90422 v1

Kyrgyz Republic:

Diagnostic Review of

Consumer Protection and Financial Literacy

Volume I: Key Findings and Recommendations

THE WORLD BANK

Financial and Private Sector Development Vice-Presidency
Europe and Central Asia Region
Financial Inclusion and Consumer Protection Service Line
Washington, DC

May, 2014

ACKNOWLEDGMENTS

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The team expresses its appreciation to the Kyrgyz authorities for their cooperation during the preparation of the Review. The project team would like to thank all those who so generously contributed to the final report.

The Review was prepared as part of the Swiss State Secretariat for Economic Affairs (SECO) Trust Fund on “Financial Sector Development”.

Table of Content

Tables

Boxes

ABBREVIATIONS AND ACRONYMS

AFI	Alliance for Financial Inclusion
AMFI	Association of Microfinance Institutions
CCMD	Coordination Council for Microfinance Development
CPFL	Consumer Protection and Financial Literacy
EU	European Union
GDP	Gross Domestic Product
IAIS	International Association of Insurance Supervisors
IFC	International Finance Cooperation
IOSCO	International Organization of Securities Commissions
IRG	International Resources Group
KfW	*Kreditanstalt fuer Wiederaufbau* (English Translation)
MFO	Microfinance Organization
MoU	Memorandum of Understanding
MTO	Money Transfer Operators
NBKR	National Bank of the Kyrgyz Republic
NGO	Non-governmental organization
OECD	Organization for Economic Cooperation and Development
RCT	Randomized Control Trial
UNDP	United Nations Development Program
WB	World Bank

PREFACE

The Diagnostic Review for Consumer Protection and Financial Literacy (CPFL) provides a detailed assessment of the institutional, legal and regulatory framework for consumer protection in two segments of the financial sector: banking and microfinance[1]. The review was undertaken in response to a request for technical assistance in the field of financial consumer protection made by the National Bank of the Kyrgyz Republic (NBKR) in November 2012.

A World Bank (WB) mission visited Bishkek from February 27-March 7, 2014 to prepare the review. An Aide Memoire was prepared in the field highlighting preliminary findings and recommendations and shared with official counterparts for comments. The objectives of the CPFL Review were: (i) to assess the existing consumer protection and financial literacy framework by reviewing laws, regulations, and practices in Kyrgyz Republic compared to international good practices; and (ii) to provide recommendations on ways to improve the level of financial consumer protection and financial literacy in the country. As the second part of the review, four focus group discussions have been conducted during the mission with the view of gaining quick insights into people's knowledge and understanding of financial concepts and products, their attitudes, financial behaviors and experience in using financial products.

The CPFL Review is part of the World Bank's Program on Consumer Protection and Financial Literacy. It seeks to identify key measures in strengthening financial consumer protection, with the ultimate aim of increasing the availability and transparency of financial information, helping build consumers' trust in the financial sector and expanding their capacity to wisely use financial services.

CPFL Reviews against Good Practices have been conducted by the World Bank in a plethora of countries including Armenia, Azerbaijan, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Indonesia, Kazakhstan, Kosovo, Latvia, Lithuania, Malawi, Mozambique, Nicaragua, Pakistan, Peru, Philippines, Romania, the Russian Federation, Rwanda, South Africa, Slovakia, Tajikistan, Tanzania and Ukraine.

The main objective of the Review is to assess the legal/regulatory and institutional frameworks for financial consumer protection in a country, with reference to international best practices. The Review addresses the following issues: 1. Institutional Arrangements, 2. Legal and Regulatory Framework, 3. Disclosure, 4. Business Practices, 5. Dispute Resolution Mechanisms, and 6. Financial Education.

[1] These include microfinance organizations (MFOs) and credit unions.

The Review is based on compliance with a set of Good Practices for Financial Consumer Protection[2] which was developed by the World Bank since 2006. They provide a set of good practices based on in-depth country level reviews of consumer protection and financial literacy conducted by the World Bank as well as international benchmarks, such as the principles released by the Basel Committee, IOSCO and IAIS, and the OECD recommendations as well as laws, regulations and codes of business practices from the EU, United States, Australia, Canada, France, Ireland, Malaysia, Mexico, New Zealand, Peru and South Africa.

[2] http://responsiblefinance.worldbank.org/~/media/GIAWB/FL/Documents/Misc/Good-practices-for-financial-consumer-protection.pdf.

EXECUTIVE SUMMARY

1. **Consumer protection and financial literacy (CPFL) are key to increasing responsible access to financial services—this is particularly relevant to Kyrgyz Republic, where access to formal financial services is still lower than the regional average.** Given the relatively low levels of financial inclusion in Kyrgyz Republic a number of initiatives are currently underway to ensure that more people are brought into the financial system. While increased access to finance can result in significant economic and societal benefits, it can be neutral or even harmful if consumers: (i) cannot exercise their rights as consumers; (ii) cannot select the financial products that suit them best and (iii) are not protected against frauds and other market abuses.

2. **Despite the lack of a clear legal mandate for financial consumer protection, the National Bank of the Kyrgyz Republic (NBKR) has been taking important steps to regulate and supervise consumer protection in relation to banking and microfinance clients, for which it should be commended.** However, new provisions are not organized in a coherent way and the sheer volume of new regulation raises concerns regarding supervisory capacity to enforce. It will be important to continue efforts to streamline and clarify NBKR's role in consumer protection through (i) support for the new NBKR consumer protection unit through the allocation of appropriate resources and regulatory and capacity building measures, and (ii) a focus on ensuring that the new Banking Code contains a clear and appropriate NBKR mandate and tools in this area. At the same time it will be important to strengthen cooperation with other stakeholders such as the Antimonopoly Agency as well as industry and consumer associations.

3. **A very significant amount of work has either recently been completed or is currently in process for the establishment of the legal and regulatory framework in a variety of important areas.** These include a series of regulations on risk management of various kinds, rules on lending processes and disclosures, draft legislation on credit reporting, draft legislation covering remittances and electronic payments, amendments of foreclosure processes, changes in administrative penalties, and others. NBKR, as well as the other stakeholders and participants in these processes, should be commended for their attention to these important issues and the substantial effort contributed. Nonetheless, progress has in some important areas been fragmented and piecemeal. This may lead to gaps in coverage and create difficulties for both financial institutions and consumers in understanding and application of the rules.

4. **Important steps have been taken in enhancing disclosure requirements, especially for microfinance institutions. However, the plethora of disclosures is likely to confuse and overwhelm consumers so there is a need for further standardization.** Consideration should therefore be given to simplifying and streamlining disclosures by requiring financial institutions to provide their clients with a standardized 'Key Facts Statement'. This product information sheet should clearly indicate all fees and charges related to the financial product or service, as well as the mechanisms for recourse available to the consumer in the event of any complaint. Publication of the effective interest rates offered by various financial institutions on the NBKR website, with parallel distribution mechanisms for consumers without internet access, can help bring down interest rates as well as spur more effective competition among financial institutions.

5. **While there is some evidence that interest rates for microfinance loans have gone down since the introduction of the usury law, several negative tendencies in the market call for a careful impact assessment of the usury law** while comparing its cost effectiveness with alternative measures targeted at increased transparency and disclosure. At the same time, the increasing number of unregulated pawnshops poses risks to consumers. It is therefore recommended to bring pawnshops under the consumer protection regime of NBKR. The low level of capacity of microfinance management and staff noted during the mission requires enhanced availability and quality of training offered to credit officers. Developing and further strengthening industry Codes of Conduct would further benefit consumers.

6. **Legal rules do exist establishing some requirements and standards for internal complaints handling but these are contained in a number of legal and regulatory acts and do not form a coherent whole.** When internal complaints handling fails to resolve a consumer problem, there is no easily accessible alternative that consumers can use. It is recommended that NBKR develop and adopt normative legal regulation defining appropriate internal complaints handling procedures for banks and non-bank credit institutions and require submission of periodic complaints statistics. Further steps should also be taken in developing a financial ombudsman scheme for Kyrgyz Republic in order to address the current lack of easily accessible and speedy alternatives available to consumers.

7. **A few activities geared towards improving low levels of financial capability exist in the Kyrgyz Republic, but they are largely uncoordinated and untargeted.** Important steps have been taken towards a more concerted approach and the development of an over-arching financial education strategy. To provide focus and momentum in the process of developing the national strategy for financial education extensive coordination and communication is needed between the recently established interagency working group chaired by the vice prime minister, the Coordination Council for Microfinance Development (CCMD), and the expert group under the CCMD. Consulting with a wide range of stakeholders would allow the expert group under the CCMD to ensure wider consensus building on the importance of financial education, knowledge exchange, and overall support and funding of the implementation of the strategy. Preliminary results of focus group discussions conducted during the mission indicate that potential groups to be targeted in the strategy and subsequent programs are migrants and their families as well as rural populations.

8. **The recommendations for strengthening consumer protection and financial literacy are summarized in the table below and are described throughout this report. Further technical analysis can be found in Volume II which provides a detailed assessment of each relevant segment compared to the Good Practices.** During the coming 1-2 years, work on the new Banking Code presents an important opportunity to clarify the NBKR mandate for consumer protection and to establish clear and appropriate rules and standards for bank conduct across all areas of importance to consumer (client) protection. It will also be important that NBKR finalizes steps to form its new consumer protection unit. Plans to further expand coverage of the deposit insurance scheme should be continued preceded by a rigorous analysis of the implications of such an expansion. Passage of the draft law on credit histories will be required to allow the creation of enforceable legal standards in the credit reporting industry. The NBKR should, in connection with the passage of the draft law on the payments system, consider the issuance of rules containing minimum standards for consumer protection in relation to money transfers and mobile banking services. Moreover, further development of specific disclosure requirements should be a focus as well as the establishment of an ombudsman scheme. To ensure ownership and provide focus and momentum in the process of developing the national financial education strategy coordination and communication between all stakeholders should be further enhanced.

Table 1: Key recommendations

Recommendations	Responsible	Term[3]
Institutional Arrangements		
Strengthen NBKR's role further in consumer protection by ensuring that a clear mandate is included in the draft Banking Code.	NBKR, government	MT
Establish a formal mechanism for cooperation between the State Antimonopoly Agency and NBKR.	NBKR, State Antimonopoly Agency	MT
Finalize the establishment of a new financial consumer protection unit within the NBKR that is separate from prudential regulation.	NBKR	ST
Strengthen capacity of consumer associations and include them in consultative processes.	Government, NBKR, donors	LT

[3] ST, short term, indicates action can be undertaken in 0-6 months. MT, medium term, indicates 6 months-1 year. LT, long term, indicates 1+ years.

Legal and Regulatory Framework		
In light of the current work on the draft Banking Code, use the unique opportunity to establish adequate rules and standards across all areas of importance to consumers, and bring more coherence to the normative legal framework.	NBKR, government	MT
Pass the law on credit histories in order to allow for creation of enforceable legal standards in the credit reporting industry, including standards for the protection of consumers.	Government, NBKR	ST
Assess impact of expansion of coverage of the current deposit insurance scheme to individual entrepreneurs, credit unions and MFOs.	Deposit Insurance Agency	ST
In connection with the passage of the draft law on the payments system, consider the issuance of rules containing minimum standards for consumer protection in relation to money transfers.	NBKR, government	MT
Begin developing rules and instructions regulating the provision of mobile banking services to consumers.	NBKR	MT-LT
Disclosure		
Introduce Key Fact Statements for lending products and test consumer understanding of the disclosure material.	NBKR	MT
Take measures to enhance disclosure and transparency of loan terms and conditions which would help to bring down interest rates as well as spurring more effective competition among financial institutions by uploading effective interest rates of products on NBKR website with parallel distribution mechanisms for consumers without internet access.	NBKR, industry associations, consumer associations, media	MT
Revise advertising rules to ensure that they are consistent and clear and that their application produces information that consumers can readily understand and compare.	NBKR	LT
Business Practices		
Reconsider the introduction of interest rate caps due to their limited effectiveness and the potential to drive lenders into informality and compare their cost effectiveness to alternative measures of enhanced transparency and financial education.	NBKR, government	ST
Consider bringing pawn shops under the consumer protection regime of NBKR.	NBKR, government	MT
Enhance the availability and quality of training of credit officers and managers of microfinance organizations in order to strengthen sound and transparent business practices.	NBKR, industry associations, market participants	LT
Develop and further strengthen industry Codes of Conduct focusing on disclosure, complaints, product appropriateness and other areas of business practices	NBKR, industry associations, market participants	LT
Dispute Resolution Mechanisms		
Develop and adopt a single, coherent normative legal act governing complaints handling by financial institutions.	NBKR, industry associations	ST
Develop and adopt a regulation requiring financial institutions to make periodic reports on the number and type of complaints they have received.	NBKR, industry associations	MT
Continue efforts to establish an independent ombudsman structure for retail financial services by (i) conducting an analysis of complaints statistics as well as the suitability of the existing complaints handling mechanisms, (ii) based on the data analysis as well as the review of international experience and best practice develop a concept on the development of a financial ombudsman in the Kyrgyz Republic.	Working Group on Financial Ombudsman, government, other stakeholders	LT

Financial Education		
Organize monthly meetings between the technical level working groups of the CCMD and banking union and quarterly briefing meetings with the high-level Inter-Agency Working Group.	CCMD financial literacy working group members and other stakeholders	ST
Consider opening membership of the CCMD financial literacy expert group to a wider range of stakeholders and conduct stakeholder consultations.	CCMD financial literacy working group members and other stakeholders	ST
Conduct a nationally representative financial capability survey and use results as a baseline to measure the overall impact of financial education initiatives.	CCMD financial literacy working group members and other stakeholders	MT
Consider giving special emphasis to migrants and rural population in the development of the financial education strategy and subsequent programs.	CCMD financial literacy working group members and other stakeholders	MT
Test financial capability enhancing programs on a small scale and only roll them out upon rigorous evaluation of their positive impacts.	CCMD financial literacy working group members and other stakeholders	LT

I. CONTEXT FOR CPFL IN KYRGYZ REPUBLIC

a. Access to financial services

9. **Kyrgyz Republic has significantly low levels of access to finance compared to neighboring countries.** The credit-to-GDP ratio is among the lowest in the region (16 percent in 2013). The supply of financial services is limited, with few financial instruments and low savings mobilizations. Only 4 percent of the adult population has an account at a formal financial institution compared to the regional average of 44.9 (see Table 2). With regards to savings accounts, figures are very low at 0.9 percent but on par with comparable countries. At the same time 11.3 percent of adults had a loan which exceeds the regional average.[4]

Table 2: Adults with a Financial Product at a Formal Financial Institution
(In percentage, adults over age 15)

Country	Account [a/]	Savings [b/]	Loan	GNI per capital (USD)
Armenia	17.5	0.8	18.9	3,200
Azerbaijan	14.9	1.6	17.7	5,330
Georgia	33.0	1.0	11.0	2,690
Kazakhstan	42.1	6.7	13.1	7,580
Tajikistan	2.5	0.3	4.8	800
Turkmenistan	0.4	1.1	0.8	3,790
Russia	48.2	10.9	7.7	9,900
Uzbekistan	22.5	0.8	1.5	1,280
Kyrgyz Republic	**3.8**	**0.9**	**11.3**	**830**
Europe & Central Asia	44.9	7.0	7.7	7,272

a/ Defined as an account at a bank, credit union, cooperative, post office, or microfinance institution
b/ Percentage of adults over 15 that saved at a formal financial institution in the past year
c/ Percentage of adults over 15 that took out a loan from a formal financial institution in the past year
Source: Global Findex, 2012

10. **Rural areas remain significantly underserved compared to urban areas**. Although the number of banks' branches increased from 254 at end-2011 to 287 in November 2013, given the mountainous character of the country and its limited infrastructure, customers in rural areas remain significantly underserved compared to urban areas. Currently 8 percent of adults in urban areas have a formal account compared to only 2.6 percent in rural areas. Despite the fact that two thirds of the population live in rural areas, most banks are unwilling to expand operations to rural areas due to associated high costs.

[4] With more than 400,000 clients, the microfinance sector (non-deposit taking) has reached systemic importance which explains the dominance of loans over formal accounts.

11. There is a significant market for the transmission of remittances from the Kyrgyz Republic's large migrant labor population, and money transfers are one of the most commonly used banking services. Total remittances transfers (both inflows and outflows) account for 42 percent of the GDP of which around 80 percent account for inflows. According to Global Findex 2012, a total of 22.8 percent of adult population received remittances in the last year compared to 9.2 percent in Russia, 8 percent in Kazakhstan and 25.7 in Tajikistan. In addition, consumers can make payments for utilities and other services through money transfers directly to the service provider through banks, post offices, and a number of payments system operators who operate "cash in" terminals that accept cash for such payments. The market appears to be quite competitive, with services available through a number of money transfer systems. Banks often offer their customers a choice among a number of transfer systems with differing costs and conditions.

a. Overview of CPFL framework in Kyrgyz Republic

12. Consumer protection and financial literacy (CPFL) are key to increasing responsible access to financial services—this is particularly relevant to Kyrgyz Republic, where access to formal financial services is still lower than the regional average. Given the relatively low levels of financial inclusion in Kyrgyz Republic a number of initiatives are currently underway to ensure that more people are brought into the financial system. While increased access to finance can result in significant economic and societal benefits, it can be neutral or even harmful if consumers: (i) cannot exercise their rights as consumers; (ii) cannot select the financial products that suit them best and (iii) are not protected against frauds and other market abuses (see Box 1 on key findings of Global Survey on Financial Consumer Protection).

Box 1. Findings of Global Survey on Financial Consumer Protection

To contribute to the international dialogue on financial consumer protection, the World Bank in conjunction with FinCoNet conducted a Global Survey on Consumer Protection and Financial Literacy to collect information from financial regulatory agencies in 114 economies. Key findings suggest that in Europe and Central Asia there has been progress from 2010 to 2013 in terms of strengthened legal and institutional arrangements for financial consumer protection. Figure 1 shows that countries increasingly assigned legal responsibility for financial consumer protection to financial supervisors and created dedicated teams or units between 2010 and 2013.

Figure 1: Financial regulators responsible

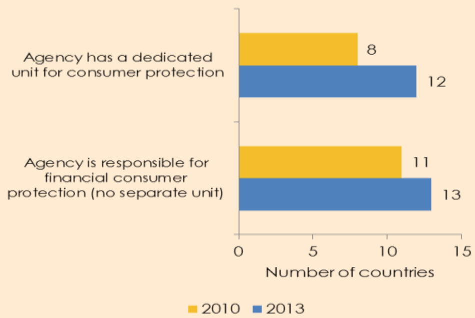


Figure 2: Disclosure and Dispute Resolution Indices[5]

	Disclosure Index	Dispute resolution Index
Russian Federation	2	0.5
Kyrgyz Republic	2	0.5
Kazakhstan	4	1
Azerbaijan	4	0.5
Armenia	5	1
Georgia	5	0.5

Figure 2 indicates the levels of disclosure and dispute resolution requirements on an aggregate level. Kyrgyzstan scores 2 out of the 5 major disclosure requirements. This index ranks low, alongside Russia when compared to other neighboring countries. The dispute resolution index measures the existence of formal internal and external dispute resolution mechanisms. Kyrgyz Republic has established an external dispute resolution mechanism within its supervisory agency. This seems to be the norm across neighboring countries with the exception of Kazakhstan and Armenia who have both put in place internal as well as external dispute resolution mechanisms.

13. **In Kyrgyz Republic, the lack of general trust of the population in the financial sector as well as the low levels of financial capability of consumers highlight the need for a strengthened CPFL framework.** Confidence in the formal financial sector is lacking as a consequence of banking crises experienced in the 1990s and in 2005, followed by the political unrest in 2010. In addition, the level of financial capability of Kyrgyz consumers is perceived to be particularly low. A few activities geared towards improving low levels of financial capability exist in the Kyrgyz Republic, but they are largely uncoordinated and untargeted. Preliminary results of focus group discussions indicate that potential groups to be targeted in the financial education strategy and subsequent programs are migrants and their families as well as rural populations.

[5] Disclosure index denotes the sum of a variety of existing disclosure requirements. These are (i) Law specifies disclosure requirements in plain language, (ii) Law specifies disclosure requirements in local language, (iii) Law specifies requirement for prescribed standardized disclosure format, (iv) Law specifies requirement for recourse rights and processes, and (v) Law specifies disclosure requirement of annual percentage rate using standard formula for credit products. The dispute resolution index reflecting the existence of formal internal and external dispute resolution mechanisms takes the value 1 if both resolution mechanisms are available, the value 0.5 if one of the mechanisms is available, and 0 if neither of the mechanisms is available.

15. **Concerns about over-indebtedness and predatory lending practices especially in the microfinance sector have led to the introduction of a number of important consumer protection provisions to the existing legislation.** Existing financial laws contain several provisions intended to protect customers. With over 400 000 clients, the microfinance sector has reached systemic importance, and NBKR should be commended for having taken timely action in introducing relevant consumer protection provisions in the areas of disclosure and responsible lending. A recently passed usury law, however, may not have the expected positive effect on reducing interest rates and has the potential for negative impact on financial access and consumer protection.

16. **Although significant work has been done on the regulatory framework, new provisions are not organized in a coherent way and the sheer volume of new regulation raises concerns regarding supervisory capacity to enforce**. NBKR as a regulator and supervisor of banks and non-bank credit institutions monitors and enforces a variety of consumer protection provisions related to disclosure and transparency of information, unfair business practices, data protection and freedom of choice. Many of the amendments to existing laws and regulations, especially related to financial consumer protection of microfinance institutions, have recently been introduced. The piecemeal approach as well as the volume of recently issued legislation results in a voluminous and somewhat fragmented framework that contributes to potential gaps in coverage and poses challenges to the existing supervisory capacity of NBKR as well as to the absorption capacity of individual institutions.

17. **Several initiatives are currently underway to further strengthen the consumer protection and financial literacy framework.** The NBKR is in the process of establishing the institutional and legal framework for financial consumer protection, including the issuance of normative rules of conduct and the creation of a consumer protection unit at the central bank. Several working groups have been established with the aim to strengthen the financial capability levels of the Kyrgyz population. A financial education strategy is to be developed by the end of the year. In addition, an initiative has recently been launched to establish a financial ombudsman scheme.

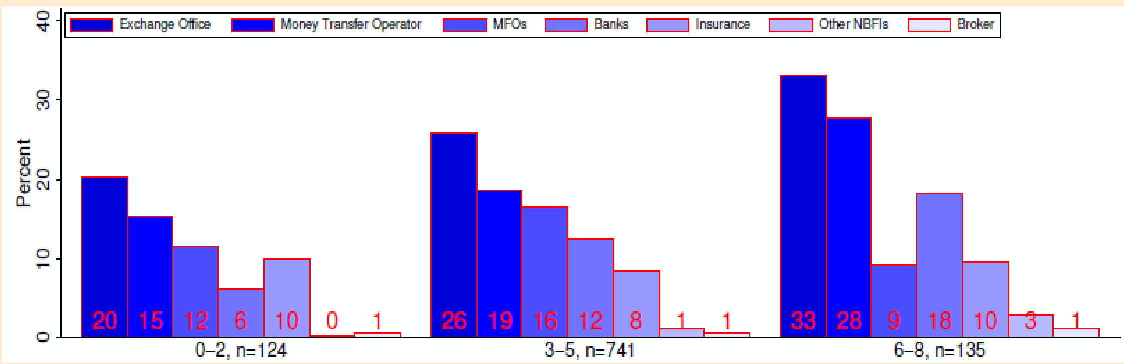
b. Financial Literacy

18. **Financial knowledge and skills enables consumers to make well-informed decisions about the products and services that best fit their needs.** As financial products and services become more sophisticated and households assume greater responsibility for their financial affairs, it becomes increasingly important for individuals to manage their money well, not only to help secure their own and their family's financial well-being, but also to facilitate the smooth functioning of financial markets and the economy. A well-educated consumer is able to understand consumer disclosures, the risks and rewards, and their legal rights and obligations. Based on this, a financially literate consumer will be able to make informed decisions on their choice of financial products and services. Such empowered consumers can play an active role in shopping for the best financial products and services - and the best providers that meet their needs. People who lack financial knowledge, on the other hand, either end up choosing financial products they do not fully understand or they may not even use them at all (see Box 2).

Box 2. Relationship between financial literacy and inclusion

Findings of the WB financial capability survey conducted in Tajikistan in 2013 show that the higher the level of financial literacy is, the more likely respondents are to use financial products from different providers. To capture financial literacy levels of the Tajik population, randomly selected respondents were requested to answer eight quiz-like questions regarding basic economic concepts, as well as questions to test their basic numeracy skills. Respondents were then categorized into three groups according to the number of questions they answered correctly. The figure highlights that compared to those who answered two or less questions correctly, those who scored better are more likely to use products offered by different types of providers.

Proportion of respondents who use financial products from different providers, by their financial literacy levels.



19. **Available evidence from the Kyrgyz Republic highlights the need for policy actions to boost financial literacy levels.** In 2013 a financial literacy survey was conducted in the Kyrgyz Republic by the International Finance Corporation (IFC) with the objective to assess people's financial literacy levels and to obtain information on their financial behaviors. According to this survey 60 percent of the respondents lack awareness and understanding of the term 'effective interest rate'. Much less, only around 10 percent of the survey participants were familiar with the term 'compound interest'. Similarly, the results of the focus group discussions which were conducted as a second part of this review show that the majority of participants lack understanding of basic financial concepts (see Box 3).

Box 3. Key findings of focus group discussions

The results of four focus group discussions with financially active adults suggest a number of priority areas for the national strategy. These results can by no means be interpreted as being nationally representative. They are, however, indicative of pressing areas which deserve policy attention. According to the analysis of the focus group discussions, participants show strengths in performing simple financial calculations but struggle to understand basic financial concepts such as inflation, compound and simple interest, the purpose of insurance products and lack awareness of the maximum amount covered by the Deposit Insurance Agency in case a bank goes bankrupt (see Figure 1). Other major findings are that participants appear to be very skilled in managing their day-to-day finances but struggle with setting funds aside for unexpected and old age expenses. The results further suggest that consumers do not widely report complaints or other conflicts with providers of financial services.

Figure 1: Proportion of participants who answered FL questions correctly

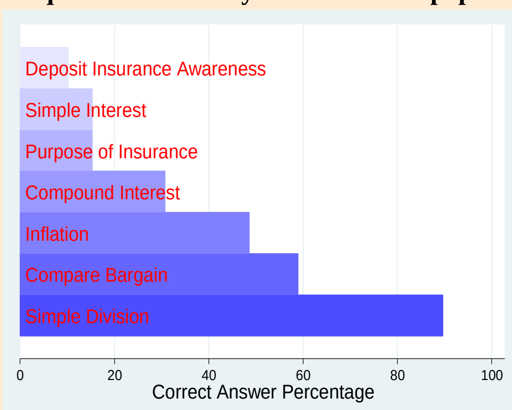
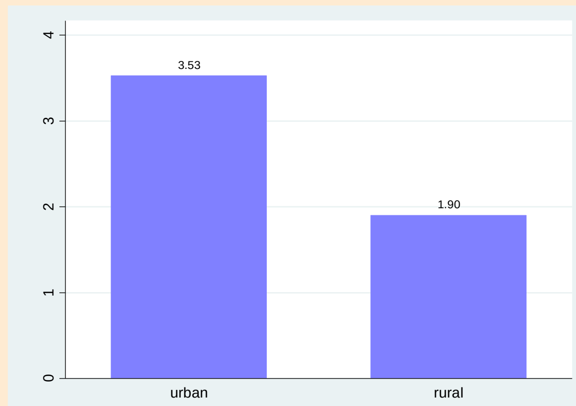


Figure 2: Average FL scores for urban and rural populations



The focus group discussions reveal the need for certain subgroups of the population to be specifically targeted with financial capability enhancing programs. As shown in Figure 2, a wide gap seems to exist between the financial literacy levels of rural and urban participants. While urban dwellers were on average able to answer 3.5 questions out of 7 correctly, their rural counterparts provided only around 2 correct answers. Similarly, Kyrgyz participants who migrated for labor purposes to other countries, answered on average less financial literacy related questions correctly than those who did not migrate to another country. Compared to non-migrants, migrant participants also appear to be more challenged with managing and monitoring their higher incomes and expenses.

II. *FRAMEWORK FOR FINANCIAL CONSUMER PROTECTION IN KYRGYZ REPUBLIC*

a. Legal and regulatory framework

Findings

18. **Significant work has recently been completed or is currently in process for the establishment of the legal and regulatory framework in a variety of important areas including disclosures, credit reporting, and others, for which NBKR should be commended.** But progress has in some areas been piecemeal with rules for consumer protection included in normative acts that deal primarily with other subjects. This piecemeal approach, as well as the sheer volume of recently issued legislation particularly in the microfinance area results in a voluminous and somewhat fragmented framework that may create difficulties for both financial institutions and consumers in understanding and application of the rules.

19. **The evolving legal and regulatory framework is complex and at times inconsistent, and poses a substantial burden particularly on smaller entities.** Over the last 1.5 years, more than 50 amendments to the legal and regulatory framework of microfinance organizations were put in place. While the larger financial entities have the size and human resources to incorporate the changes on their own, the many small players lack both human resources and capacity to understand and adjust their internal procedures and structures to the evolving regulatory framework. The frequency of changes is a considerable cost for both and support from the associations is not yet available.

20. **Microfinance loans and individual entrepreneurs are currently not covered by the deposit insurance scheme.** Deposits by individual persons who carry out entrepreneurial (income earning) activity without having registered a legal entity for this purpose, are currently not covered if the deposits are connected with that activity. This exception is likely to be difficult to administer and to unfairly distinguish between individual banking consumers, as there is very often no real distinction between the personal (family) funds of an individual engaged in small scale economic activities and the funds that are used for those activities. Moreover, neither microfinance organizations nor credit unions are currently covered by a deposit insurance scheme. This leaves around 1200 clients of the currently 12 deposit taking credit unions uncovered. Government plans to expand coverage to individual entrepreneurs, MFOs and credit unions are thus very timely and preferable from a cost-efficiency and risk pooling point of view but will have to be rigorously assessed regarding its impact.

21. **A dedicated legal framework for credit bureaus is currently lacking.** A draft law regulating credit reporting was adopted by the parliament in November 2013, but the law was returned by the President in January 2014 with a number of objections, including the absence of any identified state body responsible for the licensing and oversight of credit reporting activities. Credit reporting is currently accomplished through a single credit bureau, founded in 2003, that is run as a non-profit organization providing reporting services to more than 100 participating lenders. Participants may choose to be members of the organization and participate in its management (currently 37 in total) or may simply conclude a contractual agreement for exchange of information. Nearly all of the banks currently operating in the Kyrgyz Republic are full members of the bureau. In addition to the credit bureau, a credit registry is currently being established through the NBKR. The credit registry is designed to allow banks and other lenders to receive information on other loans that a borrower may have. Provision of information to the credit registry is mandatory.

22. **There is a significant market for the transmission of remittances from the Kyrgyz Republic's large migrant labor population, and money transfers are one of the most commonly used financial services.** There are three formal channels for sending remittances: money transfer operators (MTOs), bank accounts and transfers via Kyrgyz Post with almost all remittances entering via MTOs. The market appears to be quite competitive, with services available through a number of money transfer systems. Results from the focus group study suggest that users of such services are highly positive about the performance of these remittances systems. Neither migrant workers nor remittances receivers who participated in the focus group discussions mentioned any negative experiences in sending or receiving money (mainly from Russia). According to the focus group participants, transfer fees are quite low, with an average of 1 to 3 percent depending on the amount transferred and the country of destination. During the focus group discussions, participants further explained that a passport is the only requirement for sending and receiving money and that transactions are done almost instantaneously, literally within 15 minutes of dispatch. Counterparts generally agreed that problems and complaints concerning both remittances and payments transfers are not a common occurrence. At the same time, NBKR has expressed a desire to increase its oversight over payment flows and the payments system in general, for the purposes of combatting money laundering and also for the protection of consumers. A draft law "On the Payments System in the Kyrgyz Republic" that is now in the process of passage contains some general provisions on money transfers.

23. **The development of mobile financial services is still at very nascent stage of development but is seen as an important means to provide services to the unbanked population.** Most forms of mobile banking are not yet available at all. There is, however, very strong interest in the development of mobile phone banking as a means to provide services to the large mass of currently unbanked consumers. The mobile phone networks have wide coverage and voice and text services are reported to be affordable and widely used, making this a potentially promising direction for rapid expansion of access to banking services. Although the legal and regulatory frameworks are not yet well developed, work on this is in process.

Recommendations

24. **A draft Banking Code currently in development takes a unified approach and offers an important opportunity to address both institutional authority and substantive consumer protection rules and to bring more order and coherence to the legal framework.** The draft Code directly establishes broad requirements for market conduct in relation to clients and authorizes NBKR to issue regulation containing further detail in a variety of areas as well as strengthening and clarifying the NBKR mandate in this area. Substantive rules address important issues including disclosures and dispute resolution, but need to be further elaborated and clarified in a number of areas (advertising and public disclosures, regular communication with clients, requirements on early repayment of loans, restrictions on changes in contract provisions and others). The process of bringing laws and normative acts into compliance with the provisions of the Banking Code will also offer an opportunity for NBKR to bring greater order to the normative legal framework and to consider the consolidation of some of the many existing provisions into a more coherent and compact framework that is easier for financial institutions to apply, consumers to understand and NBKR to supervise.

25. **Further expansion of coverage of the deposit insurance scheme should be considered preceded by a rigorous analysis of the implications of such an expansion.** Exclusion of the deposits of individual entrepreneurs from the deposit guarantee is likely to create administrative complications, and may unfairly disadvantage small farmers, traders, and craftspeople and discourage them from using the banking system. Steps toward eliminating this exception from the guarantee scheme should continue as quickly as is reasonably possible. Moreover, further consideration should be given to bring deposits of MFOs and credit unions under the guarantee scheme. However, a detailed analysis will need to be conducted first to determine whether the Deposit Insurance Agency would be able to cover those deposits and at what level of contribution.

26. **Passage of the law on credit histories will be required to allow the creation of enforceable legal standards in the credit reporting industry, including standards for the protection of consumers who are the subjects of credit history reporting**. A determination will need to be made concerning the appropriate entity to perform the licensing, regulatory and supervisory tasks required. NBKR, as the regulator for most lenders and a member of the existing credit bureau, appears to be the state body best placed to perform these functions. Additional resources should be provided to NBKR if necessary for the fulfillment of these tasks. The new unit responsible for consumer protection within NBKR should participate in the work, in particular in the creation of appropriate regulations concerning consumer protection issues.

27. **The NBKR should, in connection with the passage of the draft law on the payments system and with the participation of those providing payments services, consider the issuance of rules containing minimum standards for consumer protection in relation to money transfers**. These rules should more clearly define the information that must be made available to consumers prior to use of the service, the form and content of records and of documents (receipts) that must be provided to senders and recipients, and clear rules concerning the minimum protections for consumers (senders and recipients) in the case of mistake or fraud.

28. **The NBKR should start developing rules and instructions regulating the provision of mobile banking services services to consumers.** A first priority at the present time should be improvement of consumer protection in relation to the types of accounts and services that are currently offered to consumers in the Kyrgyz Republic. However, it is clear that the types of services are beginning to expand, and also that mobile banking services in particular are likely to be an important tool to increase the access of Kyrgyz citizens to banking services. Given the difficulties experienced by the banking system in recent years and the correspondingly low levels of consumer trust in banking services, it will be quite important for effective consumer protection standards on mobile banking to be in place as those services are rolled out to the population. Significant consumer difficulties with mobile banking services could frustrate plans to make mobile banking a strong component of systemic development and expansion of financial inclusion.

b. Institutional arrangements for financial consumer protection

Findings

29. **Regulatory authority and enforcement responsibility for consumer protection in the banking and non-bank credit institution sector are not clearly assigned.** Banking legislation makes NBKR responsible for protection of depositors and creditors, and also specifically for enforcement in relation to its licensees of antimonopoly legislation, including rules on unfair competition. Some counterparts viewed this as sufficient to provide NBKR with authority in the area of consumer protection. References to protection of depositors and creditors, however, can also be understood to refer to prudential supervision (an interpretation consistent with the structure and remaining content of the banking legislation). The lack of a clear legal assignment to NBKR of authority and responsibility for protection of all users of banking and services may raise questions about the scope and extent of NBKR's authority in this area and may force NBKR to address issues of bank conduct in relation to clients through prudential supervision and competition law tools and concepts that are less clear and efficient than is desirable.

30. **The State Agency for Antimonopoly Regulation on the other hand is responsible for enforcement of a general consumer protection law.** The law is broadly drafted to cover all kinds of goods, work and services, but its provisions are more appropriate to everyday consumer goods than to financial products and the Agency would currently interpret the law's definition of "consumer purpose" to exclude coverage of interest bearing bank deposits and any other financial product that earns income. The Agency lacks any experience in addressing banking or other financial matters and a single staff member in the central office[6] is now assigned to address all financial markets issues. Agency counterparts explained that a focus of consumer protection activity to date has been the protection of consumers through oversight and control of tariffs and fees on important consumer items (e.g. utilities, transportation) and that it would need assistance to develop other appropriate approaches. Just recently the Agency has recently initiated a study of consumer lending by banks to determine whether general consumer protection norms are being violated.

[6] Out of 81 total staff in the head and 9 regional offices.

31. **Despite the lack of a clear legal mandate for banking consumer protection, NBKR has been taking important steps to regulate bank conduct in relation to consumers, and to create institutional structures and enforcement channels, for which it should be commended.** NBKR has included provisions addressing financial consumer protection issues in a significant number of recent regulations, including those addressing risk management, internal bank procedures, and competition issues. A specialized consumer protection unit within the NBKR legal department is expected to have its first staff and begin operation soon and regulation now provides explicitly for a NBKR role in addressing consumer complaints. Draft amendments to regulations on supervision would further clarify its ability to address consumer protection issues through the supervision process and to employ supervisory measures. The draft Banking Code that is currently in development takes a clearer and more comprehensive approach, establishing broad requirements for market conduct in relation to clients and authorizing NBKR to issue and enforce regulation containing further detail.

32. **There are a few existing consumer protection associations however they lack resources and do not directly deal with financial consumer protection matters.** Financial issues and banking concerns do not appear to have been a topic of work for the existing consumer associations in the Kyrgyz Republic. Due to their wide focus and a lack of resources and specialized training, consumer organizations are not yet effective in supporting proper financial consumer protection environment in Kyrgyz Republic. Moreover, consumer associations have so far not taken active part in legal and regulatory consultative processes initiated by NBKR or other stakeholders.

Recommendations

33. **Efforts to expand and clarify NBKR's role in banking consumer protection should be continued through ensuring that the new Banking Code contains a clear and appropriate NBKR mandate and tools in this area.** Although the draft amendments to the regulations on supervision allow only limited supervisory measures to be imposed in relation to consumer protection problems, it is important for NBKR to have a clear ability to include consumer protection issues in supervision processes while the Banking Code and associated regulations are being refined and adopted. And it is particularly important that the new Banking Code provide not only for NBKR ability to regulate further in narrowly specified areas, but also for a clear general mandate for protection of consumers (and of other banking clients) and the ability to use regulatory and enforcement tools to achieve this end.

34. **It will be important that NBKR finalizes steps to form its new consumer protection unit.** The consumer protection division within NBKR which is currently under formation will need resources and support for human capacity building, as well as appropriate regulatory support to ensure that it receives needed information and has effective channels for reaction in handling complaints. Immediate priorities for the new consumer protection unit within NBKR, in addition to staffing, will have to be the establishment of working procedures, dissemination of contact information through individual institutions and other channels, and creation of a reliable flow of information on the kinds of problems that banking consumers are encountering and whether those problems are appropriately resolved by banks

and microfinance institutions. Resources should be sufficient to allow the unit not only to take over the task of addressing complaints directly received by the NBKR, but also to monitor and respond to information on consumer concerns received from individual institutions and to carry out effective coordination with consumer bodies, industry associations, and other state bodies involved in banking activities. International experience shows that financial consumer protection departments within the financial regulator are typically tasked with a number of objectives and responsibilities, ranging from core supervisory activities (e.g. on-site inspections, off-site supervision and market monitoring) to broader financial consumer protection activities such as rule-making, enforcement complaints handling and financial education. Given the limited supervisory capacity, it may be wise to develop an initial risk-based agenda that determines immediate priorities and leverages resources for optimum impact.

35. In light of severe capacity constraints and to avoid conflicts with market conduct regulations issued by NBKR, the State Antimonopoly Agency should not separately enforce the provisions of the general consumer protection law against financial institutions. A form for the interaction of the Agency and NBKR should be defined by regulation or by an agreement or Memorandum of Understanding (MoU) between the bodies. A pattern that might be appropriate at the present time would be a more formalized Agency responsibility to produce a periodic report on competition and consumer protection issues, which in the banking sphere would be discussed with NBKR and then publication and/or delivery to the Government and other state bodies. This would provide for alternate views and approaches to be aired while maintaining clarity on the roles.

40. The role of consumer organizations in financial consumer protection should be strengthened. Consumer associations could play an important role in raising awareness of financial consumers' rights, monitoring business practices (for example by mystery shopping[7]), and giving advice to consumers, among other activities. Grant funding for specific projects and technical assistance could be provided to consumer organizations to develop a more effective consumer protection role. The NBKR should involve such organizations in consultative processes, for example on regulations and draft laws, in order to ensure that the voice of consumers is heard during the formulation of financial services policies and the rules that flow from them.

[7] Mystery shopping or a mystery consumer is a tool externally used by market research companies or watchdog organizations or internally by regulators themselves to measure quality of service or compliance to regulation, or to gather specific information about products and services. The mystery consumer's specific identity is generally not known by the establishment being evaluated.

III. CONSUMER DISCLOSURE

Findings

34. **Recent legal amendments to enhance disclosure and transparency, in particular in the microfinance industry, in many instances follow international best practice.** International experience shows that measures to enhance the transparency of lending conditions can play an important part in enhancing consumer protection, as they allow the client to compare lending conditions between institutions, and to take an informed decision. A number of important provisions along those lines were introduced by the NBKR. For example, for microfinance institutions, disclosure of annual effective interest rates, commission fees and nominal payment schedule was made mandatory, as well as a requirements introduced to make information on general loan conditions publicly available in a dedicated area of each branch. Furthermore, the framework provides for compounded interest rates to be used. In addition, a special memo from the NBKR and standardized Annex informing the client of his rights and responsibilities has to be signed by the client to ascertain reception of adequate information.

35. **The presented information has the potential to be overwhelming for the client, and is not very efficient in creating transparency for comparison across entities.** For example, instead of presenting the most relevant facts in one single factsheet, the information is spread over the document and annexes. Given the low overall level of financial literacy, the wealth of presented information is likely to overwhelm the borrower, and also leaves room for the loan officer to select the information to highlight. As noted during visits to the selected entities and in line with findings of on-site supervisions, the staff of financial entities does not necessarily understand the complex calculation of the interest rate and many errors are reported. The publicly available information is usually presented in the form of a “booth”, and requires scanning of pamphlets to retrieve the relevant information. Interest rates are either presented in nominal terms, or not disclosed at all. This makes comparison shopping more difficult and time consuming. The NBKR includes on its website information on interest rate, but the information is not easy to find, and both nominal and effective interest rates are presented in different files and locations.

Recommendations

36. **The disclosure framework should be revised to simplify requirements, reduce cost of compliance, and increase impact.** International experience shows that one page long key facts statements are the most efficient way to create transparency in lending. The factsheet could for example include information on the effective annual percentage rate, the monthly installments broken down by component, and the commission fee, and provide concrete information on cooling off, early repayment and options and contacts for dispute resolution. Prior to its launch, it would be beneficial to undertake consumer testing of key fact statements in order to ensure that the presented content is properly understood by consumers and that the format covers all necessary information.

37. **Disclosure and transparency of interest rates and terms and conditions on consumer loans should be further enhanced.** Publication of the effective interest rates offered by various financial institutions on the NBKR website, with parallel distribution mechanisms for consumers without internet access, can help bring down interest rates as well as spur more effective competition among financial institutions. NBKR could compile comparison tables of fees, charges and effective interest rates and publish them on its website. NBRK needs to ensure, however, that this information is easily accessible and presented in an understandable way. As a complement to the webpage, price comparison tables could also be made available through newspapers and the industry associations. This would be especially beneficial for microfinance clients as publicly available pricing information tends to be difficult to access. Considerations should be given to revising advertising rules to ensure that they are consistent and clear as well as readily understandable and comparable to the consumer. It is recommended that advertising use as a single comparable measure, such as the effective interest rate, to allow consumers to compare credit products.

IV. BUSINESS PRACTICES

Findings

38. **The NBKR also issued a number of legal amendments and regulations to improve business conduct in the financial sector.** This includes the requirement that internal pricing policies and pricing changes be notified to NBKR, minimum documentation requirements and assessment standards for credit evaluations, and requirements for internal risk management standards, as well as the newly introduced usury law that introduces interest caps for lending activities. However, anecdotal evidence suggests that overall business practices of microfinance organizations and credit unions continue to pose consumer protection concerns, especially in relation to creditworthiness assessment and disclosure practices. Low levels of capacity in management and staff in many of the smaller institutions contribute further to challenges in ensuring that those institutions duly collect and assess information about consumers in order to provide them with suitable financial products.

39. **The recently passed usury law has the potential to have a negative impact on financial consumer protection by pushing low-income clients into the informal market where they have no protection.** It is unclear whether the usury law is meeting its objective of protecting the borrower, rather than simply increasing the complexity of lending and pricing schemes and excluding borrowers at the margin. Banking sector data indicates a significant increase of fees and commissions that may be a consequence of the law's introduction, while the maturities of loans provided by microfinance entities increased.[8] Anecdotal evidence also suggests that some microfinance organizations have shifted into informality.[9]

40. **At the same time, the increasing number of unregulated pawnshops poses risks to consumers.** Until 2009, pawnshops were licensed by the NBKR, and provided basic information on a regular basis. This requirement was however dropped in 2009, leading to an explosive growth of the sector from 189 entities at the end of 2008 to the currently estimated 699 entities[10]. According to anecdotal evidence, most pawnshops and moneylenders do not provide written contracts and lack basic transparency and disclosure standards in their operations. The average reported interest rate of pawnshops stood at 130 percent in 2008, and reportedly continues to increase. There are also reports of abusive enforcement practices. A law has recently been passed requiring licensing of pawnshops, but this task has not been assigned to a government body.

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[8] In the banking sector, the income from services and commissions as a share of total income spiked from 6-9 percent in earlier years to 16.2 percent in 2013.

[9] 17 institutions closed within three months of the adoption of the law.

[10] Most recent data as of August 2012.

41. **There is a code of conduct applicable to the microfinance industry, while a code of conduct for the banking sector has not yet been developed.** The Association of Microfinance Institutions (AMFI) issued an Ethics Code in 2010. The Code is mandatory for all members, and accordingly was signed by all 34 members. The Code aims at safeguarding the reputation of the members, and establishes as core values (i) transparency, (ii) high quality of products and services, (iii) equality for all members and clients, and (iv) professionalism at every level. It already provides for fair and transparent disclosure requirements, right to early repayment, clarity in language, and information on consequences of failure to the obligations assumed under the contract, and non-offensive debt collection. However, the wording is very general and requires further implementation guidance. There exists currently no code of conduct for banks.

Recommendations

42. **Reconsider the introduction of interest rate caps due to their limited effectiveness and the potential to drive lenders to informality.** While there is some evidence that interest rates for microfinance loans have gone down since the introduction of the usury law, several negative tendencies in the market call for a careful impact assessment of the usury law while comparing its cost effectiveness with alternative measures. Enhanced disclosure and transparency of loan terms and conditions have proven to have a positive effect in bringing down interest rates and spurring more effective competition among microfinance organizations. A national price comparison website established by the financial regulator in Peru, for example, has increased competition and reduced consumer prices.[11]

43. **In addition, considerations should be given to bringing pawnshops under the consumer protection regime of NBKR.** It is recommended that pawnshop clients receive the same protection as other microfinance clients, particularly with regard to disclosure and complaints handling provisions and procedures. While the law on licensing was amended in October 2013, reinstating the requirement for pawnshops to be licensed, no supervisory agency is yet assigned. As the NBKR is the supervisor of all other entities that conduct banking services, as has previous experience with supervising them, it would be best suited to assume such as role.

[11] The Superintendence of Banking, Insurance and Private Pension Funds of Peru found that online publication of consumer loan rates reduced the average consumer lending rate by 1000 basis points (or ten percentage points) at the time of stable interest rates – see http://www.sbs.gob.pe.

45. The development and further strengthening of industry Codes of Conduct for banks and non-bank credit institutions would benefit consumers. The Union of Banks should revisit the question of development of a basic voluntary code of conduct or code of ethical principles with member banks and facilitate the beginning of work on such a code. It might be beneficial for work on such a code to be connected with the work the Union of Banks is already doing on customer concerns, such as the meetings that have been held to discuss the borrower issues that have been the subject of public attention in recent months. A voluntary code of conduct might be seen as a responsible and desirable step on the part of banks in addressing such concerns. It is recommended to further promote the adoption of the Ethics Code within the microfinance sector and provide more guidance material on its application.

46. Proper training of credit officers needs to be ensured in order to strengthen sound and transparent business practices of microfinance organizations and increase their efficiency. The Banking Training Center currently offers capacity building courses. However, the main target audience of these training programs is so far limited to management officials. The low level of capacity in management and staff noted during the mission requires a move away from the ad hoc provision of uncoordinated and limited training toward a system of formalized training and dissemination of best practice. Possible institutional approaches in the medium to long term include (i) identifying a private or public training facility that could add capacity building courses for microfinance institutions and credit unions into its curriculum, and (ii) establishing a separate training center, possibly together with the Union of Kyrgyz Banks.

V. DISPUTE RESOLUTION MECHANISMS

Findings

47. Legal rules do exist establishing some requirements and standards for internal complaints handling by financial institutions, but these are contained in a number of legal acts and do not form a coherent whole. For example, the requirement that banks maintain a journal for customer complaints and comments as well as time frames for response to customer complaints are specified in different legal acts. In addition, the law on microfinance stipulates that the client be informed of the complaint procedure and the contact person responsible for receiving requests while there are no requirements for internal statistics and processes. A single normative act on proper handling of customer complaints would provide both financial institutions and consumers with clarity that is now lacking.

48. Overall, consumers lack any direct channels to quickly and effectively resolve disputes that are not resolved by the financial institution's own initial complaint procedures. Counterparts reported that court processes are long and costly and that consumers do not tend to resort to the courts except in relation to enforcement proceedings against their property that have already been initiated by banks. Only a few consumers are currently raising complaints with regard to financial institutions and the services they provide. This can be attributed at least partially to the absence of accessible complaint mechanisms as well as the lack of a lacking 'complaints culture' in the country. NBKR is dealing directly with consumer complaints and inspectors may sometimes ask to review institutions' records on the issue (such as the required journal of complaints and suggestions). In 2013, NBRK received a total of 985 written complaints. In large, these have been complaints concerning the unwillingness of an institution to restructure, or forgive, a debt that was legally contracted but that the consumer is not able to pay. In addition, NRKR and its regional offices receive more than 100 calls weekly from citizens concerning financial services and the operation of the central bank. However, NBKR cannot directly resolve a large number of individual consumer complaints.

49. **Initial steps to develop external dispute resolution mechanisms have been undertaken by the Kyrgyz authorities to address the current lack of easily accessible and speedy alternatives available to consumers.** Currently there is no financial ombudsman or any institution performing similar function in Kyrgyz Republic. A working group has recently been established under the Coordination Council for Microfinance Development (CCMD) comprising financial regulators, industry associations and private market participants to work on the establishment of a financial ombudsman but no progress has been made so far.

Recommendations

50. **It is recommended that NBKR develop and adopt normative legal regulation defining appropriate internal complaints handling procedures for banks and non-bank credit institutions.** This will provide NBKR with systematic information on the nature and frequency of consumer problems as well as the levels of institutions' observance of legal and regulatory requirements in relation to consumers. Consumer experiences with banks and non-bank credit institutions will in large part determine overall levels of trust in and willingness to use the financial system, in turn affecting system stability and the achievement of policy goals, such as increasing non-cash settlements in the economy as a whole.

51. **In addition, banks and non-bank credit institutions should be required to submit periodic complaints statistics.** Without a regular reporting requirement, the newly forming consumer protection unit within NBKR will lack critical information needed for it to function effectively. At a minimum, the suggested reports should allow NBKR to see patterns and trends in consumer complaints. It may also be useful to require the inclusion of some indication of the means by which complaints have been resolved, although this is a more complicated exercise.

52. **Further steps should be taken in developing a financial ombudsman scheme for Kyrgyz Republic.** It is recommended that the working group conduct a detailed analysis of complaints statistics (courts, NBKR, individual institutions) as well as the suitability of the existing complaints handling mechanisms. Based on the data analysis as well as the review of international experience and best practice[12], a concept should be developed by the working group on the most appropriate institutional set-up for a financial ombudsman in Kyrgyz Republic. A number of design issues will need to be considered including the legal framework under which a financial ombudsman could operate, governance structures, coverage of the ombudsman scheme, funding, accessibility and accountability.

[12] A World Bank note on financial ombudsman schemes was shared with NBKR in December 2013.

VI. FINANCIAL EDUCATION

Findings

53. **Financial capability levels in the Kyrgyz Republic appear to be low, even though comprehensive, nationally representative, and precise evidence is scarce.** An individual-level survey on financial literacy has been undertaken in 2013 which shows low levels of financial capability in the Kyrgyz Republic. However, the sample size of this survey has been rather small and the data was collected through computer-assisted telephone interviews which limit the reliability and precision of the survey results as well as the depth and complexity of the covered topics. The key findings of the four focus groups discussions which were conducted as a second part of this review confirm low levels of financial capability among the selected participants (see box 3). They do not allow, however, for extrapolation of the results to the general population.

54. **A few financial capability enhancing activities in the Kyrgyz Republic undertaken by public or private institutions exist, but they have been largely uncoordinated and untargeted.** The NBKR conducted several public education campaigns through mass media outlets. Private financial institutions and industry associations, in particular in the non-banking financial sector have also been active in initiating financial capability programs. Commercial banks, on the other hand, appear to have no financial education initiatives outside of materials handed to clients to explain their products and services as well as credit counselling sessions when issues arise with loans.

55. **Important steps have recently been taken which are geared towards increasing financial literacy levels of the Kyrgyz population:** (i) a high policy-level interagency working group chaired by the vice prime minister has been established for the development and implementation of a national financial education strategy. At the same time, (ii) an expert working group has been established under the Coordination Council for Microfinance Development (CCMD) in the Kyrgyz Republic which is tasked with the drafting of the national financial education strategy based on the results of their planned demand-side financial capability survey and their findings from an initial stocktaking of existing financial capability enhancing initiatives. In addition to these efforts, another working group has been established under the banking union.

Recommendations

56. The development of the envisaged financial education strategy requires extensive coordination between different working groups and a wide consultation process including relevant stakeholders from the public, private and non-profit sector. To ensure ownership and provide focus and momentum in the process of developing the national strategy extensive coordination and communication is needed between the interagency working group chaired by the vice prime minister and the expert group established under the Coordination Council for Microfinance Development (CCMD) which is tasked with the actual drafting of the concept and a subsequent national financial education strategy. Furthermore, to avoid overlaps and duplications, better coordination is needed between the expert group under the CCMD and the financial literacy working group established by the banking union. It is recommended to conduct monthly coordination meetings between the technical level working groups of the CCMD and banking union as well as quarterly briefing meetings with the high-level Inter-Agency Working Group.

57. Consider extending membership of the CCMD financial literacy expert group to a broader range of stakeholders. The expert group under the CCMD[13] needs to comprise a wide range of stakeholders to ensure wider consensus building about the importance of financial education, knowledge exchange, and most importantly to secure overall support and funding of the development and implementation of the strategy. There are, however, a plethora of other stakeholders from public, private and non-profit sectors which could provide additional insights to the working group (e.g. the deposit insurance fund, the credit bureau, the antimonopoly agency, etc.). A consultation with a wider range of stakeholders would also be helpful to mitigate the risk that scarce resources are inefficiently allocated or certain needs in the population remain unaddressed.

58. It is recommended that the strategy and subsequent programs give special emphasis to migrants and rural populations. Given that total remittances transfers (both inflows and outflows) account for 42 percent of the GDP and that migrants demonstrate weaknesses in the area of understanding of financial concepts as well as managing their day-to-day finances and planning ahead, a potential target group of the financial education strategy could be migrants and their families. The results of the focus group discussions also suggest the need to extend financial capability enhancing programs to rural populations.

59. To validate the focus group results and create a baseline against which the impact of financial capability enhancing initiatives can be measured, it is recommended to conduct a comprehensive and nationally representative financial capability survey. This financial capability survey should cover awareness and understanding of basic financial concepts and products. Since knowledge does not always translate into proper action, it should also capture attitudes, such as impulsiveness, farsightedness and action orientation as well as behaviors related to day-to-day money management, planning for unexpected and old age expenses, choosing and using financial products and using information and advice. In order to get a better understanding if people in the Kyrgyz Republic benefit from the financial products they use, it is further recommended to measure their reported incidences of conflicts with financial service providers and their levels of satisfaction with different types of financial products they used.

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[13] Currently, the expert group comprises four government agencies, four industry associations, and four multilateral and bilateral donor organizations.

60. **Representative, reliable, and precise survey results which effectively inform policy objectives require careful consideration to be given to the questionnaire design, the sampling methodology, the mode of interviewing, and data analysis and interpretation.** In particular, careful consideration should be given to the size of the sample of individuals to be interviewed, the use of standard probability sampling methods, the design and customization of the questionnaire, the training of supervisors/enumerators in administering the survey, the conduct of a small pilot survey, the use of face-to-face interviews, the monitoring of the fieldwork, and the proper analysis and interpretation of the collected data.

61. **In addition to the financial capability survey, the design of financial education programs should be informed by the results of rigorous impact assessments of similar programs in other countries.** Even though the impact of financial education programs is context dependent and may vary within and between countries, relying on previous experience is expected to increase the effectiveness of newly designed programs. For instance, recent research shows that financial education works best, when delivered to adults during teachable moments[14].

62. **Financial capability enhancing initiatives should be tested initially on a small scale and only be rolled out upon rigorous evaluation of their positive impacts.** International experience shows that increasing the number of financial capability enhancing programs does not always lead to desired outcomes in terms of enhanced financial capability levels among the targeted populations. It is therefore crucial to identify programs which are most effective. When properly done, a Randomized Control Trial (RCT) is the best possible methodology for identifying the causal impact of a financial education initiative.[15] Only those programs which prove to be most effective should receive wide support.

Box 4. Impact assessments of financial capability targeted at migrants and their families

A recent RCT from Indonesia shows, that targeting not only remittances senders but also their families is expected to deliver promising results (see Doi et al., 2012)**.** The study also shows that providing financial literacy to migrant workers and their families at a teachable moment, when they are more likely to be receptive to new information as they can relate it directly to their own lives can have huge value too. Right before the migrant leaves, could offer such a moment as migrants and their families will not have the familiarity with different methods of sending and receiving remittances. At that time they will not have formed any habits either on how to effectively manage their new and relatively higher earnings. Simple actions such as providing guidance on budgeting, record-keeping, and financial planning can help migrant workers – and their families – gaining control over their financial lives and make realistic plans for the future.

Evidence from Australia and New Zealand further shows that financial education offered to migrants can increase the development impact of remittances by changing migrant's knowledge about the costs of remitting and leading them to rely on less expensive remittances channels (see Gibson et al., 2013). On the other hand, the study finds that teaching migrants that bundling smaller transactions into a single large transaction saves costs ultimately did not change the frequency or the level of remittances.

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[14] Teachable moments are times in people's lives when they are more likely to be receptive to new information.

[15] In this method, similar to a clinical trial, participants are randomly assigned to treatment and control groups, whereby the treatment group receives the financial capability intervention and the control group does not. The control group forms then the basis of comparison against which the change in outcomes of the treatment group can be assessed.