



## Improving Protection in Financial Services for Bulgarian Consumers

Evgeni Evgeniev and Magdalena Filipova<sup>1</sup>

### Key Messages

- **Optimal consumer protection in financial services and high consumer financial capability are at the heart of a financial sector in Bulgaria that aims to be effective, competitive, and fair.**
- **Regulation of consumer protection and access to financial education programs have become highly relevant due to the global financial crisis and subsequent government attempts to reduce risks to financial stability.**
- **A 2009 World Bank report<sup>2</sup> found gaps in Bulgaria's financial consumer protection framework and recommended: i) strengthening the institutional structure; ii) improving rules on consumer disclosure; iii) reinforcing rules governing financial institutions' consumer business practices; iv) improving consumer complaint mechanisms; and v) expanding financial education for consumers.**
- **A 2010 World Bank survey<sup>3</sup> found that consumers have low trust in private financial institutions and that a large percentage have limited financial information and knowledge, preventing them from making advantageous financial decisions.**

### Outline of Bulgaria's Financial Services Industry

Financial services in Bulgaria have grown significantly over the past decade. Consumer debt increased almost sixfold

between 2003 and 2011, as household borrowing rose from 7 percent of GDP in 2003 to 25 percent in 2011. Loans for household purchases gained an increased share in the loan portfolio. Since December 2003, the percentage of loans with maturities of between one and five years has decreased (from 65 percent of total household loans to 6 percent by end-2011); loans with maturity above five years have increased proportionately and stood at 66 percent by end-2011. Bad and restructured loans rose from 1 percent of total households in December 2004 to 18 percent by the end of 2011. Loans by nonbank credit institutions have shown higher delinquencies than those from commercial banks.



© petrazhivkova.daportfolio.com, used with permission

The use of bank/debit cards has significantly increased since January 2005, as confirmed by a survey conducted in 2010 by the market research institute GfK Bulgaria. Thirty-four percent (20 percent in 2005) of respondents reported having a bank card, using it only for direct deposits from their employer, and 9 percent (2 percent in 2005) own a credit card. Findings from the survey suggest that Bulgarians continue to be underinformed about the opportunities – and risks – offered by the ownership and use of credit and debit cards, highlighting the need for improving access to, and the quality of, financial education.

Although the expansion of financial services has brought significant benefits for consumers, it has exposed both providers and recipients to greater financial risk. The recent financial and debt crises point to the array of risks consumers face. In Bulgaria, these risks relate to the high share of Greek-owned banks (25 percent of assets), the growth of nonperforming loans (NPLs) (15 percent of total loans), and a further delay in the recovery of credit, which in turn is slowing economic recovery. Given these risks, financial consumer protection requires strengthened market supervision and regulation and wide-ranging financial education initiatives.

<sup>1</sup> The authors would like to thank Sue Rutledge and Juan Carlos Izaguirre from the World Bank for helpful comments on this knowledge brief, which builds on key results in two World Bank studies: the 2009 report “Diagnostic Review of Consumer Protection and Financial Capability in Bulgaria” and the 2010 “Household Financial Capability Survey in Bulgaria.”

<sup>2</sup> World Bank, “Diagnostic Review of Consumer Protection and Financial Capability in Bulgaria” (Washington, DC: World Bank, 2009).

<sup>3</sup> “Household Financial Capability Survey in Bulgaria,” conducted by Alpha Research for the World Bank in May 2010.

### Why is Financial Consumer Protection Important?

Greater prudential financial regulation and oversight have become medium-term targets as a result of the global financial crisis impact. Furthermore, robust consumer protection and financial literacy are needed to: (i) help mitigate financial risks; (ii) promote the deepening of financial markets to serve a broad population, including low-income households; and (iii) improve the efficiency of the retail financial market. These measures help ensure the long-term stability of the financial system. Financial sector governance and business conduct regulation and supervision also play an important role in medium- to long-term stability, as they help build consumer trust in financial institutions, generate conditions for the best choice in the supply of and demand for financial products, and ensure that financial institutions address consumer needs.

At its heart, the need for consumer protection arises from an imbalance of power, information, and resources in favor of financial service providers, thus disadvantaging consumers. In addition, complex financial products may be difficult to assess even when full information is disclosed. Consumers empowered with information and basic rights are an important source of market discipline, encouraging financial institutions to compete by offering better products and services. By strengthening transparency and accountability in the delivery of financial services, consumer protection also helps promote good governance in the financial sector.

Throughout Europe (including Bulgaria), the rapid growth of household lending over the last decade has been accompanied by increasing consumer difficulty in understanding the risks and obligations assumed and/or the full range of choices available. Effective and efficient consumer protection should thus provide consumers with:

- **Transparency**, by providing plain, adequate, and comparable information about prices, terms and conditions, and risks of financial products and services;
- **Choice**, by ensuring fair and noncoercive practices in the sale and promotion of financial products and services, and collection of payments;
- **Redress**, by providing inexpensive and speedy mechanisms to address complaints and resolve disputes;
- **Privacy**, by ensuring protection from third-party access to personal financial information.

### The Evidence in Bulgaria

Under Bulgaria's Consumer Protection Act, the Ministry of Economy, Energy and Tourism (MEET) is the main government authority responsible for consumer protection.

National policy on consumer protection is developed by the National Consumer Protection Council (founded in 1999). Its role is to advise MEET and to develop multiyear strategic plans for consumer protection. To date, the National Council has been slow to start, and there is currently insufficient coordination among government agencies responsible for financial consumer protection.

The Consumer Protection Commission (CPC) under MEET's authority is the primary body responsible for enforcing consumer protection legislation and handling complaints on consumer credit, payments, and remittances. It has strong authority, including the right to issue individual administrative acts and penal decrees and impose "forceful administrative measures". However, on consumer disputes, the CPC is limited to mediation, primarily through *ad hoc* conciliation committees. In other parts of the financial sector, such as insurance, pensions, and securities, consumer protection is enforced by the Financial Supervision Commission (FSC), which has its own complaint mechanism.

The European Union's (EU) Directives on Consumer Credit, Distance Selling, and Unfair Commercial Practices, which strengthened consumer rights, became law in Bulgaria upon its EU membership in 2007. However, while Bulgaria's legal and regulatory financial consumer protection framework has improved, many gaps remain, resulting in limited financial knowledge and low trust in private financial institutions among Bulgarian consumers.

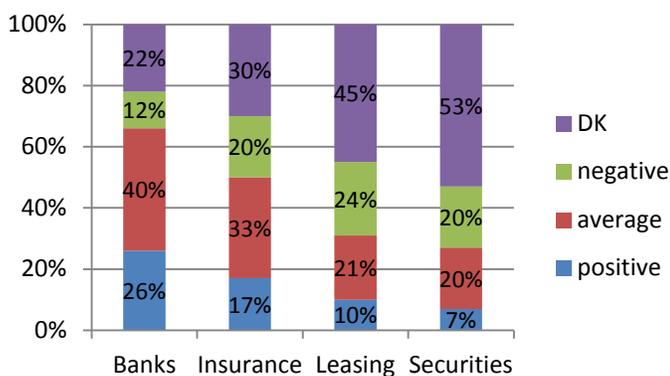
Figure 1: Trust in the Private Financial System



Source: Household Financial Capability Survey in Bulgaria, May 2010.

The Bank survey found that trust among financial consumers is particularly low in the leasing and securities sectors, while over 50 percent of Bulgarians indicate either unsatisfactory or no knowledge when asked to self-evaluate their financial literacy level. The survey methodology (developed by the World Bank) incorporated a test for the respondents, which showed similar distribution.

**Figure 2: Quality of Financial Services**



Source: Household Financial Capability Survey in Bulgaria, May 2010.

## Five Recommendations

The World Bank “Diagnostic Review of Consumer Protection and Financial Capability in Bulgaria”<sup>4</sup> included the following objectives: (i) examine the country’s existing rules and practices against good practices; (ii) recommend ways to improve consumer protection and financial literacy; and (iii) refine a set of good practices for assessing consumer protection and financial literacy. The review used international good practices that incorporate EU provisions on consumer protection; reports of European financial regulatory and supervisory agencies; laws, regulations, and business codes in the United States, Australia, and Canada; and good practices for financial education and awareness used by the Organisation for Economic Co-operation and Development (OECD). The review on Bulgaria resulted in a number of recommendations.

**Strengthening the institutional structure.** A clear institutional structure is needed for consumer protection in financial services in Bulgaria. Based on international experience, the long-term recommendation would be to establish a financial ombudsman (as in the United Kingdom) that would clarify and consolidate the institutional structure for financial consumer protection. This presents some challenges in Bulgaria, however, as the Constitution restricts authority to make binding final legal decisions to the court system. The review therefore recommends expanding the CPC’s authority and capacity as an interim solution. Various – and not mutually exclusive – alternative institutional frameworks include:

- The CPC is responsible for supervising compliance with consumer protection legislation for all financial services, not only consumer credits and payments.
- The financial supervisory agencies are responsible for ensuring this compliance.
- A financial ombudsman handles disputes, complaints, and inquiries related to consumer financial services, eventually replacing the conciliation committees.

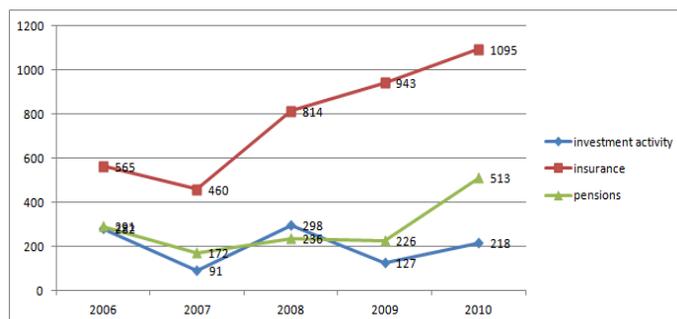
<sup>4</sup> The study is available at [www.worldbank.org/consumerprotection](http://www.worldbank.org/consumerprotection).

**Improving consumer disclosure laws.** Consumer disclosure forms the core element of consumer protection, which can be obtained by enforcing restrictions and requirements on financial institutions in presenting financial products. For instance, due to the growing variety and complexity of financial products, a clear and standardized format is needed to help consumers make informed choices and ensure that they fully understand the financial products they purchase. The *Law on Consumer Credit* in Bulgaria, which applies to loans between €200 and €20,000 and requires detailed disclosure to consumers, is a good start. A “Key Facts Statement” for each type of standard retail financial product would also help consumers understand the material conditions of their contracts. Professional associations could develop standardized formats for this kind of statement for each retail item, and consumers should be able to obtain a copy of the full terms and conditions without having to apply for any product.

**Strengthening the rules governing consumer-related business practices.** The Association of Bulgarian Banks has developed a code of ethics, but it needs to be widely disseminated and regularly monitored by professional associations and the CPC. Cases of noncompliance could be published on the websites of professional associations to warn future clients, and all providers of consumer financial services could be registered and become subject to monitoring by a supervisory agency. In addition, special attention could be paid to financial intermediaries and debt collection services, and training and/or certification requirements for all sellers of financial products may be considered.

**Enhancing consumer complaints and dispute mechanisms.** Consumers need to be confident about using the available redress system, that is, that their concerns will be addressed efficiently and in a fair and transparent manner. This is especially required in Bulgaria, where consumers have expressed a strong distrust in the financial institutions. The violation of consumer protection laws has gained increasing importance within the EU. In Bulgaria, only about 1,800 complaints were received by the FSC in 2010, showing an upward trend since 2006.

**Figure 3: Dynamics of Complaints**



Source: Bulgaria, FSC report.

All financial institutions need to establish a clear process by which consumers can submit disputes over transactions. Also useful would be to analyze statistics on the number and types of consumer complaints for systematic risks that may threaten financial sector stability. In Bulgaria, no supervisory agency can take a binding decision on the action to be taken by financial institutions in a consumer dispute. A conciliation committee can attempt to find an out-of-court solution, but such committees must operate on the basis only of an amicable settlement acceptable to both parties. In this respect, the limited number of settled-out-of-court cases in Bulgaria and the prolonged duration of court proceedings mean that there is no effective dispute-settlement mechanism for financial services issues currently in place. This is limiting the conditions for a fair, open, and healthy financial market. Clearly, the structure of conciliation committees needs to be improved.

**Expanding financial education for consumers.** In the long term, effective financial consumer protection relies on well-educated financial consumers who have easy access to education about their financial services – not just the terms of service, but also the risks and rewards of different personal financial strategies.

---

### Where Are We Now?

Several measures to improve Bulgaria's financial services system have already been implemented. The 2007 revisions to various laws based on EU directives were mentioned above. Changes to securities and insurance legislation incorporated several other EU directives, including the Payment Service Directive (2007), which became the *Law on the Payment Services and Payment Systems*. And revisions to the *Law on Credit Institutions* brought leasing and consumer finance companies under the supervision of the Bulgarian National Bank (BNB).

In response to the financial crisis, the EU introduced some new directives and made revisions to existing ones aimed at strengthening regulation and supervision (including consumer protection). The Directive on Credit Agreements for Consumers was amended in 2011 and is due to be transposed into member states legislation by end-2012. The amendment provides new assumptions for calculating the annual percentage rate for credit charges without fixed duration or repayable in full repeatedly, and also standards for the timing of the initial drawdown of credit and consumer payments. A Mortgage Credit Directive is

expected to be adopted also in mid-2012, which will set common EU rules and requirements for securing mortgage loans. Finally, a new Directive on Deposit Guarantee Schemes is expected to be adopted by the EU as well.

Bulgaria would be required to transpose and incorporate all of this new EU legislation. Thus far, the only recent change in the area of consumer protection in financial services was the amendment to the *Consumer Credit Law* in 2010 (amend. State Gazette, vol.58/30/06/ 2010), which aimed to make calculation of the reference interest rate more transparent. Also as part of this change, credit institutions were required to publish the methodology applied on their website to make it visible on their premises, and to give consumers access to historical reference values.

In December 2011, the FSC launched an international event entitled "Development Outlook of the Non-Banking Financial Sector," bringing together the Bulgarian Prime Minister and high-level government officials and experts from the European Commission, World Bank, and the European Securities and Markets Authority, as well as nonbanking and bank regulators from the region, private sector, and academia to discuss a range of topics, including financial consumer protection and financial literacy. The FSC pointed to the need for a national strategy on financial consumer protection and financial education. As a follow-up, the FSC held a press conference in January 2012 offering its own Program on Consumer Protection and Literacy in Financial Services for public consultation. The program was adopted by the FSC in March 2012.

Finally, the FSC has also championed an initiative, involving key ministries (Economy, Energy and Tourism; Education, Youth and Science; and Finance) and the Central Bank, to prepare a national program for financial education and literacy that requires the active involvement of private financial institutions, their professional associations, and members of civil society. The result will be empowered financial consumers – and, it is hoped, a stronger and more stable financial system.

### About the Authors

Evgeni Evgeniev is a Private Sector Development Specialist with the Private and Financial Sector Development Unit of the Europe and Central Asia Region of the World Bank. Magdalena Filipova is an Intern with the Private and Financial Sector Development Unit of the Europe and Central Asia Region of the World Bank.