

**LITHUANIA**

***Diagnostic Review of  
Consumer Protection and  
Financial Literacy***

**Volume I  
Key Findings and Recommendations**

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# LITHUANIA

## ***Diagnostic Review of Consumer Protection and Financial Capability***

### **Volume I – Key Findings and Recommendations**

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## **Abbreviations & Acronyms**

APR	Annual Percentage Rate of Charge
ATM	Automatic teller machine
B2B	Business to business
B2C	Business to consumer
CEE	Central and Eastern Europe
CC	Competition Council
CIU	Collective investment undertaking
COE	Council of Europe
DG SANCO	Directorate-General for Health and Consumers (of the EC)
DOLCETA	Development of On-Line Consumer Education Tools for Adults
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ESIS	European Standardized Information Sheet
EU	European Union
EU-15	Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and United Kingdom
EURIBOR	Euro Interbank Offer Rate
FIN-NET	Financial Dispute Resolution Network
FSA	Financial Services Authority
GDP	Gross domestic product
ISC	Insurance Supervisory Commission
KYC	Know your customer
LSC	Lithuanian Securities Commission
LTL	Lithuanian Lita
MFI	Markets in Financial Instruments
MiFID	Directive on Markets in Financial Instruments
MTPL	Motor third party liability
NGO	Non-governmental organization
NMS	EU New Member State
OECD	Organisation for Economic Co-operation and Development
PHARE	Pologne, Hongrie Assistance à la Reconstruction Economique
SCRPA	State Consumer Rights Protection Authority
SDPI	State Data Protection Inspectorate
SME	Small and medium enterprise
SRO	Self-regulatory organization
SUDII	State Undertaking Deposits and Investments Insurance
UCITS	Undertakings for Collective Investment in Transferable Securities
UK	United Kingdom
US	United States of America
USD	United States Dollar
VILIBOR	Vilnius Interbank Offered Rate

n.a. Not Available

1 USD = 2.34 LTL (October 2009)

## **Foreword**

*Consumer protection in financial services lies at the heart of any financial sector that is efficient, competitive and fair. Three areas are important. Customers of financial institutions should have the right to receive information that is clear, complete, accurate and comprehensible before they decide to borrow or to invest. They should have access to recourse mechanisms that are efficient and cost-effective. They should also be able to obtain sufficient financial education to understand the terms and conditions and other information provided to them as financial consumers.*

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

## ***Acknowledgments***

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## **Executive Summary**

**The global financial crisis has put the international financial architecture under stress.** Governments have been undertaking immediate actions to diminish the impacts of the crisis and support recovery and sustainable development of both financial and real sectors. These short-term measures include liquidity support to the financial sector, extending deposit insurance and guarantees, preserving access to financial services especially for poor households and for small and medium enterprises through microfinance lending, and launching fiscal stimulus packages to save and create jobs. In addition, policymakers are taking steps to build better foundations for future development of the financial systems through improved regulatory reforms. These medium-term measures involve enhanced financial prudential regulation and oversight, financial sector governance (including financial regulators and supervisors) business conduct regulation and supervision, and financial consumer protection. The latter receives an increasing emphasis not only in developed countries but also in emerging market economies, including Eastern Europe, as most of the risk exposures associated with the latest credit boom period were assumed primarily by households.

**Financial consumer protection improves efficiency of financial intermediation—and indirectly reduces risks to financial stability.** At its heart, consumer protection addresses power, information, and resource imbalances which place consumers at a disadvantage *vis-à-vis* financial institutions. Financial institutions are very familiar with the terms and conditions of their financial products and their risk characteristics. By contrast, retail consumers may find it difficult or costly to obtain sufficient information on their financial purchases or understand complex financial products even when relevant information is disclosed. Consumers who are empowered with information and basic rights—and who are aware of their responsibilities—provide an important source of market discipline to the financial sector, encouraging financial institutions to compete on the basis of useful products and services. In addition, financial consumer protection builds trust in financial systems and helps broaden and diversify the depositors' base. Such public confidence indirectly reduces the liquidity risk of the banking sector.

**Consumer protection is gaining increasing importance at both the EU and Lithuanian level.** The EU Consumer Policy strategy of 2007-13 sets three objectives to: (i) empower consumers by ensuring that they have real choices, accurate information, market transparency, and the confidence that comes from effective protection and solid rights; (ii) enhance consumers' welfare regarding price, choice, quality, diversity, affordability and safety of products; and (iii) protect consumers as a group from the serious risks and threats that cannot be withstood on an individual basis. An October 2008 report of the European Parliament also identified measures to be taken to improve financial education throughout the EU.

**The basic foundations for effective financial consumer protection are in place in Lithuania.** The State Consumer Rights Protection Authority (SCRPA) has been established and its authority includes the sphere of financial services and products. The key financial supervisory agencies are also in place and have established basic rules of market conduct for business with retail customers. In addition, Lithuania's Strategy for Consumer Protection 2007-10 has as primary objectives to: i) guarantee protection of consumer rights and ii) harmonize Lithuanian laws with EU legislation related to consumer rights protection and surveillance of market activities. In this context, EU Directives related to financial services have largely been implemented and a Consumer Credit Law is under preparation.

**Consumers have increased their use of financial services in Lithuania and they would need a strengthened consumer protection framework.** Mortgage loans have increased from almost negligible levels in 1995 to around 20 percent of GDP by end-2007, one of the highest ratios among EU new Member States. The share of low-income households with housing loans has also increased, reaching 59 percent in 2007. The October 2008 Eurobarometer survey of consumer protection in the 27 EU Member States suggests that Lithuanian consumers need a strengthened consumer protection framework. The survey published by the Lithuanian Consumer Institute in 2009 also notes the need for stronger legislation on the details of consumer protection.

**Measures to improve consumer protection and financial literacy should be pragmatic and effective—and empower consumers.** The Review recommends six main measures:

- 1) Strengthen the capacity of SCRPA to enforce key financial consumer protection laws,
- 2) Strengthen the effectiveness of the consumer associations,
- 3) Improve the quality of consumer information regarding financial services,
- 4) Take measures to strengthen market practices in retail financial services,
- 5) Improve the process for resolving consumer disputes and analyzing consumer inquiries and complaints, and
- 6) Focus financial education on measurable improvements in financial literacy and consumer behavior

#### **1) Capacity of SCRPA**

**Enforcement of financial consumer protection legislation is uneven in Lithuania.** The insurance supervisor has strong powers to enforce consumer protection issues, under a specific institutional mandate established in the Insurance Law. For securities, the capital markets legislation provides high levels of investor protection but does not give the supervisor authority in case of customer disputes. For the banking sector, the legislation does not give the central bank any authority over resolution of consumer disputes and the mandate does not cover consumer protection. Such authority lies instead with SCRPA.

**SCRPA should be given additional legal authorities to effectively enforce financial consumer protection.** SCRPA should be given the authority to make binding decisions for financial institutions enforceable by fines. As a first stage, SCRPA should take over responsibility for consumer protection in all financial services except insurance. Given that the Insurance Supervisory Commission (ISC) is conducting effective and efficient supervision of consumer protection in the insurance sector, ISC should retain its responsibility while SCRPA enhances its capacity and increases its expertise in financial services. However the ISC should also be given legal authority to make binding decisions regarding consumer protection in the insurance market. At a later stage, SCRPA should expand its responsibility to cover supervision of consumer protection in all parts of the financial sector, including the insurance sector.

**Consideration should be given to other measures to improve the institutional arrangements for financial consumer protection.** SCRPA could establish a coordinating body that brings together all financial supervisory agencies to discuss consumer protection issues and ensure consistency of approaches. Legislation might also be amended to raise the status of SCRPA and allow it to report directly to the Government or the Parliament. SCRPA would benefit from having access to additional outside experts and extending training programs for its staff. In addition, SCRPA could establish itself as the central point for receiving all inquiries, complaints and disputes from financial consumers. At the first stage, SCRPA would forward to the ISC those consumer communications related to insurance. SCRPA should also expand the public information about its activities on financial consumer protection.

## 2) Consumer Associations

**Consumer associations need additional funding to be effective but they should also improve their governance.** Lithuania has over 20 consumer associations but few are active in the field of financial services. Some consumer associations receive limited government funding but this is not sufficient. Government funding should be complemented by funding from European agencies or twinning arrangements with well-established European consumer associations. At the same time, all consumer associations receiving funds must publish an annual report of their budget, sources and uses of funds and activities. Among their main activities, consumer associations should assist individuals in preparing and lodging complaints against financial institutions. Consumer associations should also develop programs of information, education and awareness on financial consumer protection. Consumer associations should also be authorized to receive complaints regarding noncompliance with the codes of conduct, analyze the common forms of complaints and prepare recommendations to address them. Consumer associations could publish on their websites recommendations on mechanisms to improve the compliance of financial institutions with the codes of conduct.

## 3) Consumer Information

**The quality of information on financial services disclosed to consumers should be improved.** The professional associations should be encouraged to develop a simple and standard Key Facts Statement for each major financial product oriented toward retail consumers. The format should be reviewed by the financial supervisory agencies and the Statement should be provided to the consumer at the point of sale of the contract. In addition, financial institutions should make their standard contracts for financial products readily available to consumers. For financial products where the price may vary over time, consumers should also receive information about the impacts of the changes. For residential mortgages, the Association of Lithuanian Banks should adopt the European Standardized Information Sheet (ESIS). Consumers should also have access to comparable quotes for standard financial products, elaborated by the financial regulators, SCRPA or consumer associations.

## 4) Market Practices

**Market practices in the retail financial sector should be strengthened.** The financial professional associations should develop codes of conduct, subject to review by SCRPA and the financial supervisory agencies, and made them widely available to consumers. In addition, sellers of retail financial services should receive specialized training. Consideration should also be given to increasing competition in the financial sector by authorizing new entrants into specific areas of financial services (such as payments or money transfer services) and by ensuring that consumers can select the provider of any financial product required for another product. At the same time, all financial services providers should be authorized and supervised by one of the financial supervisory agencies and be required to disclose their regulatory status in their advertising. SCRPA should play a role in alerting consumers to possible unfair practices, by different means such as setting up a special section on its website or distributing press releases to the media.

**Specific measures are needed to improve market practices in credit, insurance and pension segments.** When transposing the EU Consumer Credit Directive into Lithuanian law, it would be helpful to include small amounts of credit and all types of credit providers, such as finance companies, leasing companies and retailers. The credit bureau should be expanded to cover most households and include not only negative but also positive information. Accordingly, the

legislation on data protection should be reviewed to improve the usefulness of the credit bureau for lenders. The State Company for Deposit and Investor Insurance should reduce the time between an insurance event and a payout to the shortest possible time. Consideration should also be given to approving legislation on personal insolvency. In the insurance sector, the assets of clients should be segregated from those of the insurance companies. In addition, measures should be taken to enhance the sustainability of motor third party liability insurance programs and improve disclosure requirements, particularly for complex products, such as unit-linked insurance contracts. In the pensions sector, a consumer awareness program is needed, especially for consumers to know that, after three years of signing a pension agreement, they have the right to change their funds manager.

## **5) Inquiries, Complaints and Disputes**

**The processes of handling inquiries, complaints and disputes should be improved.** All public agencies should periodically forward the consumer communications they receive, using a common format, to SCRPA, which should maintain a central database of financial consumer communications. SCRPA and professional associations should analyze trends in consumer communications and prepare proposals on ways of addressing issues that are repeatedly raised. All financial institutions should be obliged to have a designated official (or department) responsible for receiving customer complaints. SCRPA should establish itself as the central point for helping consumers resolve problems related to financial services. In the short term, SCRPA should be in charge of handling consumer complaints and disputes for all financial services except for the insurance sector, which would remain the responsibility of ISC. As a second stage, SCRPA should expand its responsibilities to include handling complaints and disputes for insurance. As the consumer protection system becomes stronger, the number of inquiries, complaints and disputes is likely to increase and the SCRPA is likely to become overwhelmed with the task of resolving consumer disputes. For this matter, consideration should be given to establishing an independent financial statutory ombudsman. Cost-benefit analyses should be prepared of the possible approaches to ombudsmen.

## **6) Financial Education**

**Lithuania should develop a national program of financial education focused on measurable initiatives to improve financial literacy and consumer behavior.** The Ministry of Education has already launched a program of financial education through the schools. In addition, financial education should be provided for adults, especially at the times when consumers want to receive information and in a form that meets their needs (“teachable moments”). Financial institutions, non-government organizations and media should all play a role in educating consumers. Financial education programs should be carefully designed and rigorously evaluated and viewed as a long-term investment. A baseline nationwide survey of financial capability should be conducted and used to identify vulnerable parts of the Lithuanian population and design targeted programs of financial education and consumer awareness. Follow-up surveys should be conducted every three to five years to evaluate the effectiveness of the programs.

## **Introduction**

**The Diagnostic Review on Consumer Protection in Financial Services in Lithuania is the seventh report in a World Bank-sponsored pilot program to assess consumer protection in financial services in developing and middle-income countries.**<sup>1</sup> The objectives of this Review are three-fold to: (1) conduct a review of the existing rules and practices in Lithuania compared to international good practices on consumer protection in financial services; (2) provide recommendations on ways to improve consumer protection in financial services in Lithuania and (3) refine a set of good practices prepared by the World Bank for assessing consumer protection in financial services, including financial literacy. The Diagnostic Review was prepared at the request of the State Consumer Rights Protection Authority of Lithuania and the Ministry of Finance of Lithuania.<sup>2</sup>

**The Review was conducted using a set of draft international Good Practices as a reference point.**<sup>3</sup> Working with international regulators, the World Bank has drafted a set of international Good Practices on Consumer Protection and Financial Literacy. The Good Practices have been released as a Consultative Draft for international review and comment—and are expected to evolve following discussions among stakeholders. The Good Practices incorporate provisions of the EU Directives related to consumer protection and reports of European financial regulatory and supervisory agencies, as well as laws, regulations and business practice codes in the United States, Australia, Canada and other countries worldwide. The OECD has also released sets of good practices to enhance education and awareness on risk and insurance, pensions, and credit products<sup>4</sup>, supplementing the recommendations presented in its 2005 global review of financial education programs.<sup>5</sup> As part of the process of further refining and developing the Good Practices, the Diagnostic Review for Lithuania was prepared using the Good Practices as a reference point.

**The recommendations in the Review incorporate the EU Directives and EC Recommendations but in some cases go further to reflect good practices used internationally.** As described in the EU Consumer Protection Strategy of 2007-2013<sup>6</sup> and the April 2007 Green Paper on Retail Financial Services, European financial consumers would

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<sup>1</sup> The first report on consumer protection in financial services was prepared for the Czech Republic. The other country reviews were (in chronological order) Slovakia, Azerbaijan, Romania, Croatia and Russia. The full set of published reports on financial consumer protection can be downloaded at [www.worldbank.org/eca/consumerprotection](http://www.worldbank.org/eca/consumerprotection).

<sup>2</sup> An assessment mission was conducted November 10-19, 2008 in Vilnius. In addition, the mission met with members of the financial and legal community and financial press.

<sup>3</sup> The World Bank has released the document *Good Practices for Consumer Protection and Financial Literacy in Europe and Central Asia: A Diagnostic Tool* as a Consultative Draft. A copy can be downloaded at <http://www.worldbank.org/eca/consumerprotection>. The document summarizes the good practices and includes annotations noting which international experiences have been used. The Consultative Draft has been published to stimulate discussion on what constitute good practices in consumer protection and financial literacy and obtain feedback and input from regulators and other stakeholders worldwide.

<sup>4</sup> See OECD, *Improving Financial Education and Awareness on Insurance and Private Pensions* (2008) available at [http://www.oecd.org/document/8/0,3343,en\\_2649\\_34851\\_41210376\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/8/0,3343,en_2649_34851_41210376_1_1_1_1,00.html) and OECD, *Recommendation on Good Practices on Financial Education and Awareness Relating to Credit* (2009) at [http://www.oecd.org/document/39/0,3343,en\\_2649\\_15251491\\_43269479\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/39/0,3343,en_2649_15251491_43269479_1_1_1_1,00.html)

<sup>5</sup> See OECD, *Improving Financial Literacy: Analysis of Issues and Policies* (2005), available at [http://www.oecd.org/document/28/0,2340,en\\_2649\\_201185\\_35802524\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/28/0,2340,en_2649_201185_35802524_1_1_1_1,00.html)

<sup>6</sup> See [http://ec.europa.eu/consumers/strategy/index\\_en.htm](http://ec.europa.eu/consumers/strategy/index_en.htm)

benefit from stronger legal and institutional protections than those currently in place. Both in Europe and globally, contemporary thinking on consumer protection is rapidly evolving. This Diagnostic Review takes into account the international discussion on financial consumer protection and evolving good practices in financial consumer protection. Thus the Review presents recommendations that are applicable to the Lithuanian financial sector but in some cases go beyond the existing requirements set by EU legislation. However the recommendations included in the Review should be considered only as suggestions for the Lithuanian authorities and other stakeholders.

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

**The Review is presented in two volumes.** Volume I notes the importance of consumer protection in financial services, provides statistics on the size and growth of the retail financial sector in Lithuania and the Government's strategy, and sets out the key findings and recommendations of the Review. Volume II provides an assessment of the Lithuanian consumer protection framework and practices compared to the template of good practices for three segments of the financial sector—banking (including mortgage lending), securities, and insurance. In light of the early development of the pension sector, no specialized review was conducted for private pensions.

## ***Importance of Consumer Protection & Financial Literacy***

**The global financial crisis has put the international financial architecture under stress.** Governments have been undertaking immediate actions to diminish the impacts of the crisis and support recovery and sustainable development of both financial and real sectors. These short-term measures include liquidity support to the financial sector, extending deposit insurance and guarantees, preserving access to financial services especially for poor households and for small and medium enterprises through microfinance lending, and launching fiscal stimulus packages to save and create jobs. In addition, policymakers are taking steps to build better foundations for future development of the financial systems through improved regulatory reforms. These medium-term measures involve enhanced financial prudential regulation and oversight, financial sector governance (including financial regulators and supervisors) business conduct regulation and supervision, and financial consumer protection. The latter receives an increasing emphasis not only in developed countries but also in emerging market economies, including Eastern Europe, as most of the risk exposures associated with the latest credit boom period were assumed primarily by households.

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

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

**At its heart, the need for consumer protection arises from *an imbalance of power, information and resources between consumers and their financial service providers, placing consumers at a disadvantage.*** Consumer protection aims to address this market failure. Financial institutions know their products well but individual retail consumers may find it difficult or costly to obtain sufficient information on their financial purchases. Personal insurance, such as auto or life insurance, are often cited as examples of the imbalances. The complex contracts prepared by insurers—and the risk allocation between the consumer and the financial institution—are often beyond the capacity of most consumers to understand. The same may be true for consumers who take on mortgage loans denominated in foreign currencies, as seen throughout Eastern Europe. A well-designed consumer protection framework can help reduce the imbalances of power and information between consumers and financial institutions.

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

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

**In addition, consumer protection helps financial firms in facing the specific risks that arise in dealing with retail customers.** In its April 2008 report, the Joint Forum of the Basel Committee on Banking Supervision, the International Organization of Securities Commission and the International Association of Insurance Supervisors identifies three key risks related to

possible "mis-selling" of financial products to retail customers.<sup>7</sup> They are: (1) legal risk, if successful lawsuits from collective action by customers or enforcement actions by supervisory agencies result in obligations to pay financial compensation or fines; (2) short-term liquidity risk and long-term solvency risk, if retail customers are treated unfairly and thus shun the financial institution and withdraw their business; and (3) contagion risk, if the problems of one financial institution (or type of financial product) spread across the financial sector. Effective consumer protection can help ensure that the actions of financial firms do not make them subject to criticisms of mis-selling.

**Consumer protection could also shield the financial sector from the risk of political over-reaction in periods of financial turmoil.** The political response to collapses of parts of the financial sector may be to over-compensate with heavy regulation. The impact of too little consumer protection became evident, for example, during the insurance and superannuation scandals in the United Kingdom and Australia. The result of the scandals was seen in extensive studies on recommendations for wide-ranging regulatory reform.

**Financial consumer protection has two modes of delivery: (1) regulation and (2) financial education.** Some substitution is possible. For example, in developed markets with informed consumers, financial education can empower consumers to demand clear and comparable information and seek redress over disputes. However in most markets, financial education alone is not sufficient and some regulation is needed. The reasons are three-fold: (1) financial education will always lag behind the development of financial markets, (2) the direct (immediate) costs of implementing financial education programs are relatively higher compared to regulation, and (3) the existing governance structure (incentives) of financial markets does not support adequate market discipline.

**However regulation also imposes a cost on the financial sector.** Regulation can impair both competition and innovation in the financial sector, thus raise consumer costs and obstruct development of adequate market discipline that would hold risk-taking in check. Clear priorities need to be set. Regulation should be subject to cost-benefit analysis and consumer protection regulations should be assessed to determine their impact on sound consumer finance.

**An effective and efficient consumer protection framework should provide consumers with:**

- **Transparency** by providing full, plain, adequate and comparable information about the prices, terms and conditions (and inherent risks) of financial products and services;
- **Choice** by ensuring fair, non-coercive and reasonable practices in the selling of financial products and services and collection of payments;
- **Redress** by providing inexpensive and speedy mechanisms to address complaints and resolve disputes; and
- **Privacy** by ensuring control over access to personal financial information.
- **Access to financial education** that enables consumers develop the financial capability required to understand the risks/return (cost/benefit) trade-offs, and their rights and obligations regarding the financial products and services that they buy.<sup>8</sup>

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<sup>7</sup> Joint Forum of the Basel Committee on Banking Supervision, the International Organization of Securities Commission and the International Association of Insurance Supervisors, *Customer suitability in the retail sale of financial products and services*, April 2008

<sup>8</sup> Financial education is also needed to help households in making long-term financial decisions, such as savings for retirement or sending children to college. However such "life-cycle" planning is beyond the direct scope of consumer protection in financial services.

## ***Lithuanian Policy for Consumer Protection in Financial Services in the EU context***

**The EU Consumer Policy strategy 2007-2013<sup>9</sup> aims to strengthen consumer protection and financial literacy.** The strategy has three objectives to: (1) empower consumers by ensuring that they have real choices, accurate information, market transparency, and the confidence that comes from effective protection and solid rights; (2) enhance consumers' welfare regarding price, choice, quality, diversity, affordability and safety of products; and (3) protect consumers as a group from the serious risks and threats that cannot be withstood on an individual basis. Key steps for the implementation of the strategy involve development of benchmarks for national consumer policies, including a consumer protection policy for the financial sector, and collection of service quality data and complaint statistics. The EU takes the approach that an effective regime of financial consumer protection covers three areas. Consumers should have access to: (1) sufficient information to make informed decisions in the purchase of financial services, (2) cost-effective recourse mechanisms to redress violations of the financial service contract, and (3) programs of financial education.

**Financial education is being emphasized in the program under development in the EU.** In November 2007, the European Commission (EC) released its survey of over 150 financial education programs conducted in the 27 Member States. An October 2008 report of the European Parliament identified six measures to be taken to improve financial education throughout the EU.<sup>10</sup> They are that:

- 1) A basic program in financial education should be developed at the EU level to set common rules and principles to be applied in Member States;
- 2) The Commission should recommend that Member States include financial education in their national school curricula;
- 3) Special targeted approaches should be developed for school children, college students, adults, low-income households and pensioners;
- 4) Member States should develop networks of financial education, with participation of government and non-government agencies, as well as specially trained tutors;
- 5) The Commission should encourage Member States to establish special programs for pensioners and consumers at the end of their professional careers; and
- 6) The Commission should create a budget for financial education programs at the EU level, covering media campaigns to increase consumer awareness of the problems created by low financial literacy

In its *Communication on Financial Education*<sup>11</sup> the Commission noted it would conduct a comprehensive review in 2010 to evaluate the effectiveness of existing programs of financial education among Member States.

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<sup>9</sup> EU Consumer Policy Strategy 2007-2013, COM (2007) 99 final  
[http://ec.europa.eu/consumers/overview/cons\\_policy/EN%2099.pdf](http://ec.europa.eu/consumers/overview/cons_policy/EN%2099.pdf)

<sup>10</sup> European Parliament, *Report on protecting the consumer: improving consumer education and awareness on credit and finance* (2007/2288(INI))  
<http://www.europarl.europa.eu/sides/getDoc.do?language=EN&reference=A6-0393/2008>

<sup>11</sup> European Commission, *Communication from the Commission: Financial Education*, COM (2007) 808 final <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52007DC0808:EN:NOT>

**Lithuania's Strategy for Consumer Protection 2007-10 was approved in 2007.** The primary objectives of the strategy are to guarantee protection of consumer rights and harmonize Lithuanian laws with EU legislation related to consumer rights protection and surveillance of market activities. Among other activities, the Strategy called for strengthening of the institutional structure of the State Consumer Rights Protection Authority (SCRPA) and improving collaboration between the SCRPA and state and municipal authorities as well as with non-government organizations.

**The October 2008 Eurobarometer survey of the 27 EU Member States suggests that Lithuanian consumers need a strengthened consumer protection framework.**<sup>12</sup> The Eurobarometer survey was requested by DG SANCO to look at consumer protection in all sectors (including financial services). Only 37 percent of Lithuanian consumers felt that they were adequately protected by existing measures to protect consumers, compared to 59 percent in the EU. Moreover Lithuanian consumers were reluctant to rely on either government or non-government organizations to protect their interests. Only 37 percent in Lithuania trust public authorities to protect their interests (vs. 54 percent average among the EU.) Slightly more would rely on consumer associations to help them: 42 percent of Lithuanians trust independent consumer organizations to protect their consumer rights (vs. 64 percent in the EU). Furthermore arbitration has not yet become an effective method of recourse for Lithuanian consumers. Only 23 percent thought that it was easy to resolve disputes using arbitration, mediation or conciliation bodies (vs. 39 percent among the EU.) When trying to decide what to do when a complaint was not satisfactorily resolved, 22 percent of Lithuanian consumers (but only 14 percent in the EU) went to a consumer association or consumer help desk for assistance. However more than half gave up. 66 percent of unsatisfied consumers in Lithuania took no further action (vs. only 51 percent among the EU). When asked what the best ways to protect consumers are, most would like to see strong legislation. The preferred approach (36 percent of Lithuanian consumers) was laws prohibiting sellers from misleading or deceiving consumers. The next preferred methods in Lithuania were the right to replace, repair or ask for a price reduction on a faulty product (34 percent), and clear and transparent pricing (33 percent). Among the EU, the preferred approach (48 percent) was the right to replace, repair or obtain a price reduction. Second in ranking was clear and transparent pricing (41 percent) and third was the right to a cooling-off period (40 percent.)

**A 2009 study by the Lithuanian Consumer Institute noted the need for stronger legislation on the details of consumer protection.** The study identified weaknesses in consumer contracts and travel services, noting that many include unfair conditions. The Institute commented that the consumer protection provisions of EU Directives are scattered in several pieces of Lithuanian legislation and tend to be translated on a literal basis, with specific application to the needs of Lithuanian consumers. The Institute also noted that consumers rarely take their cases to court, because consumers are either unaware of their rights or not prepared to take legal action to defend their legal rights.<sup>13</sup>

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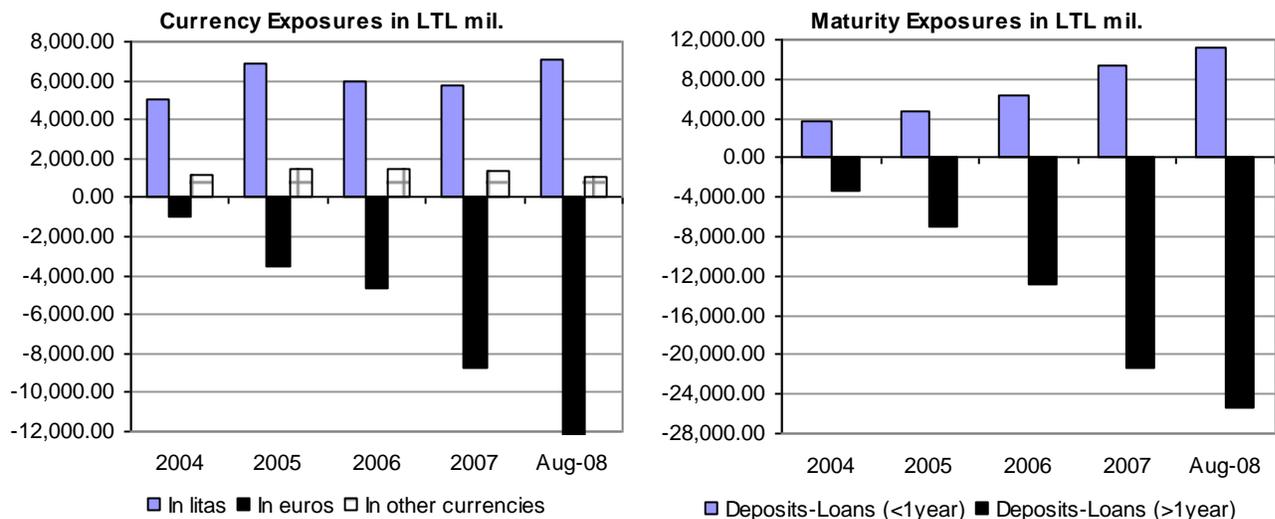
<sup>12</sup> European Commission, *Special Eurobarometer No. 298, Consumer protection in the internal market*, October 2008

<sup>13</sup> Lithuanian Consumer Institute, <http://www.vartotojai.lt/#>

## Background on Lithuanian Household Finances

**Aggregate net exposure of households to foreign exchange risk rose in 2007 and early 2008.** While over 95 percent of foreign exchange borrowings are in Euros, households nevertheless assume some currency exposure when borrowing. Comparing household savings vs. credit in Euros and Litas, household net exposure in Euros was nearly double that of Litas at the end of August 2008 (see Figure 1 left panel). For households to be hedged against foreign exchange risk, they need to receive their income increasingly in Euros. This development could also suggest that most of the additional funds that banks raise to finance the rapid growth in household credit demand is in the form of external funds in Euros. The aggregate maturity of household net borrowings has also been extended. This could be seen as a desirable development since households are able to extend the maturities of their housing loans and better protect themselves against refinancing risk. (See Figure 1 right panel).

**Figure 1: Aggregate Household Exposures to Currency and Maturity Risks**



Source: Bank of Lithuania

**Borrowings by households with low disposable income have also increased.** The trend prevailing until the middle of 2008—severe competition in the banking sector and easing of credit standards—increased the number of households with lower than average income that took out housing loans. Over 2007, the share of low-income households rose from 5 to 12 percent of all borrowing households. At the same time, households who borrowed for housing—but had no other savings—rose. The share of households with housing loans but no savings in reserve increased by six percentage points to 59 percent over 2007. Of the households that save, the monthly savings cover on average the costs of one-month servicing of a housing loan. Households that do not save and do not have any accumulated assets represent 11 percent of households with housing loans.

**Mortgage loans (loans made for housing purposes) have grown very rapidly over the past decade.** Rising from negligible levels in 1995, mortgage debt represented around 20 percent of GDP by the end of 2007. Among EU new Member States, Lithuania has one of the highest ratios of mortgage debt to GDP, although still lower than that of Estonia or Latvia (see Table 1).

**Table 1: Mortgage Debt to GDP**

	Mortgage Debt / GDP (%)	GDP per Capita (USD)
Estonia	32.7	17,364
Latvia	28.9	14,232
<b>Lithuania</b>	<b>19.2</b>	<b>11,665</b>
Croatia	15.3	12,373
Hungary	11.4	14,624
Poland	8.3	11,694
Ukraine	7.1	3,297
Bulgaria	7.0	5,946
Kazakhstan	5.3	7,330
Russia	2.0	10,468

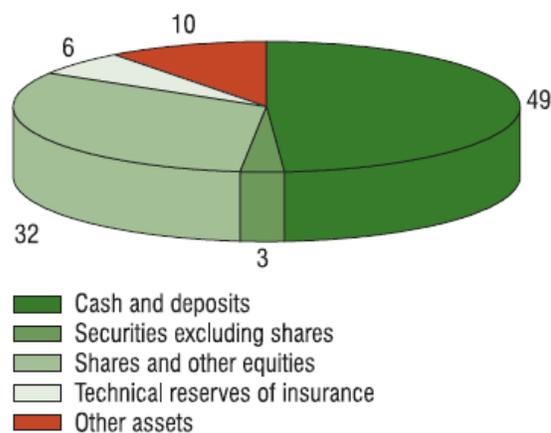
Note: Data as of December 2007, except for Lithuania (October 2008)

Source: Various sources compiled by World Bank

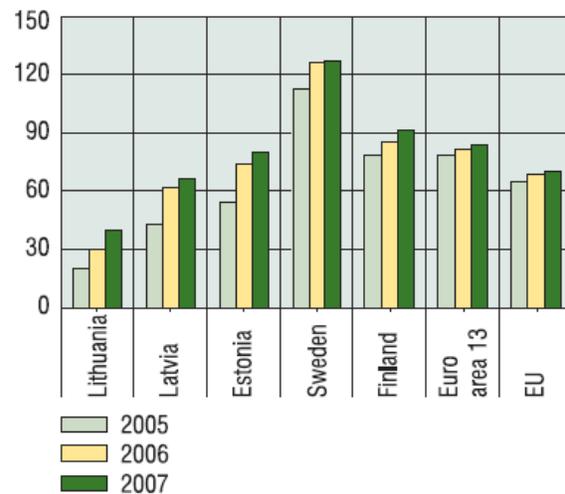
**The bulk of households financial assets are held as deposits with banks.** In view of the turmoil in international financial markets in 2007, households in Lithuania opted for a more conservative saving with the preference given to liquid financial instruments with moderate return. However riskier investments into equities or equity-linked investment funds made up significant 32 percent of household assets at the end of 2007.

**Figure 2: Household Financial Assets and Housing Loans to Disposable Income**

**Structure of Household Financial Assets**  
(in percentage, 2007)



**Housing Loans to Disposable Income in EU Countries**  
(in percentage)



Source: Bank of Lithuania

## Key Findings & Recommendations

**The Diagnostic Review found that the basic foundations for effective financial consumer protection are in place in Lithuania but would benefit from additional strengthening.** The State Consumer Rights Protection Authority (SCRPA) was established in 2001 and its authority includes the sphere of financial services and products. The key financial supervisory agencies are

also in place and have established basic rules of market conduct for business with retail customers. In addition, the EU Directives related to financial services have largely been implemented, with a Consumer Credit Law under preparation. However the next stage of development will require further strengthening of the key institutions for financial consumer protection. Additional measures are also needed to improve the levels of financial literacy and behavior of financial consumers.

**In summary, the Review recommends six measures:**

- 1) Strengthen the capacity of SCRPA to enforce key financial consumer protection laws,
- 2) Strengthen the effectiveness of consumer associations,
- 3) Improve the quality of consumer information regarding financial services,
- 4) Take measures to strengthen market practices in retail financial services,
- 5) Improve the process for resolving consumer disputes and analyzing consumer inquiries and complaints, and
- 6) Focus financial education on measurable improvements in financial literacy and consumer behavior.

## **Capacity of SCRPA**

**Enforcement of financial consumer protection legislation is uneven in Lithuania.** Different parts of the financial sector—and different financial services and products—fall under various supervisory agencies, some of which have strong powers in dealing with consumer protection and resolution of consumer disputes and some of which have no authority related to consumer issues.

**The insurance supervisor has strong powers to enforce consumer protection issues.** The Law on Insurance specifically mandates that the Insurance Supervisory Commission (ISC) protect the interests and rights of the policyholders, insured, beneficiaries, and injured parties. The insurance legislation also makes board members of insurance companies accountable for failure of the company to protect policy-holders. While the ISC has the authority only to make recommendations on measures to address specific disputes between retail customers and their insurance providers, failure to implement the recommendations results in a referral to SCRPA, which can place the names of the offending company on SCRPA website with a summary of the dispute in question. The combination of personal legal liability for insurance company board members combined with a clear process for reviewing customer disputes ensures that the companies take the necessary measures to address the problems. Furthermore the ISC, as part of its responsibility for supervision of the sector, reviews customer complaints from each company and incorporates them into its regular onsite supervision, checking to see if other insurance companies are engaged in the same troublesome practice. While supervision of the private pension system is less well-refined (due to the early stage of development of the sector), the same approach applies.

**By comparison, the banking supervisor takes a hands-off approach to consumer protection.** The Law on the Bank of Lithuania specifies that the mandate of the Bank of Lithuania is to maintain price stability and provides the central bank with authority to supervise licensed credit institutions. These include both banks and credit unions and their subsidiaries—but not independent consumer finance companies. However the central bank legislation does not give the Bank of Lithuania any authority over resolution of disputes between retail customers and credit institutions. Such authority lies instead with SCRPA.

**For securities, the capital markets legislation provides high levels of investor protection but does not give the supervisor authority in case of customer disputes.** Lithuania has implemented all the current EU Directives related to capital markets, including the Directive on Markets in Financial Instruments (MiFID), Directive on Undertakings for Collective Investment in Transferable Securities (UCITS), and the Transparency Directive (including transparency of ownership and control of traded companies). Among them, the Directives establish clear rules on maintenance and handling of customer accounts and segregation of client funds. In addition, the Central Securities Depository has issued regulations on accounting and record-keeping for client records. All brokerage houses and investment management companies (including those handling pension funds) are obliged to follow the Depository's regulations.

**SCRPA requires additional authorities to effectively enforce financial consumer protection.** SCRPA is currently responsible for enforcing four pieces of legislation. They are: (1) the parts of the Civil Code related to consumer credit (i.e. articles 6.886 to 6.891), (2) the Law on Payments, (3) the Law on Prohibition of Unfair Business to Consumer Commercial Practices and (4) the Law on Advertising. In the latter two laws, SCRPA enforces the provisions that are not related to misleading and comparative advertising, which are responsibility of the Competition Council. Regarding the Law on Payments, SCRPA can make decisions that are binding on the financial service provider (with a one-month appeal period) and starting in 2010 will have the authority to impose fines of up to Lit 120,000 when the revised Law on Payments enter into force. With regard to the other legislations, SCRPA can only make recommendations for consideration by the financial service provider. If the financial firm chooses to ignore the recommendation, the only penalty is for SCRPA to publicize the name of the offending firm by placing a note on SCRPA website. Since financial service firms lack legal liability for protection of consumers, SCRPA's negative publicity has minimal impact on the practices of many financial firms.

**The legislation should give SCRPA authority to make binding decisions enforceable by fines.** Using the approach taken for the Law on Payments, SCRPA could be given legal authority to make binding decisions, for which the financial institution must either follow or dispute within 30 days of receiving the decision. As with other decisions made by other government agencies, the decisions of SCRPA would still be subject to appeal to the courts. Economic sanctions, such as fines, should also be applicable in the case that the financial firm did follow the decision made by SCRPA.

**The SCRPA should assume responsibility for supervising consumer protection in all financial services, but this process should be done in stages.** SCRPA should start by strengthening its institutional capacity by increasing the number of specialized and trained staff in financial services. As a first stage of institutional development, SCRPA should take over responsibility for consumer protection in all financial services except insurance. Given that the ISC is currently conducting effective and efficient supervision of consumer protection in the insurance sector, the ISC should retain responsibility for the insurance sector while SCRPA enhances its capacity and increases its expertise in financial services. However the ISC should also be given legal authority to make binding decisions regarding consumer protection in the insurance market. At a later stage, SCRPA should expand its responsibility to supervise consumer protection in all financial services including insurance.

**In addition, SCRPA could establish itself as the central point for receiving all inquiries, complaints and disputes from financial consumers.** At the first stage, SCRPA would receive all consumer communications and then forward to the ISC those communications related to the insurance sector. Through this mechanism, consumers would have only one consumer center where to go whenever they face any problem with financial products or services.

**It would also be useful to increase the legal liability of board members of financial institutions to include consumer protection.** The Lithuanian insurance legislation includes provisions that establish a clear legal liability for members of boards of directors of insurance companies on issues related to consumer protection. As a result, if the recommendations of the ISC are not followed in a case related to protection of policy-holders as consumers, board members run the risk of being publicly exposed to criticism for failing to provide sufficient consumer protection. The legal liability within the law makes the publication of the case—and the names of the board members—pay close attention to issues of consumer protection. Given that such an approach is highly effective for the insurance sector, consideration might be given to extending the same professional liability for board members of all firms providing financial services and products to households.

**Consideration could also be given to raising the status of SCRPA and strengthen its coordinating role.** SCRPA was established in 2001 as part of the Ministry of Justice. However part of the role of SCRPA is to co-ordinate the activities of the financial supervisory agencies on issues of consumer protection. Since the insurance, banking and securities supervisors are all independent agencies or commissions reporting to the Government or directly to Parliament, it is difficult for SCRPA to co-ordinate the consumer protection work across the financial sector. It may therefore be helpful to revise the Law on Consumer Protection to authorize SCRPA to establish a forum (or other coordinating body) to bring together the insurance commission, securities commission and central bank to discuss consumer protection in financial services and ensure consistency of approaches.

**SCRPA might report to the Government or directly to Parliament.** Under the Law on Consumer Protection, the Ministry of Justice was given responsibility to participate in shaping and implementing a policy of protection of consumer rights, and participate in the organization of the protection of consumer rights (article 10). It may therefore be difficult to transfer responsibility for SCRPA to Parliament or the Government. However consideration could be given to other measures to heighten the status of SCRPA.

**SCRPA would benefit from having access to additional technical resources on financial services.** The world of financial services—and particularly financial products—changes rapidly and it is difficult even for financial experts to stay abreast of the changes. Particularly in the post-transition countries of Central and Eastern Europe, the consumer protection agencies that include financial services within their remit have difficulty in maintaining the necessary financial expertise among its staff. SCRPA might consider ways of further strengthening their institutions' capacity by having access to additional outside experts and extending training programs for SCRPA staff, including access to international training. The PHARE project “Strengthening of Consumer Rights Protection in the Area of Consumer Credit” of Euros 180,000 with the Financial Services Authority of the United Kingdom is an important step in their direction.

**At the same time, SCRPA should improve its transparency and accountability by expanding the public information about its activities on financial consumer protection.** The annual report should provide detailed information about SCRPA's work. Currently the report indicates only the number of decisions made by SCRPA but the report should provide detailed statistics and trends on the number and type of inquiries, complaints and disputes and the final resolution of each type of issue for all financial services and products. Increased public information about SCRPA's activities would also counter-balance SCRPA's expanded legal authorities by increasing the agency's transparency and public accountability.

## **Consumer Associations**

**Lithuania has over 20 consumer associations but few are active in the field of financial services.** The Lithuanian Consumer Institute represents Lithuania in the pan-European network of financial users. However few consumer associations have sufficient expertise in financial sector issues or sufficient financial capacity to play an effective role in supporting protection of consumers of financial services.

**Consumer associations will need additional funding to be effective but they should also improve their governance.** Some associations receive limited funding from the government budget but this is not sufficient. It may be useful for government funding to target a limited number of associations to finance their projects. However such funds should be complemented by funding (in cash or in-kind) from European agencies, through either bilateral donor agencies in the EU Member States or twinning arrangements with well-established European consumer associations. At the same time, all consumer associations that receive funding from the government or elsewhere should be obliged to publish an annual report of their budgets, the sources and uses of funds, and the activities conducted by the associations. Such published annual reports will help to strengthen the transparency and accountability of consumer associations. Improved governance arrangements will also assist the associations in raising funds from both government and non-government sources.

**Consumer associations should play an active role in helping consumers understand their rights and obligations as purchasers of financial products and services.** Consumer associations should have an active program to inform, educate and make the public aware of issues related to financial consumer protection. Consumer associations should assist individuals in preparing and lodging complaints against financial institutions. Consideration should also be given to the role of non-profit financial advisors, which can help indebted people sort out their debts and provide them with necessary counseling.

**Consumer associations should be able to officially receive complaints regarding possible violations of the codes of business conduct applicable to financial service providers.** The associations should then analyze the common forms of complaints and prepare recommendations on policy and institutional measures that would address the common forms of complaints. Consumer associations could publish on their websites recommendations on mechanisms to improve the compliance of financial institutions with the codes of conduct. They could also work closely with the financial press and media in order to highlight common types of complaints or mechanisms to improve compliance with codes of conduct, and to conduct consumer awareness campaigns.

## **Consumer Information**

**One of the key ways of strengthening financial consumer protection is seen in simple and easy to understand consumer disclosure.** The increasing complexity of financial products—and the different terminology used by each financial service provider—makes it difficult for any consumer to differentiate among the providers and choose wisely a product to meet his or her needs. Measures to set a simplified and standardized approach to disclosure of consumer financial products empower consumers to shop around to find the best product. Simple and standard presentation of consumer information also encourages financial service providers to compete on the basis of price and quality of service rather than on complex terminology for financial

products. Simple and standard formats also provide a form of consumer education, making it easy for consumers to ask questions about the different products.

**As a first step, the Association of Lithuanian Banks should be encouraged to adopt the European Standardized Information Sheet (ESIS) for residential mortgages.** Most EU countries, including new Member States, have adopted ESIS to facilitate consumer disclosure for mortgages.

**The professional associations should also be encouraged to develop a Key Facts Statement for each major financial product oriented toward retail consumers.** International good practice suggests that a simple and standard key facts statement for all financial products provides a significant level of clarity for financial consumers. The Statement of Key Facts should be provided at the point of sale of the contract. Implementation of the EU Consumer Credit Directive will improve the quality of information provided to borrowers. However a standardized Key Facts Statement would also be helpful.

**The Key Facts Statement should include all the key facts needed by consumers.** The Statement should thus cover not just the Annual Percentage Rate (APR) but also: (1) the total amount of the credit, (2) the amounts of monthly payments, (3) the final maturity of the credit or investment, (4) the total amount of payments to be made, (5) all fees—particularly prepayment and overdue penalty fees—and any other charges that could be incurred, (6) any required deposits or advance payments, (7) if the interest rate is variable, the basis on which the calculation is made, and (8) if any additional insurance (such as personal mortgage insurance) is required to maintain the credit. If the credit is used to finance a consumer product, such as a television or washing machine, the consumer should be advised of the cash price of the product without financing charges. The disclosure to consumers should also indicate what mechanisms for recourse are available to the borrower or investor. The format for key facts disclosure should allow consumers to easily and quickly identify the key terms and conditions for the financial products, particularly on the issue of prepayment penalties, which in some countries can be as high as the original cost of the loan. The professional associations for each part of the financial sector should develop a standardized format for review by the supervisory agency. The Key Facts Statement would not replace the contract for legal purposes but financial institutions would be obliged to ensure that the Statement had no incorrect information.

**Consumers should also be able to access comparable quotes for standard financial products.** The financial regulators in the United Kingdom, Ireland, Australia and Canada conduct tariff surveys on a regular basis, release the surveys to the press or publish them on their websites. In Lithuania, the SCRPA could perform a similar task. Alternatively if any of the non-government organizations (NGOs) has sufficient technical capacity, that NGO could conduct the survey. As a third option, the SCRPA could set a standard format and a methodology (and basic set of assumptions) and require that each financial service provider publish its quote on its website. For example, for life insurance, the insurance rates by all the major insurance companies for similar types of life insurance could be reviewed using a standard reference, such as 30-year non-smoking male head of household. Publication of the different costs by each insurance company would allow consumers to do accurate cost comparisons. The result would be seen in informed consumers and an increasingly competitive financial sector. Consideration could also be given to the use of similar formats for comparison of products across financial segments, where investments products might be used as substitutes (e.g. mutual funds and unit-linked insurance products).

**Financial institutions should be obliged to make their standard contracts for financial products readily available and easily accessible.** For example, banks could be obliged to place their standard consumer credit loan agreement on their website. In this way, consumers would be able to read and review the contract prior to signature of the agreement. While financial institutions may argue that their contracts are constantly changing, in practice such contracts are developed by the in-house legal counsel and remain unchanged for several years at a time. Consumers should also be informed if the contract that they are asked to sign differs from the contract available on the website of the credit provider. The contracts should also be available for consumers who call or visit the offices of the financial institution.

**For financial products where the price may vary over time, consumers should receive information about the impact of the changes.** Around 70 percent of all housing loans in Lithuania are in foreign currency. While about 98 percent of foreign currency housing loans are denominated in Euros—and the Lita is pegged to the Euro—the consumer absorbs some risk in the unlikely event that the peg to the Euro is dropped. Of more immediate concern to consumers may be changes in interest rates. A significant share of housing loans are variable rate loans, tied to either Vilnius Interbank Offered Rate (VILIBOR) or the Euro Interbank Offer Rate (EURIBOR). Around 80 percent of the new housing loans in Litas granted in 2008 had an interest fixation period of up to one year, whereas around 60 percent of new loans in Euros were granted with an interest fixation period of up to one year. Consumers should receive information to stress-test changes in interest or foreign exchange rates so that they can evaluate the impact on their household budgets. Consumers should receive a base case analysis and then an optimistic and a pessimistic scenario.

## **Market Practices**

### *Codes of Conduct*

**Codes of conduct should be developed for financial service providers.** Codes of business conduct have been standard practice in developed countries as a mechanism of encouraging financial firms to adhere to high standards in their relationships with retail customers. While the codes are voluntary, they set a benchmark for market practices. They also inform consumers of what they can expect regarding quality of service. Different countries use different levels of detail in specifying conduct codes but in general, they should state that the financial institutions should treat their customers fairly and transparently. In some countries, the codes also provide specific deadlines for responses on customer inquiries and resolution of disputes.

**Some work has already been done on codes of conduct but more is needed.** Most large financial institutions in Lithuania have already developed their own ethics code, either adopted from their parent institution or developed on their own. In addition, the Association of Brokerage Houses, the Association of Investment Fund Management Companies and the Chamber of Insurance Brokers have adopted codes of conduct or ethics codes, mandatory for members of the respective associations. Similar codes should be developed for all parts of the financial sector.

**The codes of conduct should be developed by the professional associations and subject to review by SCRPA and the financial supervisory agencies.** The codes should apply to the institutions that are members of the associations. Since compliance with the codes is voluntary, financial institutions may decide whether or not to follow. However institutions which are concerned about their reputations will generally publicly state that they follow the code of

conduct for their industry. To further encourage adherence, the financial supervisory agencies could require that all firms issue an annual statement indicating if they have complied with the code or the reasons for their failure to do so (“comply or explain” approach first used by the London Stock Exchange for their corporate governance code.) In addition, at the time of onsite supervision, the financial supervisory agencies should verify if the financial firm has followed the association’s code of conduct—and provide recommendations on measures that would enable the institution to comply with the code. The codes should be made widely available to consumers including through the websites of the professional associations. Financial institutions should also place the code of conduct on their website and make it available to consumers who visit their offices. Recommendations on measures to improve compliance with the codes of conduct could be published on the website of the professional associations or the SCRPA.

### *Training & Qualifications for Sellers of Financial Services*

**In addition to codes of conduct, sellers of financial services should receive specialized training.** Among sellers of financial services and products, those who sell and provide advice regarding private pensions are required by law to have sufficient knowledge of their industry and its products (Law on Accumulation of Pensions, article 15.9). In addition, insurance brokers and natural persons requesting license to act as securities brokers are required to pass examinations. However more should be done. A tiered system for the training and certification of all intermediaries and other sellers of all financial products would be useful. While not all EU Member States differentiate among different levels of complexity of financial products—and the required training and certification for different products—a tiered system could be helpful in Lithuania. For example, Tier 1 could apply to individuals who sell simple products, such as savings account. For selling of Tier 1 products, training and supervision from the financial institution would be sufficient. Tier 2 could relate to complex products, such as pension funds, collective investment funds or life insurance that included a savings component. For this, training and certification could be done by the industry association under guidelines set by the supervisory agency. Tier 3 could be the highest level covering certified financial advisors (or planners). For Tier 3 certification, individuals would be obliged to complete extensive training conducted by the supervisory agency, or a program under the direct review by the supervisory agency. Tier 3 individuals would be able to sell any and all products offered by any financial institution. Tier 3 financial advisors would also be obliged to meet high levels of business integrity. They would be obliged to follow a strict code of ethics.

### *Competition Issues*

**Increased competition in the financial sector would also improve retail financial services.** Not all banking types of financial services need to be provided by full-service banks. A case in point is payments and money transfer services, where low levels of competition among providers result in relatively high fees for services. Authorizing new entrants into the payments services market would put pressure on the banks to reduce their fees for transferring money. Other areas of financial services should also be open to new entrants with specialized niche markets. In addition, consumers who purchase financial products, such as motor third party liability coverage, should be able to buy the product from any provider within the EU. While private pensions are complex, consumers should not be limited to just the products offered by the seven investment management companies operating in Lithuania. They should be able to buy pensions from any authorized investment management company within the EU.

**Financial services should also be unbundled.** The EC's 2005 Retail Banking Inquiry found among the EU countries that Lithuania suffered from among the highest levels of bundling of financial products. In their survey, 100 percent of consumers with mortgages on their residence also had current (i.e. checking) accounts with the bank. Similarly 100 percent of those with small business loans had current accounts. Providing several levels of service to the same customer may facilitate risk management for the banks and other financial institutions, since they are able to collect more information about the consumer's financial investing and borrowing programs. However consumers should not be saddled with fees for a service that is mandatory in order to obtain another service. Where one financial product is needed to buy another product, the consumers should be able to select any qualified and licensed provider of the product. For example, many banks ask that borrowing customers also obtain life insurance policies before obtaining household loans. For such insurance, the borrower should be able to choose any insurance company that is authorized to provide the insurance in Lithuania, including providers in other EU member countries.

### *Supervision of Financial Service Providers*

**At the same time, all providers of financial services in Lithuania should be authorized and supervised by one of the financial supervisory agencies.** As new financial service companies enter the Lithuanian financial sector, some level of supervision by the supervisory agencies should be established. Under the current banking legislation, the Bank of Lithuania is only authorized to supervise licensed credit institutions, i.e. banks and credit unions. However some financial firms provide services such as "quick loans" to retail consumers. Some of the companies are financial institutions registered in other EU member countries. They operate on a cross-border basis without incorporation in Lithuania and are supervised by their home financial supervisory agencies. However others are not supervised by any supervisory agency. They are registered under the Lithuanian business registry of legal entities without any financial supervision. It is standard practice in the United Kingdom and other EU Member States to require that all providers of financial services be authorized by a financial supervisory agency. The financial legislation should be revised to require that even limited service providers be authorized by one of the Lithuanian financial supervisory agencies, such as the Bank of Lithuania.

**However such supervision should be light in nature given the limited risks posed to consumers.** Since the aforementioned financial service providers do not take deposits from the public, prudential supervision is not needed. However the financial supervisors should receive minimum information about the credit providers. The supervisors should verify that those owning and controlling significant stakes of the companies are free of criminal records. Audited financial statements should be filed with the financial supervisors and the supervisors should monitor the total volume of business by such entities. This would apply not just to the companies providing quick credits but also the proposed money transfer companies.

**Financial service providers should also be obliged to say that they are supervised and by which supervisory agency.** One measure of building public confidence in the financial sector is to require that in their advertising financial institutions publicly state under whose supervision they fall. In the United Kingdom and Ireland, all financial firms are obliged to include in their print, radio and television advertising that they are regulated by the financial supervisory agency. In addition, the regulator states on its website that it is responsible for regulating all financial service providers and that consumers should take care when dealing with a firm that is not supervised by the regulator. One key advantage of this approach is that the supervisory agencies can clearly highlight what financial service providers may be engaged in financial frauds, pyramids, Ponzi schemes and other frauds. For any country that has experienced a collapse of the

financial sector, building public confidence that the sector is adequately regulated and supervised is a necessary building block for a robust financial sector.

**SCRPA could release a set of consumer alerts to warn consumers about possible unfair practices.** SCRPA should play a key role in alerting consumers to illegal practices in financial services. SCRPA should put in place a system of consumer alerts to highlight to the press and public all consumer protection issues in the financial sector. One useful approach would be to set up a “Financial Consumer Affairs” page on the website of SCRPA, with links from the supervisory agency websites to SCRPA’s financial consumer website. These pages could then be linked directly to consumer and investor alerts, thus making it easy for consumers (and their advocates) to identify possible scams and schemes from unauthorized financial institutions. Another useful approach would be to ensure the regular distribution of relevant press releases to the media. SCRPA’s website could also include examples of specific unfair practices with different scenarios so that financial consumers could differentiate legitimate business practices from those that are prohibited.

### *Consumer Credit & Credit Bureaus*

**When transposing the EU Consumer Credit Directive into Lithuanian law, it would be helpful to include small amounts of credit, including those provided by leasing companies.** The EU Consumer Credit Directive, initially adopted in 1987 and revised in 2008, aims to create an environment where consumers are sufficiently protected throughout the EU, so that they can carry out cross-border borrowings with confidence. The Directive sets a clear methodology for establishing the Annual Percentage Rate (APR) or effective borrowing costs, including fees and other charges. The Directive is based on minimum harmonization, which means that Member States are obliged to implement at least the provisions contained in the Directive. However, they may also maintain or introduce stricter rules in favor of consumers. The Directive set a minimum limit of Euros 200, under which the legislation need not apply. However it is often on the small borrowing amounts where consumers are most vulnerable to abusive disclosure practices. The consumer credit legislation should apply to all consumer borrowings regardless of the provider of the credit. This should include not only banks and credit unions but also finance companies, consumer leasing companies, and retailers.

**Increasing the access of Lithuanian consumers to credit will depend on development of a more comprehensive system of credit bureaus.** In the absence of reliable and comprehensive information in credit bureaus, lenders will be reluctant to extend credit, particularly to those consumers with few assets to provide as collateral. A comprehensive and reliable data-base of credit histories is needed to develop credit scoring, which is a statistical technique applied to consumer data to determine which variables contribute to the probability that a consumer will pay his or her credit obligations. Credit scoring is the basis for competitive consumer lending in developed consumer finance markets.

**The EU Consumer Credit Directive requires all credit granting institutions to base their decisions on the available data for the applicant consumer.** A complete credit-bureau would include information on consumers’ employment, age, education, and family status as demographic information. It would also contain information on the value of assets (house, automobiles, equities and bonds, etc.) as well as liabilities, such as consumer credit, housing loans, and leases. Consumers’ credit histories indicate how well they have met contractual debt and lease obligations in the past.

**The credit bureau should be expanded to cover most households.** Currently only one credit bureau is in place. It is supervised by the Bank of Lithuania and is available only to banks and not other credit providers such as credit unions. However the credit bureau is not as effective as needed. Fewer than 10 percent of households are covered by the credit bureau. Also the credit bureau is limited to negative information, so that consumers only appear on the data base only if they have failed to meet the payments under a contractual credit agreement. In a fully effective credit bureau, all information (both positive and negative) is registered in the data-base.

**The legislation on privacy of data should also be reviewed.** The Law on Legal Protection of Personal Data provides a high level of protection of personal data—but at the cost of limiting the usefulness of the credit bureau for lenders. The law gives the consumer four important rights to: (1) be informed of the processing of personal data, (2) have access to the data, (3) demand correction of errors, and (4) object to the processing of the data (if, for example, it is used for direct marketing).

### *Personal Insolvency Legislation*

**Consideration should also be given to approving legislation on personal insolvency.** The issue is complex. For households with high levels of indebtedness—and no way of meeting their obligations—declaring bankruptcy under a court-supervised plan of financial reorganization may be the only solution. Where personal insolvency is an easy option, households may accumulate large debts and then default on their obligations, thus undermining lending institutions. However where personal bankruptcy is not possible, unscrupulous lenders may aggressively target vulnerable households, knowing that consumers cannot walk away from their financial debts. The Ministry of Economy has developed a concept policy note for legislation on insolvency of natural persons. Consideration should be given to developing a program in line with that in place in western Europe, which has had decades of experience in dealing with consumer debt issues.

### *Special Issues on Insurance & Pensions*

**In insurance, attention should be paid to segregating client assets, enhancing the sustainability of motor third party liability insurance programs and improving disclosure requirements.** Standard practice in the EU insurance markets and internationally is for insurance companies to segregate the assets of the clients of insurance companies from those of the companies themselves. Strong regulation of the sector and high levels of technical reserves establish a strong position for insurance companies but segregation of client assets is a basic consumer protection for the financial sector. Client assets are segregated in the securities and private pension sectors and should also be segregated in insurance. At the same time, some parts of the insurance sector are incurring heavy losses, notably motor third party liability. Such high levels of losses are not sustainable and resetting of premia should be reconsidered in order to return a minimum level of profitability to the vehicle liability policies. There should also be additional disclosure requirements regarding commissions paid by agents and the calculation of estimated investment returns and their use in advertising and marketing of life insurance products.

**Special attention should be paid to the disclosure of complex insurance products, such as unit-linked insurance contracts.** Experience from other countries shows that clients do not know how much of their monthly payments goes for investments, risk insurance and costs, usually believing they invest the full amount. Therefore, their disappointment will be high when contracts run their period and they find out they invested much less than they believed and their pensions are thus underfunded. Better disclosure should help avoid this risk.

**The private pension sector has not yet developed to adequately meet consumers' needs.** To date, the system for both Pillar II and III pensions remains in the accumulation phase as participants continue to build up their contributions to the pension programs. However regulation of technical and actuarial parameters is needed so that those managing pension funds (both insurance companies and asset management companies) can develop products for the upcoming pay-out phase of the program.

**In addition, an expanded program of consumer awareness is needed.** In particular, consumers need to become aware that three years after signing a pension agreement, they have the right to change the manager of the funds, if they so choose. To date, only one percent of all participants have changed their asset manager, suggesting that either 99 percent are happy with their pension managers—or that many are not aware that they have a choice.

### **Inquiries, Complaints & Disputes**

**Consumer communications should be used as an early warning signal of possible weaknesses in the consumer protection framework.** Inquiries, complaints and disputes are all very useful information that can be utilized to enhance several aspects of consumer protection.

**Data on consumer communications should be carefully tracked with a central data-base held by SCRPA.** Currently complaints are sent to the Bank of Lithuania, Insurance Supervisory Commission, Lithuanian Securities Commission and other public institutions as well as SCRPA. All complaints to public agencies (including those sent to the insurance supervisor) should be forwarded to SCRPA to be part of a central data-base on financial consumer complaints. Furthermore the data should be gathered in a standardized format from the various agencies involved. Responsibility for maintaining and analyzing these data should lie with SCRPA. However as the insurance and securities supervisory agencies receive consumer communications, they should maintain records of all that are submitted to the agencies. A common format should be set and the records should be periodically forwarded to SCRPA, which should maintain an integrated data-base of all communications with financial consumers.

**Inquiries, complaints and disputes should be treated separately.** Limiting tracking to disputes will lead to a distorted picture of the level of consumer protection and is likely to understate the amount of resources devoted to dealing with consumers. In Australia, for example, it is estimated that 80 percent of consumer communications are in the form of inquiries with only 20 percent relating to complaints or disputes.

**The different types of consumer communications can be used differently to develop consumer protection policies and programs.** If consumers make inquiries indicating that they fail to understand some aspects of a financial service, SCRPA may wish to consider revising the format of consumer disclosure and review compliance with the professional association's code of conduct. Complaints that do not result in disputes can also provide useful insights. A pattern of complaints regarding a particular product or service may suggest to SCRPA that the code of conduct should be revised—or new entrants should be encouraged. For example, complaints about charges for simple payment transactions provided part of the impetus behind the strategy of encouraging non-bank financial institutions to provide payment services under a draft revised Law on Payments. Financial supervisory agencies could also use information about complaints.

Where one financial institution receives a particularly high number of complaints, the supervisory agencies may wish to pay particular attention to that institution when conducting onsite and offsite supervision, since harmful business practices may affect the safety of a financial institution at risk. For example, an increase in complaints from mortgage borrowers about their difficulties in meeting payments could be an early warning signal to supervisors. Consideration should be given to strengthening the coordination mechanisms between SCRPA and the financial supervisory agencies (including the signing of memoranda of understanding), in order to enhance the flow of information regarding financial consumer inquiries, complaints and disputes.

**Data on consumer communications can also indicate where more study is needed.** The data could provide the impetus for further research that would be useful. Publication could lead to improved consumer understanding as well as some potential changes in business practices. Publication of the data also serves to indicate accountability by the various agencies involved. SCRPA and the professional associations should analyze trends in consumer communications and prepare proposals on ways of addressing issues that are repeatedly raised.

**All financial institutions should be obliged to have a designated official (or department) responsible for receiving customer complaints.** At the time of signing the contract, the customer should be advised of the name of the department (or the individual) to whom any inquiries, complaints or disputes should be addressed. Currently the large financial institutions all maintain complaint departments but all providers of financial services should have an easily identifiable contact point for complaints. The codes of conduct should provide guidelines for financial institutions on the number of days in which a response should be given for a simple complaint and a longer period for complex disputes.

**SCRPA should establish itself as the key central point for helping consumers resolve problems related to financial services.** SCRPA should open a toll-free telephone line ("hot line") where consumers can obtain reliable and easy to understand information about financial services and their rights (and responsibilities) under the consumer protection legislation. SCRPA should also consider an expanded program of consumer awareness regarding financial services, where consumers can call, write an email and visit the office of SCRPA to obtain useful information about financial services.

**Consideration could also be given to improving the dispute resolution system for information in the credit bureaus.** The legislation on personal data protection identifies the State Data Protection Inspectorate, which reports directly to the Government, as being responsible for enforcing the legislation. The Inspectorate administers the Register of Personal Data Controllers and receives complaints as set out in the Law on Public Administration. However the best way to ensure that the data in the credit bureaus is accurate is to require that the credit bureaus respond in a timely fashion to any challenges by consumers and to make the necessary changes in customer records. To be effective, the credit bureaus should be subject to financial service consumer protection laws and supervision by the SCRPA.

**In the short term, SCRPA should be in charge of handling consumer complaints and disputes for all financial services except insurance.** The ISC should remain in charge of consumer complaints and disputes for insurance, given its current level of specialized capacity in the sector. However, both ISC and SCRPA should have the authority to issue binding decisions regarding consumer disputes. As a second stage, once SCRPA has strengthened its institutional capacity and gained more expertise in financial services, it should take over the responsibilities for handling complaints and disputes for the insurance sector too.

**Over time, SCRPA is likely to become overwhelmed with complaints regarding financial services.** Currently SCRPA has four key responsibilities related to financial services: (1) monitor trends in financial consumer protection and develop government policy on national consumer protection, (2) recommend legislation and regulations on financial consumer protection, (3) enforce financial consumer protection legislation, and (4) resolve disputes on financial services (except for insurance) between individuals and private sector financial institutions. The fourth area of resolving disputes requires time-consuming analysis of specific cases. As the system of consumer protection becomes stronger—and the public gains heightened confidence of the effectiveness of the system of inquiries and complaints—the number of cases is likely to grow rapidly. It would be better to have the key policy issues handled by an agency focused on the strategic issues of national importance, and leave to an independent agency that can take the time and trouble to handle each case with due care. However the issue is complex and needs extensive study.

**Over the long-term, consideration should be given to establishing an independent statutory ombudsman for financial services.** As the dispute resolution system is strengthened, the number of inquiries, complaints and disputes is likely to increase. However the process of responding to inquiries, providing consumer awareness of their rights, investigating complaints and adjudicating disputes is a time-intense process. SCRPA and the other authorities should consider creating an ombudsman to take over the process of dealing with complaints and related activities.

**Two models for ombudsmen are in place for financial services.** The approach used in Germany establishes an ombudsman set up by the professional associations, such as the bankers' association. The ombudsman is funded by the banking sector and is without charge to the consumer. Decisions by the ombudsman are binding on the bank for amounts up to Euros 5,000 but the consumer can still appeal the decisions to the courts. To maintain a level of independence from the banking sector, the choice of the individual ombudsmen to handle specific disputes is subject to the approval of the Consumers' Union. However the German approach is one of an ad-hoc dispute resolution process and the office of the ombudsman does not address underlying issues, such as weak business practices. By contrast, the ombudsmen structures in the United Kingdom and Ireland provide for an independent ombudsman authorized by statute. The statutory nature of the independent ombudsman allows him to maintain an office to monitor trends and identify issues of importance for financial consumers, even if only a few complaints (or even a single complaint) have been submitted.

**A study could be conducted of the different approaches to financial sector ombudsmen.** Lithuania's success with ombudsmen for other sectors (notably human rights) suggests that a financial sector ombudsman might also be effective. However a cost-benefit analysis should be prepared of the possible approaches. Based on the experience in the United Kingdom, Ireland and elsewhere, an active and proactive financial sector ombudsman can build public confidence in financial services and increase the use of financial services by retail consumers. At the same time, the cost of the ombudsman office—and the additional work required to fulfill the ombudsman's decisions—impose a cost that ultimately financial consumers will be obliged to pay.

**The EU Consumer Policy Strategy 2007-2013 underlined the importance of effective redress mechanisms for consumers and announced its intention to address consumer collective redress.** In November 2008, the EC released the Green Paper on Consumer Collective Redress<sup>14</sup>.

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<sup>14</sup> European Commission, *Green Paper on Consumer Collective Redress*, 2008. Available at: [http://ec.europa.eu/consumers/redress\\_cons/greenpaper\\_en.pdf](http://ec.europa.eu/consumers/redress_cons/greenpaper_en.pdf)

According to a background study commissioned by the EC<sup>15</sup>, financial sector is where consumers find most difficult to obtain redress for mass claims. Three main barriers for effective redress in courts are identified: high litigation costs, complex and lengthy procedures and lack of consumer awareness on the available redress mechanisms. The Green Paper presents four options to address collective redress: 1) Maintaining status quo and evaluating effectiveness of national and EU measures on consumer redress in place or soon to be in force; 2) Strengthening cooperation between Member States, to ensure that they all have collective redress mechanisms in place and that they open up their mechanisms to consumers from other Member States; 3) Implementing a mix of policy tools, such as improving alternative dispute resolution mechanisms, allowing national small claims mechanisms to process mass claims, extending the scope of the Consumer Protection Cooperation Regulation among Member States by giving local authorities the power to require consumer compensation, encouraging business to improve their complaint handling schemes, and raising consumer awareness; and 4) Dictating an EU measure to ensure that all Member States have effective and efficient judicial collective redress mechanisms, considering key issues such as funding to reduce costs for consumers, prevention of unmeritorious claims, provision of legal standing to qualified entities representing consumers, introduction of opt-in or opt-out procedures, and mechanisms to distribute compensations.

**Although group actions cannot be initiated in Lithuania, representative actions are allowed in the field of consumer protection.** The Civil Procedure Code (article 49) states that a group action may be submitted to protect public interest, but there is no specific regulation that specifies the procedure for handling group actions. In addition, some provisions of the Civil Procedure Code conflict with the principles of group actions. Nevertheless, the Law on Consumer Protection does allow for representative actions to protect the consumers' interests. Article 30 of the Law states that SCRPA and consumer associations may file a claim or petition before the court, in order to protect public interests of consumers. In order to represent consumers, consumer associations should satisfy four basic requirements: being registered in the Register of Legal Entities, having as purpose of activities the representation and protection of consumer rights and lawful interests, having at least 20 members, and being independent of business interests and other interests related to consumer protection. Consumer associations have 5 working days to notify the SCRPA on the acceptance of the claim or petition and 5 working days to send the court's decision to SCRPA. SCRPA is responsible of announcing on its website both the acceptance of a claim or petition and the effective court decisions in which infringements of public interests are established. The introduction of representative actions in the Consumer Protection Law is an important step to address collective redress, but its effectiveness should be monitored. In addition, the Civil Procedure Code should be amended in order to provide for the conduction of group actions.

**Lithuania is part of FIN-USE and FIN-NET.** FIN-USE is the pan-EU system of financial users that provide input into the EC on issues related to financial consumer protection. FIN-NET links the ombudsmen and all other national out-of-court dispute resolution mechanisms across the EU. SCRPA has been a member of FIN-NET since 2005. If a financial sector ombudsman's office is established by law in Lithuania, the office should be made part of FIN-NET.

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<sup>15</sup> Civic Consulting, *Study regarding the problems faced by consumers in obtaining redress for infringements of consumer protection legislation, and the economic consequences of such problems*, 2008. Available at: [http://ec.europa.eu/consumers/redress\\_cons/finalreport-problemstudypart1-final.pdf](http://ec.europa.eu/consumers/redress_cons/finalreport-problemstudypart1-final.pdf)

## Financial Education

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

**A distinction should be made between financial education vs. consumer information vs. financial advice.** *Financial education* should provide a general background so that consumers understand that all financial choices include both rewards and risks, that those options with the highest rewards may come with the highest risks, and that not only overly aggressive strategies but also overly conservative approaches can lose money in financial investments. *Consumer information* consists of not only financial disclosures but also information about financial services and consumer rights and responsibilities under the law. *Financial advice* consists of recommendations on the purchases of one financial product or service or another. Financial education should also help consumers differentiate between information and advice.

**Academic research on the effectiveness of financial education in developed economies is mixed.** Recent research from the United States suggests that financial education for high school students has little impact (except for interactive computer games involving stock market investments). However effective financial education can be conducted to establish robust savings and spending habits for children up to the age of 12 years. To date, virtually all research on the effectiveness of financial education programs has been conducted in developed economies. However in post-transitional economies, such as Lithuania where financial markets are not well-developed but general education standards are high, financial education may be more effective than elsewhere. It would be helpful if the SCRPA were to work with the financial supervisory agencies and the Ministry of Education and Science to experiment with different types of financial education to see what methods worked best.

**A national program of financial education is important.** Children need to learn that financial health is as important as physical health. The public school system should be primarily responsible for delivering a long-term program of financial education. United Kingdom, Ireland and France as well as other countries, including the United States, Canada and Australia, include financial education in the curricula of their primary or secondary schools. In primary schools, children should learn the values of maintaining strong financial health and the need to avoid over-indebtedness. Where high-school students have access to the internet, interactive computer games can help students learn the dynamics of investing in securities markets.

**The Ministry of Education has already launched a program of financial education through the schools.** The Ministry has worked with the National Council on Economic Education in the United States to adapt the US materials for Lithuanian students. The program covers primary

school students (with special materials aimed at parents) as well as secondary school students. They have incorporated financial education and improvement of financial literacy as part of other core curriculum programs, including in mathematics and civics lessons.

**Financial education should also be provided for adults.** In 2005-06, the EC funded the development of the DOLCETA program which provides an online training tool for use by teachers of adult education courses. In addition, in 2006 the EC funded a study of financial education initiatives throughout the 27 EU Members, the results of which were published in November 2007<sup>16</sup>. The objective was to exchange best practice models for improving access to financial services for those suffering from poverty and social exclusion. Focus was placed on highly-indebted consumers.<sup>17</sup> The Lithuanian versions of the four modules currently available at the DOLCETA website (Consumer Rights, Financial Services, Consumer Safety and Teacher Corner) have already been launched. The Teacher Corner was launched in 2008 as a new DOLCETA module on support for primary and secondary school teachers and for educators of adults with literacy problems. Other programs such as those of PattiChiari, developed by the Italian Banking Association, would also be helpful.

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

**Surveys of financial consumers have found that the most effective form of financial education is through the media.** In one survey in the US, 71 percent of all consumers chose television, radio, magazines and newspapers as the most effective way to learn about personal finances. Information brochures and presentations in the home were the next most effective method of acquiring financial expertise.<sup>18</sup> A financial literacy survey in Russia found that consumers look to specialized television shows, newspapers and magazines as well as specialized websites (especially for those under 35) for information about financial issues.

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

**Additional reliance could also be placed on NGOs in financial consumer protection.** In Italy and France, for example, NGOs are active in providing financial education to assist consumers in learning the basics regarding financial issues. The consumer protection law allows consumer protection associations to develop and implement projects for consumer education and

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<sup>16</sup> See *Survey of Financial Literacy Schemes in the EU27*, November 2007, available at [http://ec.europa.eu/internal\\_market/finservices-retail/docs/capability/report\\_survey\\_en.pdf](http://ec.europa.eu/internal_market/finservices-retail/docs/capability/report_survey_en.pdf)

<sup>17</sup> A comprehensive survey of financial literacy programs worldwide is provided by the OECD, *Improving Financial Literacy: Analysis of Issues and Policies*, 2005.

<sup>18</sup> Sandra Braunstein and Carolyn Welch, "Financial Literacy: An Overview of Practice, Research, and Policy," *Federal Reserve Bulletin*, vol. 87 (November 2002). Available at <http://federalreserve.gov/pubs/bulletin/2002/1102lead.pdf>

information. These associations may also represent consumer interests before the courts. Some funding is already provided by the SCRPA. However in the absence of a history of effective consumer protection associations in financial services in Lithuania, additional support is likely to be needed.

**There should be specialized training programs on financial issues targeted to professionals dealing with consumer protection issues.** Judges and staff working in courts could be subject to specialized training in order to improve their resources to deal with consumer complaints brought to court. Also, journalists from financial press and media should be adequately informed and educated in financial services and consumer protection issues in order to transmit news and stories clearly, accurately and effectively to the public.

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

**Low-income borrowers are particularly vulnerable to abusive lending practices.** Research in the US indicates that, in the residential mortgage market, predatory lending generally occurs in the "subprime" market where borrowers with weak access to credit use the collateral in their homes for debt consolidation or other consumer credit purposes. The research notes that predatory lending may also occur in the "prime" market but it is deterred by high levels of competition among lenders, the significant degree of homogenous loan terms and the prevailing high levels of financial information (and financial literacy) previously acquired by "prime" borrowers.<sup>19</sup>

**A nation-wide survey of the levels of financial capability should be conducted.** The Lithuanian Securities Commission has prepared and financed specialized surveys on financial issues since 2006. These surveys seek to find out information on budget planning skills, main savings vehicles, attitudes toward saving and investing, etc. These surveys have been a good initiative. However there is need for broader surveys to measure the levels of financial capability of the Lithuanian population. An initial nationwide survey should be conducted as a baseline analysis with a follow-up survey three to five years later. The survey should use the methods that have been successfully applied in other EU Member States, such as the United Kingdom. The survey should be comprehensive and segmented. It should be large enough to cover all key groups in Lithuania, segmented by geographic area, socio-economic level, gender, family status, household income, level of formal education, profession, and ethnic origin. Special consideration should also be given regarding how low-income groups will be reached since collecting data from these groups is notoriously difficult.

**To date, financial literacy surveys have been conducted in Australia, Canada, France, Hungary, India, Ireland, the Russian Federation and the United Kingdom.** Other surveys have been conducted by private sector organizations in many countries but none have provided nation-wide results that might legitimately be seen as useful in determining government policy in

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<sup>19</sup> *Curbing Predatory Home Mortgage Lending* (June 2000) report of the Joint Task Force of the Department of Housing and Urban Development and Department of Treasury. Available at <http://www.huduser.org/publications/hsgfin/curbing.html>

financial education. Lithuania would thus be one of the first emerging market countries to prepare a government-sponsored nation-wide financial literacy survey and would thereby inevitably provide leadership to other emerging market countries in this important respect.

**The financial literacy survey should be used to identify vulnerable parts of the Lithuanian population and design the financial education program.** Using the information in the surveys, programs of financial education and consumer awareness can be targeted to those who need the training and information the most. The survey can be used by SCRPA and NGOs to identify and focus on the most vulnerable to find the most effective ways of providing education—whether through class-room training, seminars or at the time they purchase a financial service ("point of sale").

**Follow-up surveys should be conducted every three to five years to evaluate the effectiveness of the programs of financial education and consumer awareness.** The follow-up surveys can be used to determine to what extent the programs are effective and what further modifications may be needed.

**Both the survey's methodology and its results should be published and made readily available to financial regulators worldwide.** The approach used by the United Kingdom's Financial Services Authority to publish both the findings and the detailed methodology has allowed the international community to benefit from the work done in the United Kingdom. Lithuania should take a similar approach.

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## **Annex 1: List of Report's Recommendations**

### ***Consumer Protection Institutions***

- 1) Revise Law on Consumer Protection to authorize SCRPA to establish a forum (or other coordinating body) to bring together the Insurance Supervisory Commission, Lithuanian Securities Commission and Bank of Lithuania to discuss consumer protection and ensure consistency of approaches.
- 2) Revise Law on Consumer Protection to give SCRPA authority to make binding decisions, enforceable through economic sanctions (fines) for all financial services except insurance (as a first stage).
- 3) Consider elevating position of SCRPA by having it report to Government or Parliament.
- 4) Improve transparency and accountability of SCRPA by increasing disclosure of activities, especially regarding treatment of inquiries and complaints.
- 5) Strengthen the role of consumer associations in receiving complaints over violations of the business conduct codes, informing consumers about their rights and responsibilities, and providing recommendations on policy and institutional reform to address common consumer complaints in financial services.
- 6) Extend the legal liability of board members for consumer protection to apply to all financial service providers.

### ***Consumer Disclosure***

- 1) Professional associations (or supervisory agencies) should develop format for Key Facts Statement for all standard financial products.
- 2) Require that financial institutions place standard contracts on their websites, and make them available to consumers on demand.
- 3) Require that financial institutions prepare stress tests (base case, optimistic case, pessimistic case) to show consumers impact of changes in interest rates and foreign exchange rates on products.
- 4) SCRPA should contract NGOs to compare and publish tariffs for standard products and services by financial institutions.
- 5) Financial institutions should state they are regulated and by which agency. Supervisory commissions should publish consumer pages with consumer alerts of known frauds.

### ***Market Practices***

- 1) Require that professional associations develop codes of conduct for their respective parts of financial sector.
- 2) Adopt law to implement EU Consumer Credit Directive. Ensure that law covers all consumer credits, including credit for small amounts and credits made available through leasing.
- 3) Give consumers the right to choose any qualified provider of services when one financial service requires that another financial service be purchased.

- 4) Set tiered program of minimum financial training and certification for sellers of financial products, depending on complexity of products.
- 5) Increase competition by authorizing new providers, for example, for payments and transfers.
- 6) Prepare law on insolvency of natural persons.
- 7) Prepare law on mediation.
- 8) For insurance, require segregation of client assets.
- 9) For pensions, set standard methodology for design of payout phase.
- 10) For credit histories, expand data-base. Credit bureaus should develop own systems of credit scoring. Ensure right of consumers to verify and correct information in data-base.

### ***Dispute Resolution***

- 1) Require that all financial institutions designate a specific official or department for handling of customer complaints.
- 2) Establish toll-free telephone lines to receive complaints and inquiries submitted to supervisory commissions and SCRPA.
- 3) SCRPA to receive copies of all complaints and inquiries submitted to all government institutions (including supervisory commissions). SCRPA to analyze trends in complaints and inquiries and publish statistics.
- 4) SCRPA (and supervisory commissions and professional associations) to propose programs to address issues raised by complaints and inquiries.
- 5) Over long-term, consider creating independent statutory ombudsman to handle complaints and disputes in financial sector.

### ***Financial Education***

- 1) Conduct baseline nation-wide survey of financial capability.
- 2) Use survey to design program of financial education.
- 3) Develop adult financial education program, focusing on “teachable moments” for consumers, for example, first-time mortgage borrowers.
- 4) Focus on making information available to consumers at the time they want it and in the form that they want it. Provide examples of cases of unfair practices.
- 5) Develop financial literacy program for schools, as part of programs on mathematics, science, civics etc.
  - For primary school students, focus on communicating clear values, ex. Need to maintain financial health.
  - For secondary students, use interactive games where possible.
- 6) Conduct follow-up surveys every 3-5 years to evaluate effectiveness of programs of financial education and make necessary changes.

## **Annex 2: Key Laws & Institutions for Financial Consumer Protection in Lithuania**

### ***Key Laws and Regulations***

- Civil Code
- Law on Consumer Protection No. I-657 (10 November 1994) as amended by Law No. X-1014 (12 January 2007)
- Law on Banks No. IX-2085 (30 March 2004) as amended by Law No. X-1038 (18 January 2007)
- Law on the Bank of Lithuania No. I-678 (1 December 1994) as amended by Law No. X-569 (25 April 2006)
- Law on Payments No. VIII-1370 (28 October 1999) as amended by Law No. IX-2404 (15 July 2004)
- Law on Insurance of Deposits and Liabilities to Investors No. IX-975 (20 June 2002) as amended by Law No. X-1749 (14 October 2008) and Law No. XI-376 (21 July 2009)
- Law on the Prevention of Money Laundering and Terrorist Financing No. VIII-275 (19 June 1997) as amended by Law No. X-1419 (17 January 2008)
- Law on Prohibition of Unfair Business-to-Consumer Commercial Practices No. X-1409 (21 December 2007)
- Law on Advertising No. VIII-1871 (18 July 2000) as amended by Law No. X-1414 (11 January 2008)
- Law on Legal Protection of Personal Data No. IX-1296 (21 January 2003) as amended (13 April 2004)
- Law on Competition No. VIII-1099 (23 March 1999) as amended by Law No. IX-2126 (15 April 2004)
- Law on Mortgage Bonds and Mortgage Lending No. IX-1746 (25 September 2003) as amended (15 April 2004)
- Law on Securities No. X-1023 (8 January 2007)
- Law on Markets in Financial Instruments No. X-1024 (18 January 2007)
- Law on Collective Investment Undertakings No. X-1303 (25 October 2007)
- Law on Commercial Arbitration No. I-1274 (2 April 1996)
- Law on Insurance No. IX-1737 (18 September 2003) as amended by Law No. X-1324 (15 November 2007)
- Resolution No. 149 of the Bank of Lithuania on the Organization of Internal Control and Risk Management (25 September 2008)
- Rules on the Formation and Use of the Guarantee Fund, Minutes No. 07-07 of the Board of AB Vilnius Stock Exchange (26 January 2007)
- Resolution No. 1K-22 on the Approval of the Rules on the Provision of Investment Services and the Acceptance and Execution of Client Orders (31 May 2007)
- Resolution No. 1K-17 on the Organization of Activities of Financial Brokerage Firms (17 May 2007)
- Regulations of the Insurance Supervisory Commission of the Republic of Lithuania, approved by the Government of the Republic of Lithuania, Resolution No. 27 (13 January 2004)

- Resolution No. N-74 of the Insurance Supervisory Commission of the Republic of Lithuania on the approval of the description of the procedure for the provision of information to policyholders on life assurance related to investment funds (where the policyholder bears the investment risk) (11 July 2006)
- Resolution No. N-30 on Information provided by Insurance Intermediaries to Customers (16 March 2004)

### ***Institutions***

The **State Consumer Rights Protection Authority** (SCRPA) under the Ministry of Justice was established to co-ordinate the activities of state institutions on consumer protection, including for financial services. SCRPA is the enforcement agency for the Law on Payments and the consumer credit provisions of the Civil Code. For other financial services (except insurance), SCRPA provides recommendations for consideration by financial institutions. SCRPA also enforces the Law on Prohibition of Unfair Business to Consumer Commercial Practices and the Law on Advertising, with the exception of the provisions related to misleading and comparative advertising. Those provisions are enforced by the **Competition Commission**.

The **Bank of Lithuania** supervises the activities of licensed credit institutions, i.e. those authorized to accept deposits from the public. The Bank of Lithuania maintains the central credit register used by banks. The **Association of Lithuanian Banks** acts as the professional association for banks.

The **Lithuanian Securities Commission** (LSC) supervises the securities markets. The **Central Securities Depository of Lithuania** acts as the independent central depository and sets regulations for professional participants on record-keeping, accounting, etc. The **Vilnius Stock Exchange** is owned 93 percent by NASDAQ OMX. There are two main professional associations, the **Association of Brokerage Houses** and the **Association of Investment Management Companies**, which maintains codes of ethics for their members.

The **Insurance Supervisory Commission** (ISC) supervises the insurance sector and voluntary funds and mandatory pension funds and also makes recommendations to try to resolve disputes between insurance companies and consumers. The **Chamber of Insurance Brokers** enforces a code of conduct for their members.

The **State Undertaking Deposits and Investments Insurance** provides insurance for retail depositors and investors in the case of insolvent financial institutions. For this matter, the Company administers two separate funds: the Deposit Insurance Fund and the Insurance of Liabilities to Investors Fund.

The **State Data Protection Inspectorate** ensures maintenance of the privacy of personal information.

More than 20 **consumer associations** are present in Lithuania. The Lithuanian Consumer Institute acts as Lithuania's official representative to the European Association of Financial Service Users (FIN-USE.)

The **courts** are the final arbiter of consumer protection disputes. No system of small courts (i.e. for disputes of small amounts of money) is in place.

Table 2 provides a summary of key EU Directives on financial consumer protection and their application in Lithuanian law.

**Table 2: EU Directives on Financial Consumer Protection and Applicable Lithuania Laws**

<b>CELEX Reference</b>	<b>EU Directive</b>	<b>Supervisory Agency</b>	<b>Lithuanian Law</b>
3 1987 L 0102	Directive on Consumer Credit, 1987/102/CEE, as amended	SCRPA	Civil Code (Chapter XLIII, Section III Consumer Credit, articles 6.886-6.891)
3 2008 L 0048	Directive on Consumer Credit, 2008/48/EC, repealing Directive 87/102/EEC	n.a.	Under preparation
3 1993 L 0013	Directive on Unfair Terms in Consumer Contracts, 1993/13/EEC	SCRPA	Civil Code
3 2005 L 0029	Directive concerning Unfair Business-to-Consumer Commercial Practices in the Internal Market, 2005/29/EC	SCRPA	Law on Prohibition of Unfair Business to Consumer Commercial Practices
3 1998 L 0027	Directive on Injunctions for the Protection of Consumer Interests, 1998/27/EC	SCRPA	Law on Consumer Protection
3 1994 L 0019	Directive on Deposit Guarantee Schemes, 1994/19/ EC	SUDII	Law on Banks Law on Insurance of Deposits and Liabilities to Investors
3 1997 L 0009	Directive on Investor Compensation Schemes, 1997/9/EC	SUDII	Law on Insurance of Deposits and Liabilities to Investors
3 2002 L 0058	Directive Concerning Processing Personal Data and Protection of Privacy in the Electronic Communication Sector, 2002/58/EC	SDPI	Law on Legal Protection of Personal Data
3 1995 L 0046	Directive on the Protection of Individuals with regard to the Processing of Personal Data, 1995/46/EC	SDPI	Law on Legal Protection of Personal Data
3 1997 L 0007	Directive on Protection of Consumers in Respect of Distance Contracts, 1997/7/EEC	SCRPA	Law on Consumer Protection Civil Code
3 2002 L 0065	Directive on the Distance Marketing of Financial Services, 2002/65/EC	SCRPA	Law on Consumer Protection Civil Code
3 2006 L 0114	Directive on Misleading and Comparative Advertising, 2006/114/EEC	SCRPA CC	Law on Prohibition of Unfair Business to Consumer Commercial Practices Law on Advertising
3 1985 L 0611	Directive on UCITS, 1985/611/EEC, as amended	LSC	Law on Collective Investment Undertakings
3 2004 L 0109	Directive on Transparency, 2004/109/EC	LSC	Law on Securities
3 2004 L 0072	Directive on Market Abuse, 2004/72/EC	LSC	Law on Securities
3 2004 L 0039	Directive on Markets in Financial Instruments, 2004/39/EC (MiFID)	LSC	Law on Markets in Financial Instruments
3 2002 L 0083 3 1992 L 0049	Directive on Life Insurance, 2002/83/EC Directive on Non-Life Insurance, 1992/49/EEC	ISC	Law on Insurance
3 2002 L 0092	Directive on Insurance Mediation 2002/92/EC	ISC	Law on Insurance