

## STATE POLICY OF CONSUMER PROTECTION IN THE DIGITAL FINANCIAL SERVICES MARKET IN UKRAINE

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### Abstract

The rapid development of digital financial technologies in Ukraine leads to the emergence of new risks and to significant consumers' losses in the financial market. The aim of the study is to develop strategic directions of state policy of consumer protection in the digital financial services market considering the best world practices and features of the financial system of Ukraine.

System scientific analysis was used to study the possibilities of implementing international quality standards for digital financial services in Ukrainian legislation. The method of statistical analysis of data was used to form the imperial basis of the study.

Based on the global experience and taking into account the peculiarities of Ukrainian fintech market the state policy should consist of three strategic directions: 1) create a system of legal regulation of the mechanism of protection of consumers' rights of digital financial services; 2) introducing a risk-oriented approach to regulating the digital financial services delivery process to consumers; 3) strengthening of digital financial literacy and public awareness. Such state policy will form a reliable system of consumer protection in the digital services market in Ukraine.

**Keywords:** financial consumer protection, digital financial services and products, public policy for consumer protection of digital financial services.

**JEL Class:** D18.

## INTRODUCTION

The financial technology market (Fintech) is one of the fastest growing and holds leading positions in the dynamics of its development in terms of both financial performance and number of users. Experts from different countries note that over the past five years, the number of users of financial technologies has been increasing by 15–20% annually [Private financial ..., 2018, access 1.02.2020]. Moreover, the distribution of Fintech products occurs in different consumer segments. Most of Fintech users no longer imagine their usual day without the use of technology. Thus, every third inhabitant of a large city (about 1 million inhabitants) uses more than two Fintech services on average daily. Experts estimate the spread of financial technology in Ukraine at 50% [Fintech. Guide..., 2018, access 10.02.2020].

A key factor driving the development of the financial technology market is the development of the Internet and digitalization. If at the beginning of the path of its development the market of financial technologies was limited to receiving payments and electronic money, now at the present time the most widespread is received by a number of services: P2P consumer lending, P2P property lending, balance sheet consumer lending, donation-based crowdfunding, demand deposits, saving accounts, P2P mobile payments, foreign exchange and remittances, cryptocurrency wallets, cryptocurrency exchange and trading, wealth and assets management, personal financial management, P2P insurance, usage-based insurance, robo advisors and etc.

Financial digital products and services bring significant benefits to a consumer. They reduce the value of a financial product, promote financial inclusions, help people to avoid extra commissions, save time for consumers, improve personal financial management, and increase well-being. However, digital financial services (DFS) carry significant risks, such as: insufficient security of systems while storing personal data, disability of systems that impede access to funds, inconvenient interfaces that increase the number of erroneous transactions, insufficient liquidity of providers of DFS, lack of guarantees of a returning money accumulated in non-bank financial institutions accounts, digital fraud and more. This creates new challenges for financial regulators in the form of a state regulatory policy for the protection of consumers of digital financial services.

The main purpose of research is to develop approaches for state policy for the protection of consumers of digital financial services in Ukraine, considering the high-level principles for digital financial inclusion and their practical application in the field of protection consumer rights in DFS.

## 1. THE RESEARCH METHODOLOGY

To study the current situation of the development of the digital financial services market in Ukraine the method of statistical data analysis was applied. The sources of data were materials from international consulting agencies, the Ukrainian Association of Fintech and Innovation companies, the National Bank of Ukraine, VISA company, Agency for International Development, (USAID). The systematic scientific analysis of the existing domestic legal field in the given direction was used in the development of conceptual foundations of the policy of protection consumers of digital financial services, and the prospects of harmonization of Ukrainian legislation with international standards were explored. When using the method of analogy, analysis and synthesis, and the method of theoretical generalization the strategic vectors of construction of the mechanism of consumer rights protection in DFS in Ukraine were developed.

## 2. THE RESEARCH RESULTS

The digital financial services market is booming in Ukraine. There are several reasons for this. So, as of 2019, the proportion of people using the Internet was 65%, the penetration rate of smartphones was 70%, the coverage level of 3G and higher was 62% [Ukrainian Institute..., 2020, access 2.02.2020]. The Internet and its speed in Ukraine are constantly improving, also because of reducing the cost and increasing the access, especially in the mobile Internet. Continuous investments and support for high-speed internet contributes to the development and use of fintech services and products in the country.

The level of penetration of financial services is increasing every. The proportion of people aged 15+ who had an account with a financial institution was 63% (22.5 million), 49% had a debit card, 39% used a card to make a purchase, 29% – used the internet to pay bills or make payments, 18% used the internet to access a financial account in 2017 [Fintech. Guide..., 2018, access 10.02.2020]. The share of non-cash transactions in the total volume of payment card transactions increased from 25.0% in 2014 to 49.7% at the end of September 2019 [Strategy of development..., 2020, access 10.02.2020].

The transition to digital finance is happening at a tremendous speed. In these circumstances, digital financial product and service providers have prioritize customer needs. Internet and mobile banking have significantly increased the number of banking transactions provided through these systems. Ukrainian banks offer to use smartphones not only to pay for goods and services, but also to receive payments. Innovative banks provide clients with multichannel service in 24/7 mode („State Savings Bank of Ukraine”, „PrivatBank”, „UkrSibbank” and

others). It became possible for Ukrainian consumers to apply for a loan through ATMs and SMS. Several direct credit platforms (P2P) have been launched. The technology of contactless payments is actively used by consumers. MasterCard, PayPass and Visa payWave allow to perform transactions simply by lifting a plastic card to the terminal. Electronic wallets are actively used when a payment is made in a point of sale.

The level of penetration of financial services continues to grow rapidly owing to the support of the development of state-level fintech market. Thus, in 2018, financial sector regulators have included the development of fintech as one of the priorities in the Comprehensive Program for the Development of the Financial Sector of Ukraine until 2020. The Cabinet of Ministers of Ukraine has identified the financial technologies and cashless payments as a strategic direction in the Concept of Development of the Digital Economy and Society of Ukraine for 2018–2020. In April 2019, the National Bank of Ukraine established an Expert Council on communication with innovative companies wishing to work in the financial market [Comprehensive Program..., 2018, access 15.03.2020].

According to an analytical study of the Ukrainian Association of Fintech and Innovation Companies there are more than 100 fintech companies operating in Ukraine, most of which have emerged in the last three years. Fintech providers work in the following areas: payments/money transfer – 38, mobile wallets – 22, digital/neobanks – 8, technology and infrastructure – 36, consulting/analytical systems – 26, personal and consumer lending – 10, business lending – 5, insurtech – 6, cybersecurity/anti-fraud – 11, regtech – 5, personal finance/wealth management – 6, digital comparison tool – 3, legaltech – 4 [Catalogue of fintech..., 2019, access 8.02.2020].

The rapidly growing consumer interest in Fintech products and the lack of a regulatory framework for regulating financial intermediaries in the face of implementing of innovative technologies and developing of new Fintech services with significant risks necessitate the creation of conceptual frameworks of state policy for protection of digital financial services users.

In January 2020, the National Bank of Ukraine, the National Securities and Stock Market Commission, the National Commission for the State Regulation of Financial Services Markets, the Ministry of Finance of Ukraine and the Deposit Guarantee Fund of Ukraine approved the Strategy for the Development of the Financial Sector of Ukraine until 2025 (Further – FSDU Strategy-2025).

The Strategy-2025 contains 5 key areas for the development of the financial sector, in particular: financial stability, macroeconomic development, financial inclusion, development of financial markets, innovative development 2019 [Strategy of development..., 2020, access 10.02.2020]. In order to understand how the system of consumer protection in the digital financial services market will be

formed, it is necessary to elaborate on such strategic directions of FSDU Strategy-2025 as financial inclusion and innovation development.

It is significant that state regulators are giving due priority to financial inclusion by increasing the accessibility and using of financial services. The main priorities for realization state policy in this way are: drafting and implementing the Financial Inclusion Strategy; creating conditions for development of remote distribution channels of financial services; creating the infrastructure to provide financial services in remote territories; conversing payments to the state to electronic channels; improving a regulatory framework to enhance effectiveness, competition and security of electronic payments in the financial system; accessibility of financial services for people with special needs.

In such circumstances, the protection of consumers of digital financial services should be ensured through the introduction of new models of remote identification and verification of the client, the creation of a mechanism for access of financial institutions to customer identification data in state registers (eKYC), regulation of the use of different types of electronic signatures of clients of financial institutions.

National regulators have identified increasing consumer protection in the financial services market as an important strategic objective of financial inclusion. To ensure this, state financial regulators have planned to complete such tasks: developing and introducing a regulatory framework for supervising the financial sector participants; ensuring transparency of information on commission and payments charged on services of banks and nonbank financial institutions, as well as payments guaranteed to the bank depositors and respective maturities; expanding the DFS participants and guaranteed deposits, gradual increase in the deposit guarantee amount in banks; improving means for disclosing information by financial institutions to customers, including prior to entering into agreements. The fulfillment of these obligations will allow to form the basis for safe use of financial services, including digital ones.

Low financial literacy in Ukraine is another challenge for financial authorities. The Financial Literacy Index the method of the Organization for Economic Cooperation and Development (OECD) reached 11.6 points out of 21, which is one of the lowest in the world [Financial literacy..., 2019, access 15.03.2020]. To remedy the current situation, financial regulators have committed by 2023 to focus their efforts on: creating a single communication platform (website) with useful insight on types and use of financial services; holding awareness raising campaigns for different demographic groups; opening the Information and Communications (Center in National Bank of Ukraine – Money Museum); implementing special programs for training expertise and skills in fintech for different groups of the general public.

The state strategic policy in the field of „Innovative development” includes the following tasks for realization during 2020–2025: devising and implementing the FinTech development strategy in Ukraine; introducing means for applying artificial intelligence and machine learning in finances (KYC, AML, combating fraud, personalized financial products, forecasting risks based on analysis of bank transactions, etc.); developing the framework for identifying customers using biometric data; introducing regulation for circulation and use of digital assets in Ukraine; introducing the framework set out in EU GDPR (General Data Protection Regulation) for finance [Strategy of development..., 2020, access 10.02.2020].

Concerning the increasing demand for digital financial products and services, the outlined strategic areas need to be detailed in terms of protecting the rights of consumers of digital financial services. The basis for the development and implementation of the Digital Consumer Financial Consumer Protection Strategy in Ukraine should be High-Level Principles for Digital Financial Inclusion (DFI Principles).

The DFI Principles were produced in 2016 by the Global Partnership for Financial Inclusion. The DFI Principles are focused on the need to provide the financially excluded and underserved with high-quality and appropriate financial products and services and the potential to use digital technologies to achieve this goal, where possible. The DFI Principles also recognize the need to actively balance the promise of digital innovation with the new risks that rapidly evolving technology introduces. There are 8 DFI Principles (Table 1).

Table 1. G20 High-Level Principles for Digital Financial Inclusion

Number	Title	Explanation
Principle 1	Promote a Digital Approach to Financial Inclusion	Promote digital financial services as a priority to drive development of inclusive financial systems, including through coordinated, monitored, and evaluated national strategies and action plans.
Principle 2	Balance Innovation and Risk to Achieve Digital Financial Inclusion	Balance promoting innovation to achieve digital financial inclusion with identifying, assessing, monitoring and managing new risks.
Principle 3	Provide an Enabling and Proportionate Legal and Regulatory Framework for Digital Financial Inclusion	Provide an enabling and proportionate legal and regulatory framework for digital financial inclusion, taking into account relevant G20 and international standard setting body standards and guidance.

Number	Title	Explanation
Principle 4	Expand the Digital Financial Services Infrastructure Ecosystem	Expand the Digital Financial Services Infrastructure Ecosystem Expand the digital financial services ecosystem – including financial and information and communications technology infrastructure – for the safe, reliable and low-cost provision of digital financial services to all relevant geographical areas, especially underserved rural areas.
Principle 5	Establish Responsible Digital Financial Practices to Protect Consumers	Establish a comprehensive approach to consumer and data protection that focuses on issues of specific relevance to digital financial services.
Principle 6	Strengthen Digital and Financial Literacy and Awareness	Support and evaluate programs that enhance digital and financial literacy in light of the unique characteristics, advantages, and risks of digital financial services and channels.
Principle 7	Facilitate Customer Identification for Digital Financial Services	Facilitate access to digital financial services by developing, or encouraging the development of customer identity systems, products and services that are accessible, affordable, and verifiable and accommodate multiple needs and risk levels for a risk-based approach to customer due diligence.
Principle 8	Track Digital Financial Inclusion Progress	Track progress on digital financial inclusion through a comprehensive and robust data measurement and evaluation system. This system should leverage new sources of digital data and enable stakeholders to analyze and monitor the supply of – and demand for – digital financial services, as well as assess the impact of key programs and reforms.

Source: G20/OECD (2016) High-Level Principles for Digital Financial Inclusion.

It is very important to consider the provisions of Principle 2: Balancing Innovation and Risk to Achieve Digital Financial Inclusion, Principle 5: Establish Responsible Digital Financial Practices to Protect Consumers and Principle 6: Strengthen Digital and Financial Literacy and Awareness for creating a national system of protection consumer rights in a digital age. A detailed explanation of these provisions and practical recommendations of implementing them into national strategies for policy makers are disclosed in the G20/OECD (2018) Policy Guidance on Financial Consumer Protection Approaches in the Digital Age and G20/OECD (2018) INFE Policy Guidance Digitalisation and Financial Literacy.

Policy Guidance on Financial Consumer Protection Approaches in the Digital Age helps policy makers with establishing responsible digital financial practices to protect consumers and build trust and confidence in digital financial services, by establishing a tailored approach to financial consumer protection that focuses on issues of specific relevance to digital financial services [Policy Guidance on Financial..., 2018, access 10.03.2020].

Policy Guidance Digitalisation and Financial Literacy aims to identify and promote effective initiatives that enhance digital and financial literacy in light of the unique characteristics, advantages, and risks of digital financial services and channels, to support their evaluation and dissemination, and to promote a responsible and beneficial development of digitalisation by building trust in the acquisition and use of digital financial services by the financially excluded [Policy Guidance Digitalisation..., 2018, access 25.03.2020].

Based on the analysis of the global experience of building a consumer rights protection mechanism in the digital services market and taking into account the peculiarities of the development of the fintech market in Ukraine, the state policy should be directed to the following three strategic directions: 1) create a system of legal regulation of the mechanism of protection of consumers' rights of digital financial services; 2) introducing a risk-oriented approach to regulating the digital financial services delivery process to consumers; 3) strengthening of digital financial literacy and public awareness.

The priority measures in creating a system of legal regulation of the mechanism of protection of consumer rights of digital financial services should be:

1) development of a legal mechanism for the protection of monetary funds accumulated in non-prudentially regulated service providers (financial companies, mobile operators and others);

2) creation of a legal basis for testing new innovative financial products and services, as well as business models in simplified mode (with the central bank to create a „Sandbox” communication platform);



3) development of the legal basis for regulating the activity of P2P credit platforms, crowdfunding and operations with virtual assets;

4) establishing on a legislative level the rules of using open API for all financial market participants;

5) development of rules of formation of unified databases and protection of information, determination of the order of exchange of information between databases;

6) creation of an effective mechanism for the out-of-court settlement of disputes, in particular to develop legal regulation of alternative mechanisms such as mediation, arbitration, financial ombudsman;

7) improving the institutional structure of the DFS consumer protection system, by setting up specialized consumer rights protection departments within the structure of each financial regulator and developing an effective mechanism for the exchange of information on consumers rights protection DFS with a view to further improving of legal regulation;

8) development of a comprehensive Consumer Rights Protection Strategy in the digital financial services market and an action plan for its implementation.

When adopting a risk-oriented approach in regulating process of providing digital financial services to consumers, financial authorities should focus on the following aspects of activities:

1) establishing requirements for the provision of complete and truthful information on innovative digital financial products, including commissions and tariffs, conditions of use of the service, the procedure for reporting to the consumer on the conducted transactions, disclosure of the procedure of consumer actions in conducting mistaken transaction and system outage;

2) upgrading and expanding the infrastructure of the retail payment system and open banking platforms, which will provide secure access to banks, non-banking financial institutions and new payment service providers;

3) the widespread use of government channels for the distribution of digital financial services with an adequate system of personal data protection;

4) enhancing security measures for the storage, unauthorized use, disclosure, modification and destruction of personal data; providing only the information required to complete a particular online transaction or to receive electronic services;

5) improvement of work of authorized bodies for control over compliance with the legislation on protection of personal data and protection of information in information networks;

6) protect consumers from misuse of digital product and digital crime; encourage of DFP providers to create user-friendly interfaces that reduce the likelihood of mistaken transactions;

7) development and implementation of new innovative methods of analysis of financial digital technologies for risk assessment, including cybercrime scenarios; for SupTech and RegTech to facilitate the faster, more efficient and effective enforcement of regulatory requirements by financial market participants;

8) establishing the cooperation with the private sector and risk assessment experts to promptly identify and evaluate the risks of digital financial services, to ensure the creation of an ecosystem that monitors these risks and helps to minimize them;

9) the establishment of internal departments in the financial institutions for the examination of consumer complaints and the obligation for them to formulate and report on the received complaints to the body responsible for protection of consumer rights DFS;

10) development of an effective mechanism for compensation of losses to DFS consumers in case of illegal activity of FDS providers;

11) providing support to consumers in identifying dependency on online lending and clarifying the procedure for repayment of overdue debts.

An important element in the formation of the consumer protection system in digital age is the provision of an adequate level of financial and technological knowledge in the population. This can be achieved by:

1) creating high-quality digital literacy education programs that shape the knowledge, understanding and confidence of consumers in using digital financial services (eg. online games for financial management training; digital income and expense tracking tools; interactive educational programs). Such financial literacy education programs should be continuous and tailored to target groups (teachers, school students, college students, retirees, journalists, judges);

2) use of digital (video, social networks, messengers, e-mail) and non-digital (posters, newspapers) channels to inform consumers about the features, benefits, costs of using digital financial services and means of financial security;

3) providing quality and uninterrupted customer support (24/7 call center, online chat bot, websites, social media) with simple and accessible instructions for correct action in any given situation, including the complaint mechanism.

By implementing appropriate measures to protect the rights of consumers of digital financial services, state regulators of the financial market will be able to start the process of transformation of legal regulation of the market of digital financial services, which will allow in the future to prevent uncontrolled situations due to increased impact of financial and operational risks, and to promote a reasonable balance between abundance of security and decentralization and ensuring of confidentiality and scale when providing digital financial services to consumers.

## CONCLUSIONS

The rapid development of technology has significantly influenced the transformation in the financial sector of Ukraine, which has contributed to the emergence of new digital financial products and services. On the one hand, such products bring several benefits to the clients, and on the other – cause new risks. Thus, there is a need to improve the state policy of regulating the sphere of financial technological services. The formation of such policy should be in line with the EU Directives and OECD principles on open banking, protection of privacy and security of personal data when consuming digital financial services, creating a competitive environment by setting standard requirements for providers to enter the digital financial services market, ensuring the guarantees of security of the preservation of monetary client money, compliance with anti-money laundering and terrorist financing legislation. In such circumstances, the quality standards of digital financial services will be raised and a robust system of consumer rights protection in Ukraine will be formed.

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