and they may not be vested with a liability under liabilities of the NPF in accordance with overarching provisions of the CCU (Article 96).

3. Lack of Proper Regulation of the Liability of NPF Council Members

Article 13 of the LU-NPP is imperfect in terms of the liability of the NPF council members. The council is the only managing body of an NPF and the council members should be competent to solve important issues, such as: the control over the designated use of assets of the NPF; review of contentious issues arising between the NPF and its members and/or depositors; and reporting on the performance of the NPF (Article 13 and 14 of the LU-NPP).

However, council members are neither officers of the NPF, nor do they have labor or civil-law relations with the NPF. Thus, it is impossible to draw council members to disciplinary or material liability under labor legislation and hold them liable for failure to perform their duties governed by civil law. This situation creates favorable conditions for the non-performance of direct duties or, to the contrary, the abuse of powers. Legislation does not regulate the fiduciary duty of council members to act in good faith and reasonably in the interests of the NPF and to not exceed their powers.

4. Imperfect Information Disclosure System

Disclosures of information to NPF members leaves much to be desired as well. NPF disclosures lack details about the investment experience of the AMC, the risks of investment activities, the comments of the management on activities of the NPF, and the challenges to be faced by the NPF in the market environment. It is impossible to determine the beneficial owners of NPFs and service providers, as well as their interrelations, and assess the financial sector job experience of council members. Thus, NPF participants do not have enough information to be able to assess NPF risks and to make an informed investment decision.

5. Lack of Prohibition of Investments into Securities of Related Parties of the Founders

The risk management of an NPF is defined by means of imposing quantitative investment portfolio structure limits and restricting types of financial instruments eligible for investments.

The NPFs may invest into interest-bearing cash deposits with banks, governmental securities, and shares and bonds of listed Ukrainian issuers traded on stock exchanges where the trading volume amounts to at least 25% of the total trading volume on organized securities markets of Ukraine (item 2 of part 21 of Article 47 of the LU-NPP). Additionally, the LU-NPP contains a provision prohibiting the investments into securities issued by the custodian, the entities that manage pension assets, the administrator, the auditor, and the parties providing consultancy, agency or advertising services, which the pension fund has entered into appropriate contracts and their related parties (item 1 of part 3 of Article 47).

The legislation also prohibits investments into securities issued by founders, but there is no clear prohibition of investments into securities issued by legal entities related to founders of NPFs. As a result of the lack of such prohibitions, NPF participants face a considerable risk of establishing a captive fund for the reallocation of resources to the benefit of founders. Obviously, such funds will not maximize net assets of their participants at the acceptable level of risk because they will pursue objectives other than those specified in the charter.

6. Absence of a Financial Institution from Its Registered Address

Quite often a financial institution is not located at the address registered with control agencies. This situation complicates the obtainment of benefits and undermines trust in NPFs. There is a requirement for the notification of controlling agencies of the actual place of business, but there is no direct requirement to notify consumers.

7. Transfer of Funds to Another NPF / Financial Institution

Sometimes a financial institution refuses to transfer funds to another fund/financial institution or, vice versa, forces participants and/or depositors to transfer their funds to another NPF. This is a gross violation of the current LU-NPP and human rights.

8. Absence of a Code of Ethics in the Field of the Non-state Pension Provision

There is no requirement for a Code of Ethics to be established for members of the non-state pension provision industry. Neither the LU-NPP,

nor other regulations require the fund, the service providers, or the individuals who perform specific actions on their behalf, to follow a Code of Ethics. There are no fiduciary duties to guide these parties when dealing with the NPF and reflecting the structure of their ethical commitment to the NPF and its participants.

Part 4 of Article 21 of the LU-NPP provides only that the administrator must act in interests of the fund participants. However, this article applies to the administrator only, and does not apply to the NPF and other service providers. Item 1.2 of Section IV of the Policy on Specific Features of the Exercise of Institutional Investors' Asset Management Activities approved with SSMSC Decision No. 1227 of November 2, 2006, requires the asset manager to act in interests of the institutional investor (in this case, the NPF) being serviced by the manager and specifies a relatively broad framework for the activities of asset managers. However, the reference merely to "maximizing income" instead of the "maximizing performance results" can unreasonably restrict the impartiality of the evaluation of activities of the asset manager.

The non-binding nature of the Code of Ethics and its effective absence do not foster participants' trust in NPFs as safe and protected instruments that will be profitable when the participants retire.

Conclusions and Recommendations

The protection of consumers of NPF services must be strengthened by means of the amendment of the legislation on non-state pension provision.

1. It is necessary to provide in the LU-NPP for setting up statutory capital to support the core business of the NPF to make funds able to pay liabilities to the participants from its own equity. It would be worthwhile to require founders to specify in the charter the equity to be assigned to the pension fund, its value and the time frames of the said assignment.
2. It is necessary to introduce an approach under which pension assets may only be collected on the basis of claims against the NPF held by other NPF creditors and that arise directly from the exercise of the core non-state pension provision business of the NPF. Only the property intended for securing the core business of the NPF (i.e., the

- property conveyed to the NPF in the form of founder contributions) should be permitted to be collected by non-NPF creditors arising from claims that do not directly stem from the exercise of the non-state pension provision business by the NPF.
3. Council members should be required to enter into a contract with the fund governed by the civil law; the law must specify the fiduciary duties toward participants and principles of the liability of council members that may not be modified by contract; the liability of council members for the specification of lines of the investment policy and the exercise of control must be made stronger over activities of entities that provide services to the pension fund.
 4. NPFs should be required to disclose information about the professional experience of their managers in more detail. The annual statement must contain information about risks, the comments by management on financial performance results, and investment activities of the NPF.
 5. The transactions with pension fund assets with the involvement of related parties of the founders should be regulated. The regulation must be achieved by means of the prohibition of such transactions or the disclosure of the information about the nature of such transactions to consumers and the fund council.
 6. Provisions should be made for the prevention of the development of quasi-pension products and the clear positioning of products offered by insurance companies and banks. Unclear boundaries between banking, insurance and pension products should be eliminated. It should be clearly specified that insurance companies are permitted to take part in the accumulation of non-state pensions solely by means of the establishment and the registration of a dedicated legal entity (a NPF) with the involvement of an administrator, an AMC and a custodian. Life insurance companies should only be permitted to offer non-state pension provision services in accordance with the LU-NPP.
 7. A provision should be made for the obligatory notification of consumers as to changes in the physical location of the NPF simultaneously with the notification to the FSR.
 8. NPF officers should be made accountable by way of an administrative liability for the refusal to transfer funds to another NPF/financial institution or for forcing participants and/or depositors to transfer their funds to another NPF.
 9. A Code of Ethics should be made obligatory for the NPF market.

D. Joint Investment Institutions

The JII system is supposed to support mechanisms of raising available resources from households, enterprises and organizations and the subsequent efficient investment thereof. It has been implemented upon the effective date of the Law of Ukraine "On Joint Investment Institutions (Unit Investment Funds and Corporate Investment Funds)" (LU-JII). This system is based upon unit investment funds and corporate investment funds, of which the first ones were established in 2001.

According to the Ukrainian Association of Investment Business (UAIB), 347 asset management companies were its members as of March 28, 2011 (the membership of the self-regulated organization is a pre-condition for the obtainment of the relevant license). They managed 232 corporate investment funds and 923 unit investment funds.

There are also numerous bylaw regulations that specify requirements for the operation of unit investment funds and corporate investment funds, asset management companies and custodian. The following are the major regulations:

- The Procedure for the Termination of a Corporate Investment Fund and the Settlement of Accounts with Shareholders Thereof on Liquidation is approved with SSMSC Decision No. 1324 of August 20, 2010;
- Procedure for the Termination of a Unit Investment Fund and the Settlement of Accounts with Shareholders Thereof on Liquidation is set forth under SSMSC Decision No. 1516 of October 05, 2010;
- The Policy for the Submission of Administrative Data by Issuers with the Closed (Private) Placement of Securities to the SSMSC and the Procedure of Completion of Electronic Forms for Administrative Data by Issuers with the Closed (Private)

Placement of Securities for the Submission to the SSMSC is approved with SSMSC Decision No. 187 of March 1, 2011.

Most often, consumers deal with unit investment funds (UIF). A UIF does not have a legal entity status; it is managed by an AMC.

Thus, the following issues can be identified as activities of JIIs regarding consumer protection:

1. Non-awareness of Consumers of the Complex Web of Mutual Relations of Entities That Service a JII

The JII system is characterized by the simultaneous operation of several participants being separate legal entities. They are: a corporate fund (established in the form of an open joint-stock company); an AMC, which manages assets on the basis of an appropriate contract; a custodian, which provides JII securities safekeeping and ownership registration services; and a bank, in which a participant (investor) of a JII can hold a current account. An individual may buy shares in a corporate investment funds or investment certificates of a unit investment fund from third parties on the basis of a regular securities sales contract and have no actual understanding of the party intended to buy-out the securities in question. This complex nature does not offer consumers an opportunity to determine which party has encroached upon his rights and against which party claims should be lodged, i.e. which party is liable and which party will be a defendant in case of judicial proceedings.

2. Lack of Culture of Investments via JIIs and Lack of Transparent Information about the Cost of Ancillary Services and Investment Effectiveness

A consumer is generally not conversant with specifics of a particular type of a JII and is unable to distinguish, for instance, when an AMC is supposed to buy-out JII securities (in case of an open-type JII), the timing of such purchases (in case of an interval-type JII), and when an AMC may, but is not obliged to, buy-out JII securities before the expiration of its operating period (in case of a closed-type investment institution). Sometimes, the companies make use of such unawareness of consumers.

Quite often, the JII investments are offered to consumers as a better-performing alternative to bank deposits. However, not all companies

disclose the commissions to be paid (entry and exit fees, the AMC fee, the custodian service fee), the risks inherent in investments, and the possible yield from investments depending on the timeline (the JII investments can have lower performance than bank deposits due to overhead costs in the short run). Companies mostly do not pay attention to the level of experience of potential investors or their current account status, and do not tell their potential customers about the principle of "not investing your last dollar".

3. Reimbursement for Losses Caused as a Result of Activities of JIIs

According to the LU-JII (Article 33), an AMC is liable with its property for losses inflicted upon the JII by its actions (or inaction) in accordance with the law and the terms of its contract.

The AMC is required to refund losses suffered by a JII, which performs a public (open) placement of its securities, if the value of net assets value per unit of the JII drops below its par value within one year or by more than 20 percent as a result of a violation of requirements of laws by the AMC.

The refund is disbursed at the expense of the company's reserve fund in accordance with the procedure prescribed by the SSMSC, or, in case of insufficient reserve funds, at the expense of other property of the company. The reserve fund is set up in an amount specified by constituting documents, but not less than 25 per cent of the authorized capital (fund) of the AMC managing the JII's assets. The amount of annual allocations to the reserve fund is specified in constituting documents of the AMC, but it may not be lower than 5 per cent of the net profit. The reserve fund resources are to be invested in accordance with the procedure specified by the SSMSC.

The availability of the above provision is a positive fact, but the procedure for its implementation is unclear. The most problematic aspect is proving the causal relationship between the said reduction and the violation of requirements of laws by the AMC. It seems that the relationship must be confirmed with documentary evidence, such as resolutions of the SSMSC on the violation of some laws by the AMC.

Thus, a consumer must either rely on the prudence of the SSMSC, or monitor actions of the AMC on an ongoing basis. In addition, the

LU-JII refers to the "violation of requirements of laws by the AMC", rather than those of the "legislation". It also narrows down the range of situations in which the AMC will be required to refund losses suffered by the JII.

4. Inability to Settle Accounts with a Consumer (Investor) under Concluded Contracts On Time and In Full, or Substantial Delays with Payments

Article 44 of the LU-JII specifies time frames of the buy-out of securities from an investor. However, the payments are often delayed in practice.

5. Control over Activities of Asset Management Companies

The LU-JII (Article 52) provides that the custodian must exercise control over activities of an AMC in terms of the procedure of the calculation of the value of net assets of the JII, the placement and the buy-out of JII securities, and the strategy for utilization of profits obtained on the JII assets. To this end, the custodian must verify the correctness of calculations of the value of net assets of a JII performed by the AMC once a quarter.

The custodian notifies the supervisory council of a corporate investment funds or an AMC of a unit investment fund about results of this verification in accordance with the procedure prescribed by the JII service contract.

The custodian notifies the SSMSC of any actions of the AMC that do not meet the JII securities issue prospectus or violate the JII regulations, the law, or regulations of the

SSMSC. The custodian is obliged to supply such information within one day of the detection of a violation. In case of the failure to comply with this requirement, the custodian is liable for losses inflicted upon JII shareholders or participants in accordance with the contract and law.

Again, the availability of this provision is positive, but the procedure of its implementation is unclear. For instance, the facts of the violation of the JII regulations, the law or SSMSC regulations must be proven. In addition, the value of losses and the causal relationship between actions (inaction) of the custodian and losses of JII shareholders or participants must be proven as well.

Conclusions and Recommendations

The status of protection of consumers of financial services in their relations with JIIs can be improved by means of the amendment of the legislation of Ukraine (for instance, the LU-JII) as follows:

1. It is necessary to specify minimum requirements for the information to be disclosed by JIIs to consumers both before the entry into the relevant contract and at the stage of entry into the contract, including information about all commissions and fees associated with the JII investments.
2. It is necessary to specify mechanisms guaranteeing compensation payments for investors who are unable to receive reimbursement on the basis of court decisions due to the lack of funds or other capital on the part of the debtor.

Annex Issues in Other Sectors of Non-Bank Financial Services

A. Pawn Shops

Today, there is no universal understanding of the nature of pawn shops. Pawn shops are defined as financial institutions, whose sole business is the provision of financial loans to individuals in cash or in a cashless form at its own risk and at the expense of owned or borrowed funds. Pawn shops as financial institutions accept jewelry and household items made of precious metals and precious stones from individuals for the *safekeeping* and grant loans secured with such items.

As of December 31, 2010, 426 pawn shops were entered into the State Financial Institutions Register. There are 53 institutions (or 14.2%) more than on the same date of in the previous year (373 pawn shops as of December 31, 2009). The pawn shop number increase trend is mainly due to their meeting the priority of the financial needs of individuals. The volume of financial loans granted by pawn shops in 2010 went up by 57.0% in comparison with 2009.¹²

Activities of pawn shops are regulated by a very small set of regulations: the Law of Ukraine "On Financial Services and State Regulation of Financial Service Markets", the Procedure of Entry of the Pawn Shop Information into the State Financial Institutions Register set forth under FSR Instruction No. 1140 of October 2, 2008, and the Procedure of the Provision of Financial Services by Pawn Shops described in FSR Instruction No. 3981 of April 26, 2005. There are no dedicated Licensing Conditions for the provision of pawn shop services.

Major issues are as follows:

1. *Non-return of Items to a Consumer on the Repayment of a Financial Loan due to the Improper Safekeeping of Items Handed over to the Pawn Shop*

¹² Огляд ринків фінансових послуг та підсумки діяльності небанківських фінансових установ, державне регулювання та нагляд за діяльністю яких здійснюється Держфінпослуг, за 2010 рік (*Review of Financial Services Markets and Performance Results of Non-bank Financial Institutions Subject to the State Regulation and Supervision by the State Financial Services Markets Regulation Commission of Ukraine in year 2010*) // <http://uainsur.com/wp-content/uploads/2010/01/OGLYAD2010.pdf>

Requirements of Procedure No. 1140 for a pawn shop are very general. For instance, item 2.2.5 specifies that a pawn shop must have premises (own or leased) with the area of at least 5 square meters for the provision of financial services and ancillary pawn shop services, and a special safekeeping area.

Often, the premises rented by pawn shops (especially, for their branches) are not suitable for their activities. Property can be stolen from such premises, and the pawn shop is therefore unable to return the item to the depositor. The legislation requires the pawn shop to compensate the depositor for the loss of the item. A pawn shop can offer other items by way of compensation (often, they do not bear appropriate tags, which means that there is no confirmation of the return of a jewelry item) or cash. In addition, the pawn shop attempts to extend the process of the repayment of funds.

It is necessary to clearly specify requirements for the pawn shop premises in order to make good the above issue. The sizes should be clearly specified for head offices and branches.

2. *Lack of Notification of Changes in the Location of a Pawn Shop (Branch)*

Procedure No. 1140 requires a notice of change in the location of a pawn shop or a branch thereof to be submitted to the FSR within 15 days. However, there is no requirement for the notification of the consumer about it in any manner.

3. *Conclusion of Contracts in Addition to the Financial Loan Contract (e.g., Insurance Contracts)*

According to Procedure No. 3981, insuring the pledged object is not required, but item 3.2 lists insurance services for pledged objects among ancillary pawn shop services. This type of insurance is not listed among obligatory types of insurance in Article 7 of the LU-INS. Article 967 of the CCU provides that the pawn shop is obliged to procure insurance to the benefit of the depositor for items accepted for safekeeping at its own expense. Thus, provisions of Procedure No. 3981 contradict the requirements of the CCU. In practice, pawn shops hard sell the provision of insurance services to customers at their expense and, by

doing so, they move the duty to procure insurance to the consumer.

4. Failure to Provide Complete and True Information about Conditions of the Financial Loan

Conditions of a financial loan are specified in Article 6 of the LU-FS and item 3.3 of Procedure No. 3981. In addition, provisions of Article 11 of the LU-CRP apply here. However, the provisions of the LU-FS and Procedure No. 3981 do not specify details that would protect consumers (such as the value of ancillary services), but pay more attention to contractual technicalities (such as names of the parties, etc.).

5. Lack of Requirements for Pawn Shop Founders

A pawn shop may only be established in the form of an unlimited partnership. It means that the founder is liable with its entire property under liabilities of the partnership. However, there are no requirements for founders. In practice, front persons, who do not possess any property, are often presented as founders.

Conclusions and Recommendations

It is necessary to regulate activities of pawn shops at a legislative level, for instance, by adopting a Law "On Pawn Shops and Pawn Shop Activities" and appropriate bylaws. Relevant regulations must clearly specify licensing requirements for persons intent on engaging in the Pawn Shop activities, such as the requirements for the property standing of founders and the pawn shop premises (the availability of the security system, safes, etc.); clearly define the duty of the pawn shop to conclude insurance contracts on pledged objects at its own expense; provide for the disclosure of the information about contractual conditions to the consumer before entry into a contract and the obligatory notification of the consumer in writing of changes in the location of the pawn shop (branch). It would be appropriate to develop sample or model conditions of a financial loan contract for pawn shops at the regulatory level.

B. Construction Finance Funds and Real Estate Funds

The purchase of housing via Construction Finance Funds (CFF) and Real-Estate Funds (REF) has lately become generally acceptable and affordable.

As of December 31, 2010, there were 87 financial companies licensed to conduct the business of raising funds from estate beneficiaries for the funding of construction projects and/or the performance of transactions with the real estate. There were 12,090 individuals and 122 legal entities acting as beneficiaries that entered into contracts with financial companies acting as trustees for the participation in CFFs as of December 31, 2010.¹³

In practice, mainly Type A CFFs and not Type B CFFs are established. It means that in most cases the risks are vested in the developer, rather than the CFF trustee. The number of the established REFs is very small. As of December 31, 2010, 10 financial companies obtained permits granting the right to issue REF certificates and only 4 of them actually established 4 funds. As of December 31, 2010, REF certificates have been held by 85 individuals and 1 legal entity.¹⁴

It is known that funds themselves are not legal entities. For this reason, all actions on behalf of the fund are performed by the trustee. The fund trustee serves as the core, around which the entire CFF operation system is built. The trustee is an obligatory party to almost all legal relations coming into existence within the system. The trustee enters legal relations in its own name, while acting in the interests of trustees.

¹³ Огляд ринків фінансових послуг та підсумки діяльності небанківських фінансових установ, державне регулювання та нагляд за діяльністю яких здійснюється Держфінпослуг, за 2010 рік (*Review of Financial Services Markets and Performance Results of Non-bank Financial Institutions Subject to the State Regulation and Supervision by the State Financial Services Markets Regulation Commission of Ukraine in year 2010*) // <http://uainsur.com/wp-content/uploads/2010/01/OGLYAD2010.pdf>

¹⁴ Огляд ринків фінансових послуг та підсумки діяльності небанківських фінансових установ, державне регулювання та нагляд за діяльністю яких здійснюється Держфінпослуг, за 2010 рік (*Review of Financial Services Markets and Performance Results of Non-bank Financial Institutions Subject to the State Regulation and Supervision by the State Financial Services Markets Regulation Commission of Ukraine in year 2010*) // <http://uainsur.com/wp-content/uploads/2010/01/OGLYAD2010.pdf>

Activities of the CFFs and REFs are governed by the Law of Ukraine "On Financial Lending Mechanisms and Property Management during the Housing Construction and Real Estate Transactions". In addition, the CCU (Chapter 70) and the LU-FS play an important role. The current legal and regulatory framework has established certain rules of, and requirements for, the exercise of activities related to the management of funds raised from individuals and legal entities into CFFs and REFs by trustees for the purposes of funding the housing construction or engaging into transactions with the real estate, such as:

- the need for licensing the fund raising activities of trustees and some requirements for NBFIs being trustees intent on obtaining a license;
- the requirements for the equity of the trustee and its assets both as of the time of entry of the information into the State Financial Institutions Register, and during the activity period of the trustee;
- additional requirements for contracts with beneficiaries, which reduce risks of the possible encroachment by trustees upon legitimate rights of beneficiaries;
- the requirements related to the trustee's need to perform monthly control over the use of beneficiaries' funds by the developer for designated purposes;
- target ratios of the trustee's liquidity and solvency specifying the relationship between the trustee's equity and the amount of funds raised thereby in order to partly reduce risks of the insufficient liquidity and insolvency of the trustee, and other requirements.

The Construction Finance Fund Rules are an important document, which governs relations between the trustee and the consumer (beneficiary). The sample rules have been approved with FSR Instruction No. 6473 of November 30, 2006.

In its Instruction No. 277 of April 24, 2009, "On Efficiency and Co-ordination of Activities of the State Regulation and Supervision of the Market of Financial Services Related to the Management of Construction Finance Funds and Real Estate Funds, the FSR pointed out major violations of laws by the funds:

1) the violation of requirements of the Law of Ukraine "On Financial Lending Mechanisms and Property Management during the Housing

Construction and Real Estate Transactions" in terms of:

- the non-conformity of CFF Rules, CFF Participation Certificates with requirements of the legislation, the failure to conclude mortgage contracts and construction/installation work insurance contracts for the entire period of construction;
 - the failure to timely repay funds to beneficiaries on the basis of their applications to exit from the CFF;
- 2) the violation of requirements of Licensing Conditions to conduct activities related to raising funds from estate beneficiaries for the funding of construction projects and/or the exercise of real estate transactions in terms of:
- the failure to comply with requirements for booking operating provisions;
 - the failure of chief executive officers and chief accountants of trustees to meet professional requirements;
 - the failure to provide (the late provision) of the information about changes in documents and the information submitted for the obtainment of the license;
 - the exercise of activities by the licensee outside its registered offices.

In addition, attention can be paid to the following issues:

1. Non-provision of Sufficient Information to the Beneficiary before the Contract Conclusion and in the Course of Its Performance

The Law of Ukraine "On Financial Lending Mechanisms and Property Management during the Housing Construction and Real Estate Transactions" does not require the provision of information before the entry into a contract. Article 14 of the Law merely specifies the essential terms and conditions of a contract between a trustee and a beneficiary. In addition, a number of documents must be attached to the contract: the CFF Rules; a graphic depiction of the construction layout of the investment object with names and areas of all its premises and the indication of the placement of the investment object on the premises, etc. It is difficult for an ordinary consumer to make sense of all the subtleties of these documents.

It is positive, however, that a trustee must not include conditions contradicting the LU-CRP into contracts with beneficiaries.

However, the Law does not contain clear provisions about the need to inform the beneficiary about the progress of the construction project. The Law only requires the trustee to check the financial standing of the developer on written demand of the beneficiary, require the developer to provide financial and audit statements, and provide the applicant with the information about results of the performed inspection.

2. Complex Contractual Arrangements between the Trustee and the Beneficiary

In addition to the CFF participation contract, a beneficiary and a trustee also enter into a contract of the allocation of the investment object to the beneficiary treated as the confirmation of the order for the construction of the relevant investment object as a component of the construction project. Thus, relations between beneficiaries and developers are governed by means of the entry into mutually interrelated contracts, rather than a single contract.

It is positive that these contractual relations provide at the legal level for the impossibility of the allocation of the same object to two beneficiaries. The trustee is liable with its own property for the failure to comply with this requirement resulting in the allocation of the same investment object to two or more beneficiaries.

Thus, if actions or inaction of the trustee result in the allocation of a single investment object to two different beneficiaries, the trustee will be liable to beneficiaries with its property. This provision of the Law "On Financial Lending Mechanisms..." is definitely positive. It is focused on ruling out the possibility of the violation of rights of beneficiaries in this manner.

The Law of Ukraine "On Financial Lending Mechanisms and Property Management during the Housing Construction and Real Estate Transactions" provides for the responsibility of the trustee for the compliance with restrictions upon its trust property specified in the CFF Rules, and for its performance of other commitments to the CFF beneficiaries within the scope of the Law and the CFF participation contract. However, the Law does not specify

the actual sanctions in case of the violation of this responsibility.

3. Termination of Contractual Relations between the Trustee and the Beneficiary

Article 20 of the Law of Ukraine "On Financial Lending Mechanisms and Property Management during the Housing Construction and Real Estate Transactions" provides for the possibility of the termination of contractual relations between the CFF and the beneficiary. In this case, the funds must be repaid to the beneficiary. However, the amount of funds to be repaid is refunded to the beneficiary within five days of the subsequent complete sale of the relevant investment object by the trustee or after the commissioning of the construction project. It means that the CFF does not repay funds to the beneficiary immediately.

According to item 4 of Article 3 of the Law of Ukraine "On Mitigation of the Impact of the International Financial Crisis on the Development of the Construction Sector and the Housing Construction", the funds contributed by individuals and legal entities to developers under terminated contracts, under which the housing object (a part thereof) has been paid in part, are to be refunded after the subsequent sale of the said housing object (a part thereof). No penalties are charged and paid by the developer under contracts and no funds are collected under Article 625 of the CCU. This prohibition does not apply in the event of the postponement of the deadline for the commissioning of the construction project by more than 18 months.

We believe that the funds must be repaid within the scope of requirements of Article 530 of the CCU (i.e., within 7 days).

Judicial practice has demonstrated that trustees do not repay funds immediately even in case of the violation of the commissioning deadlines by more than 18 months.

4. Replacement of the CFF Trustee

Article 23 of the Law of Ukraine "On Financial Lending Mechanisms and Property Management during the Housing Construction and Real Estate Transactions" provides that the replacement of a trustee does not result in the termination of the operation of the CFF; a CFF may be placed under the management of another financial institution by court decision. However, the law fails to clearly specify the procedure of control on the part of the state

authority in this case. It also does not provide for the notification of the beneficiary about such a replacement of the CFF trustee.

5. Developer's Failure to Meet Its Liabilities

There is no direct relationship between the beneficiary and the developer. Thus, if the developer violates construction project deadlines, fails to use funds for designated purposes or to comply with the construction technology, the beneficiary is unable to influence the situation in any manner. The Law does not specify a mechanism for the influence of the beneficiary upon the developer via the CFF trustee in such events.

Additionally, the trustee of Type A CFFs do not bear liability for the developer's failure to meet deadlines and proper construction workmanship requirements. The beneficiary is unable to present claims because of the lack of direct contractual relations between the beneficiary and the developer.

Participants of the CFF are vested by law with all risks of the improper performance of liabilities by the developer, but the fund participants are unable to even replace a CFF trustee in case the trustee fails to control the developer properly. Furthermore, there is no mechanism making it possible for CFF participants to inspect the work of the trustee.

Since the trustee is required to control the construction project, the trustee must be liable to the beneficiary (consumer).

6. Settlement of Accounts with the Beneficiary

The Law of Ukraine "On Financial Lending Mechanisms and Property Management during the Housing Construction and Real Estate Transactions" requires the paid-in authorized capital of a CFF trustee to amount to at least EUR 1,000,000, which does seem enough for meeting a beneficiary's claims. However, Type B CFFs are hardly established in practice. Almost all existing CFFs have been established as Type A CFFs: the main risks are borne not by a trustee with a large authorized capital, but by a developer, which can have minimum authorized capital and no other possessions. Additionally, it should be kept in mind that the trustee may unilaterally change the terms of a contract with the developer regarding a specific construction project in the case a violation of the terms of the contract by the developer from a Type B CFF to contract terms of a Type A

CFF. Thus, a Type B CFF may be unilaterally converted by a trustee into a Type A CFF.

The Law also fails to sort out the issue of the possibility and the procedure for the settlement of accounts by the trustee with a beneficiary in case the beneficiary refuses to take part in the CFF or the forced reallocation of an investment object from the beneficiary by decision of the trustee of a CFF of any type at the expense of the operating reserve funds. At the same time, the Law directly provides that the operating reserve is intended, *inter alia*, for the disbursement of funds to beneficiaries from the CFF.

7. Advertising for Construction Projects

It is positive that Articles 8 and 25-1 of the LU-Ad specifies requirements for advertising of a residence in reliance upon non-state funds raised from individuals and legal entities. Unfortunately, these requirements are too general.

Conclusions and Recommendations

In order to strengthen the protection of consumers in CFFs and REFs, the following aspects should be covered at the legislative level, for instance, in the Law of Ukraine "On Financial Lending Mechanisms and Property Management during the Housing Construction and Real Estate Transactions":

1. Taking into account the specific features of a contract concluded between a trustee and a consumer, the requirements should be formulated for the disclosure of the information to a consumer before entry into the contract and for the obligatory regular notification of the consumer of the progress of the project.
2. Clear sanctions that can be applied against a trustee, such as the payment of penalties to a beneficiary, must be envisaged for strengthening the trustees' liability for the failure to meet their liabilities to the beneficiary.
3. The procedure of exercise of the state control in case of the replacement of a CFF trustee should be defined clearly.
4. Clear arrangements and time frames for the settlement of accounts with a beneficiary should be specified for the event of the refusal of a beneficiary to take part in the

CFF or in case of the forced reallocation of an investment object from the beneficiary by decision of the CFF trustee.

5. Amendments should be introduced into the LU-Ad to specify detailed requirements on advertising for construction projects. Perhaps a provision requiring the FSR to endorse the contents of the advertisement could be added in a manner similar to the stock market.

C. Trust Companies

The first attempt to legislate trust relations in Ukraine was made with the adoption of CMU Decree "On Trust Companies" of March 17, 1993. Article 1 of the Decree defined a trust company as a supplementary liability company, which exercises representation activities in accordance with a contract concluded with property beneficiaries regarding the exercise of their ownership rights (funds, securities and documents confirming the ownership of a beneficiary are the beneficiary's property). The property beneficiary (a legal entity or an individual) vest the powers of the owner of their property to the trust company in accordance with the conditions of the contract concluded between them.

The unsuitability of the applied arrangement, even in such a trimmed form, was confirmed with subsequent "numerous facts of abuse and financial fraud resulting in substantial pecuniary and non-pecuniary losses of individuals and the damage to property interests of the state" (quoted from CMU Resolution No. 873 of November 1, 1995, "On Results of Comprehensive Inspections of Activities of Trust Companies"). According to the resolution, it was ascertained after the review of comprehensive inspection materials that the said institutions had committed numerous violations of the legislation, such as the late formation of the authorized fund, the exercise of representation activities with privatization securities without licenses of the State Property Fund of Ukraine, violated foreign-exchange and tax legislation, and illegitimately engaged into the performance of banking transactions. Often, no contracts had been concluded by such companies with banks and no protocols had been drawn up for the safekeeping and investment of assets resulting in the shadow circulation of funds. These violations were caused by the imperfect legislation regulating

activities of the trust companies, the inadequate control over their activities by the State Property Fund of Ukraine, the uncertainty regarding the involvement of the Ministry of Finance of Ukraine and the NBU in such control, the lack of proper statistical reports on activities and the financial standing of trust companies, the deficiencies with their registration and the non-compliance of commercial banks providing services to trust companies with requirements of the current legislation. The trusts were completely discredited as a fiduciary management tool as a result.

Being established as a result of privatization processes in Ukraine, trust companies were vested with the right to engage into representation activities with privatization securities. However, the Decree did not prohibit or restrict activities of trust companies in other fields of civil and commercial transactions. The only limitation introduced by the Decree was imposed on fiduciary transactions with privatization securities: they could have been performed solely by supplementary liability companies subject to their being in possession of an appropriate license issued by the State Property Fund of Ukraine.

Currently, the trust companies are suffering a profound setback. As of April 1, 2011, the State Financial Institutions Register contained information about 2 trust companies. However, the actual number of existing trust companies remains unknown because not all trust companies complied with requirements of the Procedure of Entry of the Trust Companies Information into the State Financial Institutions Register approved with FSR Instruction No. 5538 of March 28, 2006. This is confirmed by responses of the SSMSC to complaints of individuals regarding activities of trust companies not mentioned in the register maintained by the FSR,

Thus, the following are the major problems of the protection of consumers of services of trust companies:

1. Absolute Lack of Legislative Regulation of Activities of Trust Companies

The CMU Decree "On Trust Companies" still remains the legal foundation of their activities. The CMU Decree cannot be deemed to regulate activities of trust companies, because it contains very general provisions concentrated in four articles. In addition, the Decree has effectively remained unchanged in spite of

numerous violations on the part of trust companies (two minor changes have been introduced since 1993). Neither the CCU, nor the ComCU contain provisions on activities of trust companies. The provisions of the CCU are only applied to the estate administration contract to be concluded between a trust company and a consumer (Articles 1029 to 1045). However, these provisions are quite general and need to be detailed in the dedicated financial services legislation.

There are two more regulations in addition to the CMU Decree, which regulate activities of trust companies:

- The Procedure of Entry of the Trust Companies Information into the State Financial Institutions Register approved with FSR Instruction No. 5538 of March 28, 2006;
- The Procedure of Submission of Reports by Financial Companies, Trust Companies and Legal Entities Being Business Entities without the Legal Status of Financial Institutions That Have an Opportunity to Provide Financial Leasing Services under Laws and Regulations of the FSR approved with FSR Instruction No. 27 of January 27, 2004.

2. Lack of State Control over Activities of Trust Companies and the Performance of Their Liabilities to Beneficiaries

The LU-FS (Article 1) categorizes trust companies as financial institutions. Thus, the FSR should have provided for the legal regulation and state control of their activities. However, the CMU Decree provides that the State Property Fund of Ukraine shall issue licenses for the exercise of representation activities with privatization securities, carry out registration and exercise control over activities of trust companies related to the investment of privatization securities. Thus, different state authorities are vested with the power to issue licenses, supervise and control activities of trust companies. In addition, these powers are not coordinated.

In practice, individuals used to submit complaints on activities of such companies mainly to the SSMSC because trust companies mainly deal with privatization securities. However, the SSMSC responded that it was not competent to solve the relevant issues and that the consumer should refer the matter to court.

3. Impossibility to Enforce Court Decisions due to the Lack of Property and Funds on the Part of Trust Companies

A trust company may be established in the form of a supplementary liability company (Article 1 of the Decree). General requirements for supplementary liability companies are set out in Article 65 of the Law of Ukraine "On Corporations". However, the legislation, including the Law of Ukraine "On Corporations", lacks clear requirements for the liability of founders of the company. It is to be specified in the company's charter. The legislation does not require the authorized capital to be maintained. Thus, even if a positive court decision is obtained, it is impossible to enforce it due to the lack of property and funds on the part of trust companies.

Conclusions and Recommendations

It is necessary to develop and adopt a Law of Ukraine "On Property Trust" containing provisions that govern the notion and the legal status of trust companies, set more stringent requirements for the formation and the value of the authorized capital of a trust company, and requirements for the information to be disclosed to the consumer.

It would also be appropriate to modify the organizational and legal form of trust companies from supplementary liability companies to unlimited partnerships. This, for instance, will make it possible to strengthen the liability of trust companies to customers. Additionally, requirements for founders of such companies have to be specified.

It would be appropriate to provide in the Law of Ukraine "On Property Trust" that trust companies set up a guarantee fund for the restitution of possible losses caused to beneficiaries in case of abuse on the part of trust companies.

The powers related to the legal regulation, supervision and control of activities of trust companies should be assigned to a single state authority.

D. Credit Societies

Financial institutions may grant loans to individual consumers in accordance with items 1 and 2 of part 1 of Article 1 of the LU-FS.

If a financial institution grants loans at the expense of its own funds, the financial institution in question is not vested with the status of a credit institution. A financial institution, which is eligible for granting financial loans at own risk in accordance with the law at the expense of the borrowed funds, is vested with the status of a credit institution. These laws apply to banks and credit unions.

Additionally, credit societies are also established to operate on the market. Such financial institutions are established in organizational and legal forms of business corporations. Their activities are not governed by any law. Accordingly, they are not financial institutions permitted by law to grant loans at the expense of the borrowed funds. In fact, there is only one regulatory document governing their activities. Thus, the major problem with the activities of credit societies is their effective extra-legality.

In fact, the mechanism of emergence of credit societies relies on two consecutive actions by the FSR:

1) The issue of a license to conduct the business of the provision of financial loans at the expense of borrowed funds to a business corporation (mainly, a limited liability company) by the FSR Instruction No. 4802 on Licensing Conditions of the Exercise of Business of the Provision of Financial Loans at the Expense of the Funds Borrowed by Credit Institutions (October 18, 2005);

2) The alteration of the financial institution code, its registration number, the series and the number of the financial company certificate due to the obtainment of the status of a credit institution.

There is no judicial practice regarding activities of such credit societies.

It should be mentioned that the FSR may submit a claim for the liquidation of a legal entity to court targeting financial institutions that violate legislation on a regular basis (in this case, they provide loans at the expense of borrowed funds not according to the law, but on the basis of bylaw regulations).

Conclusions and Recommendations

In order to "legalize" the very existence of such credit societies (to bring them in accordance with the definition of a credit institution provided in item 2 of part 1 of Article 1 of the LU-FS), it is necessary to develop a specific law on such credit societies or amend existing laws as soon as possible. Requirements for the equity and regulatory capital of credit societies eligible for raising funds from individuals may not be lower than the requirements for credit unions.

E. Other Aspects of Financial Services Consumer Protection

Control by the State

A large number of legal entities, which provide financial services but have not submitted appropriate documents for the entry of their information into the State Financial Institutions Register, are established on the market. Accordingly, no proper control over such legal entities is exercised by the state.

The situation with Elita-Tsentr Investment and Construction Company can be used as an example. While activities of said company matched the criteria of a financial service set out in item 5 of part 1 of Article 1 of the LU-FS (raising funds for construction), the company has not been entered into the financial institutions register by the FSR. Thus, this company has not been supervised with regard to its borrowing funds from individuals.

Formally, there is no violation of law by the FSR. Its control and supervision activities cover legal entities which provide financial services, provided that such legal entities:

- Have obtained the status of a financial institution (and their information has been entered into the State Financial Institutions Register); and
- Have been entered into records as providers of financial services.

If a legal entity has not obtained the status of a financial institution and has not been entered into records of the FSR as a provider of financial services, then no control and supervision activities are exercised.

It is a problem for most non-bank institutions that there is no connection and no duty vested in a legal entity to start the liquidation procedure

in case of an FSR decision to remove the legal entity from the financial institutions register and no duty to notify consumers thereof. Thus, it is possible for some time to continue raising funds from consumers and commit other violations related to the performance of liabilities that the financial institution assumed before being purged from the register. Additionally, a legal entity drops out of control by the FSR on its removal from the financial institutions register. This is wrong. Item 3.2 of FSR Instruction No. 125 of November 13, 2003, "On Approval of the Policy of Sanctions Application by the State Financial Services Markets Regulation Commission of Ukraine" makes the Head of the FSR competent to submit a claim to court for the liquidation of a financial institution, while this is not a direct duty of the FSR.

For instance, about 200 credit unions, which were not located in their registered address and did not submit reports to the FSR, were removed from the state register over the last 2 or 3 years. However, the same legal entities designated as "credit unions" and having code number 925, which were deleted from the state financial institutions register (and, thus, dropped out of control by the FSR), but were not deleted from the Universal State Register of Legal Entities, could have remained on the market.

The state registration of legal entities, which may provide financial services in accordance with constituting documents, must be associated with the provision of the information about such a legal entity to the appropriate state authority (the regulator of financial markets) in accordance with the allocation of powers under Article 21 of the LU-FS. The deletion from the state financial institutions register must result in the issue of the relevant information to the state registrar for the removal of the state registration of the former financial institution.

It should be made incumbent upon the FSR to submit a claim for the liquidation and the deletion of the legal entity from the register of legal entities to court. Provisions should be made for the continued exercise of the supervision of such a financial institution by the FSR until the complete liquidation of the said legal entity and its deletion from the register of legal entities.

Provision of Financial Services (e.g., Payment Processing Services) by Non-financial Companies

The NBU has paid attention to such violations in light of the increased frequency of inquiries by law enforcement agencies and the State Tax Service of Ukraine into activities of banks and business entities, which provide retail payment processing services using self-service terminals (software/hardware self-service suites), and the increased frequency of complaints by individual users of such services. The NBU has reviewed agency contracts of banks concluded with such business entities and analyzed arrangements underlying their activities for the conformity with requirements of regulations of the NBU. However, the NBU reacted not in the form of a regulation or sanctions, which it may apply, but merely with Letter No. 25-211/1282-9740 of June 9, 2010, "On Performance of Transactions Using Self-service Terminals" stating that some banks and business entities, which had entered into agency contracts with banks, were violating requirements of NBU Resolution No. 53 of March 5, 2008, "On Regulation of Issues of the Performance of Transactions Using Self-service Terminals". There is also a draft FSR Instruction "On Approval of Changes to Licensing Conditions for the Transfer of Funds by Non-bank Financial Institutions" covering the issues of licensing the providers of transfer services by a licensee (for instance, using self-service terminals) published on the official web site of the Commission on August 12, 2010 (however, this draft document was not adopted).

Provision of Other Services, Which Are Effectively Financial

Currently, some business entities attempt to conduct the business of the provision of services, which are inherently financial, but are not fully covered under the definition of a particular financial service type provided by law. The lack of regulation of such activities weakens the protection of financial services consumers and, hence, increases the risk of the involvement of individuals into fraudulent schemes or financial pyramids (Ponzi schemes).

For instance, the "group-buy" administration services provide for raising funds from individuals and/or legal entities, the consolidation and the use thereof for the purchase of goods by these parties. These

services meet all the financial service criteria specified by law, because financial transactions with financial assets are performed in the course of the provision of such services (the administrator receives money from group members on the basis of a contract) in the interests of the third parties (for the purchase of goods in the name and in interests of group members) at their expense (the group-buy administration services are provided at the expense of group members) for profit (these activities are aimed at obtaining profit in the form of obligatory administrative charges). However, this service cannot be categorized as one of the financial services referred to in items 1 to 11 of part 1 of Article 4 of the LU-FS, and is not regulated by the special legislation.

The group-buy system is based on a company's offering a loan to all members on condition of obligatory prior contributions, whose amounts and maturities are not limited, while the right to receive the goods should be won. Such schemes can develop only on condition of the permanent inflow of new funds. These schemes are reminiscent of Ponzi schemes and distort the lending system. There is a great risk of fraud and the disappearance of both funds and business entities resulting in the crash of the entire pyramid without the implementation of the state supervision over entities, which raise funds from individuals.

Many rights of consumers (such as the right to obtain true and complete information, the right to be reimbursed for losses) are violated via the group-buy schemes.

The FSR has paid attention to this issue. For instance, it was suggested in FSR Instruction No. 67 of February 3, 2011, "On Amendment of Instruction of the State Financial Services Markets Regulation Commission of Ukraine No. 939 of December 9, 2010" that this issue be regulated at the legislative level. A draft law "On Amendment of the Law of Ukraine On Financial Services and State Regulation of Financial Service Markets (in Respect of the Prohibition of the Exercise of Business of the Provision of Financial Services, Which Are Not Effectively Defined by Law)" was developed.

It would be appropriate to regulate this legal gap at the legislative level. For instance, conditions of the participation in groups must be absolutely equivalent for all members (no participants with special conditions; the group must be closed for additional members at a certain level of participants; the termination of liabilities of a group member on exit from the group should only be possible in case of the complete performance of liabilities by such a member to all other group members and the group itself; funds and other financial assets contributed by group members must be accounted for on a dedicated bank account (separately from the bank account of a financial institution administering the group in question, in a manner similar to the estate administration). It would also be worthwhile to develop model group-buy rules similar to the CFF rules to be registered with the FSR.