

## FINANCIAL OMBUDSMAN'S ACTIVITY IN UKRAINE BY EXPERIENCE OF WESTERN EUROPE

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*Abstract. The article deals with the problems of consumer protection of financial services. The activity of financial ombudsman as the most independent body for resolving disputes between customers and financial institutions was emphasized in the article. The active experience of such kind of the Institute in Western Europe was analyzed in the given research. In general, this analysis shows the need for a creation the authorized institute to protect the rights of consumers of financial services. It is important to note that for Ukraine German non-state system is perceptible. It is less bureaucratic, less expensive and more convenient for the banks, their clients and for legal system, especially for resolving disputes concerning small amounts which are of great number in Ukraine. Furthermore introduction of Financial Ombudsman Institute is a significant step towards European standards of the banking system and financial civilized market in Ukraine.*

*Key words. Consumer protection of financial services; financial ombudsman; European standards of the banking system; financial business.*

### 1. Introduction

According to the Organization of Economic Cooperation and Development there is great attention to the protection of consumers of financial services all over the world because of peculiarities of modern financial products and services that involve substantial possibility of arising shifting risks on the consumers. The inability of consumers to understand and properly assess the risks on the base of insufficient legal regulation and aggressive methods of promoting financial services which may be accompanied by abuse, fraud and other illegal actions on the part of service providers cause threat for the economic security of the population and undermining its confidence in financial markets has a negative impact on the welfare of citizens and hampers economic development. At the same time educated and financially literate consumer cannot make unconsidered actions that indirectly promote financial and macroeconomic stability. Thus adequate protection of consumers of financial services should promote awareness of consumers of such terms of financial services, the decision of which they make themselves and reducing the risk of financial institutions whose behavior in the market is weighed and economically justified.

Improving consumer protection in financial services markets will positively affect common economic situation in the country so far as restoring confidence in financial institutions will support the financial sector savings.

The current state of relations between different categories of participants of financial services in Ukraine cannot ensure the full functioning of markets cannot ensure their sustainable development. The main reasons of such situation are: - General principles of consumers' protection of financial services of Organization of Economic Cooperation and Development are not fully obeyed; - The system of legal functioning of financial services markets in Ukraine was

created without the need for consumer protection of financial services and providing features of financial services; - On the financial services market in Ukraine there is a low level of information transparency, citizens' financial literacy and awareness. The population has insufficient basic fundamentals of financial literacy and general information about their rights and responsibilities as consumers of financial services. The least informed are the vulnerable categories of the population including pensioners;. -The lack of effective mechanisms of protection against risks and imperfect system of dispute resolution in connection with the financial services.

Due to the fact that the current system of consumer protection in the financial markets does not have a systemic nature and may adversely affect the further development of the national economy, it is necessary to reform it thoroughly and comprehensively.

### 2. Materials and Methods

The global crisis beginning in 2008 and which still exists and the European debt crisis have shown that the policy and actions of financial institutions that are motivated to maximize profits even during the crisis often provoke social upheavals. Thus, the most vulnerable segment of the financial sector is retail users of financial services, i.e. the general population. One of the most destructive consequences of the global financial crisis was the collapse of public confidence in banks and other financial institutions as well as to the State as a fair regulator that can protect people from the adverse effects of the financial crisis. International experience proves that the protection of consumers of financial services and confidence in the financial sector appear in almost all countries.

These problems are investigated by the scientists all over the world. The improvement of consumer rights and the activities of the Financial Ombudsman are investigated

by David Thomas, Francis Frizon, Tomash Pruza from Western Union [2;6]. The issue of the Institute of Financial Ombudsman in the financial market of Russia was considered by A. Yemyelin [8]. Status and activity of the financial ombudsman in the country were presented by D. Davydenko and P. Kartoshkin [3]. Institute of Banking Ombudsman as a way to protect the rights of interests of banking relationships in Belarus is investigated by Yu. Hvatyk [4]. The improvement of consumer protection and the creation of the Institute of Financial Ombudsman in Ukraine had been raised by S. Mamedov, A. Syrota [5;7].

The results of analysis of existing consumer protection in financial services markets show imperfection and necessity of improvement. One of the ways to solve this problem in Ukraine is creation of the Institute of financial ombudsman. Taking into consideration scientists' investigations and experience of the Western Europe these questions are actual and need to be solved immediately.

**3. Results.** In Ukraine for the protection of consumers of financial services, there are a lot of legal norms; the main ones are the norms of the Constitution of Ukraine, the Civil Code of Ukraine and the Law of Ukraine "About the Protection of Consumers' Rights". However, these legal acts are needed to be clarified.

According to international practice, the protection of consumers of financial services successfully solves the financial ombudsman, acting arbiter between the consumer and the financial institution. This system was implemented with the participation of the World Bank which has many achievements in this field. Therefore, in Ukraine to help solve consumer's problems out of court World Bank proposes to establish a system of financial ombudsman. If the consumer retail financial services believe that financial institution committed to it illegally but cannot have litigation process with it or he can assert his claims to financial ombudsman.

Ombudsman (from the Swedish ombudsman is a representative of someone's interests) is an independent public official. He investigates citizens' complaints against the actions of government and protects the interests of citizens from violations by government authorities. The ombudsmen can often decide disputes arising in the banking sector, the securities market in the field of insurance services.

The modern meaning of the term "ombudsman" was appeared in 1809 when the Swedish Riksdag to protect the legitimate interests and rights of citizens founded the office that is Swedish Parliamentary Ombudsman. In 1919, the PS was introduced in Finland and only from the middle of the 20<sup>th</sup> century ombudsmen began to appear in other countries [5].

The Institute of Financial Ombudsman is in 40 countries and has proved its effectiveness.

There are two basic models of ombudsmen formed around the world are German and British.

The main feature of the German system which was established at the initiative of the Union of German banks in 1992 is a quick and not bureaucratic extrajudicial procedure to review customer complaints. It has become an integral part of the general concept of German private banks with consumers. In practice, this procedure is beneficial not only

to customers and banks taking a direct part in it but bodies of Justice.

The Ombudsman is appointed by the Board of the Union of German Banks Union leadership on the proposal for three years. Ombudsman in Germany can be the judicial body which for three years as a financial ombudsman cannot work in any banking union and credit institutions. Financial ombudsman in Germany can only consider complaints of consumers. The decision of the Ombudsman is binding when the value of the dispute does not exceed 5,000 Euros. The cost of the complaint the Ombudsman carries Union of German banks.

German model Financial Ombudsman institution has become widespread in other countries, not only European. This is because of the dispute procedure allows clients to the Ombudsman in most cases not only mandatory but also a quick solution. Also free of charge and without any risk to resolve differences on financial institutions. Extrajudicial dispute resolution is particularly attractive when the value of the dispute so small that appeal to the court denied the economic sense. Namely such disputes usually more.

In the UK Financial Ombudsman institution is funded by the state. It has existed since 1981 and in 2000 the Ombudsman status was confirmed by a special law. In the UK banks in order to work with retail clients, clients must provide this opportunity to settle disputes out of court. As a result in the year the ombudsman receives 1 million appeals, the ombudsman. That is why the apparatus is more than 100 persons. There are few British ombudsmen as opposed to one in Germany.

One of the major differences from German to British system is that not only individual but the organization or charitable foundation with an annual turnover of less than 1 million the Pounds can complaint. Limit the amount of binding decisions of the ombudsman with 100 000 pounds and in some cases the ombudsman can recommend the organization to pay the customer an amount larger than this size. As the debate in the UK concerning significant amounts and they are considered a mean of 6 months is much longer than in Germany.

Despite the fact that the Financial Ombudsman established as an independent public body, it is funded by private organizations. Each case in question is paid in the amount of 500 pounds. Annual fees also must be paid by members. Their size depends on the jurisdiction, the scope and type of organization.

European Commission research shows that in every country in the European Union, both consumers and sellers/suppliers find it easier to resolve disputes through ombudsmen and other ADRs than through the courts.

The European Commission is promoting out-of-court resolution of disputes. It has laid down fundamental standards for out-of-court redress schemes. And it has sponsored a European network of financial ombudsmen/ADRs in financial services (FIN-NET) to cover cross-border cases.

Recent European directives require financial ombudsmen/ADRs in consumer credit, payment services, electronic money and collective investments. Earlier

directives encourage financial ombudsmen/ADRs in insurance intermediation, investments and distance marketing of financial services.

A proposed European directive, planned to come into force in 2014, will require ombudsmen/ADRs across the whole of the consumer sector – including the financial sector – and will lay down minimum requirements with which ombudsmen/ADRs must comply.

The financial ombudsman is the dominant kind of financial ADR in Western Europe, although its precise form may vary. Many started covering a single sector (such as banking or insurance) but there is now a trend towards a single financial ombudsman covering all financial sectors.

Some countries use alternative forms of financial ADR instead of a financial ombudsman such as a complaints department within a financial regulator, complaints boards (with an independent chair and equal numbers of members from consumer and industry bodies) or regional arbitration.

This report provides case studies of an industry-established ombudsman scheme with a governance body (non-executive board); an industry-established ombudsman scheme without a governance body and an ombudsman scheme established by law.

Ombudsman coverage of financial businesses within the relevant sector(s) should be comprehensive.

It should include all financial businesses that are based in the country – including any that are foreign-owned.

Where financial businesses based in the country do business cross-border with consumers in other countries, the financial ombudsman should accept complaints against those financial businesses from those consumers.

Financial businesses should be required to have a published complaints procedure for consumers to use first. If financial businesses handle complaints well, this will reduce the number of disputes referred to the financial ombudsman.

The financial ombudsman's procedure should include enquiry-handling, so that some problems can be resolved before they turn into full-blown cases. Resolution of cases should include informal mediation, where this is possible, as well as formal decision [2].

A growing and efficient market in financial services depends, amongst other things, on consumer confidence. Developing consumer confidence requires effective:

- Prudential regulation, to ensure that financial businesses are financially sound and run by fit-and proper people;
- Conduct of business regulation, or effective self-regulation through industry codes, to ensure financial businesses treat consumers well;
- Arrangements to provide appropriate protection to consumers if a bank or other significant financial business becomes insolvent;
- Accessible and user-friendly arrangements to resolve disputes between consumers and solvent financial businesses; and
- Measures to create confident consumers, by increasing their financial capability through public information on financial issues and on their rights and liabilities.

The G20 High Level Principles on Financial Consumer Protection<sup>10</sup>, adopted by the Organization for Economic Cooperation and Development in October 2011, include – Jurisdictions should ensure that consumers have access to adequate complaints handling and redress mechanisms that are accessible, affordable, independent, fair, accountable, timely and efficient. Such mechanisms should not impose unreasonable cost, delays or burdens on consumers. In accordance with the above, financial services providers and authorized agents should have in place mechanisms for complaint handling and redress. Recourse to an independent redress process should be available to address complaints that are not efficiently resolved via the financial services providers' and authorized agents' internal dispute resolution mechanisms. At a minimum, aggregate information with respect to complaints and their resolutions should be made public.

In focusing on resolving disputes between consumers and financial businesses, this World Bank report draws on experience in the developed market of Western Europe in order to identify considerations that are likely to be relevant elsewhere.

Information on conditions across all consumer sectors in the European Union – in the European Consumer Conditions Scoreboard (fifth edition, published March 2011)<sup>11</sup> – shows that consumers and businesses throughout the EU find it easier to resolve disputes through ombudsmen and other ADRs rather than through the courts.

Ombudsman schemes in financial services aim to provide a quicker, cheaper and less formal way of resolving disputes than the courts. Public confidence requires that – like a judge – the ombudsman should be, and be seen to be, independent and impartial.

Financial ombudsmen expect consumers to take their complaint first to the financial business, and give the business an opportunity of putting things right. And ombudsmen expect financial businesses to look into complaints properly and provide a prompt and clear response to the consumer.

If the consumer is dissatisfied with the response from the financial business, or if the financial business fails to respond to the complaint within a reasonable time, then the consumer can refer the complaint to the ombudsman for independent consideration.

Unlike the courts in many countries, the ombudsman does not rely on the parties to bring forward all the necessary evidence and arguments. The ombudsman actively investigates the case and uses his/her specialist knowledge of financial services.

This means that the consumer is not placed at a disadvantage by the financial business's greater resources and technical knowledge. And neither the consumer nor the business needs to employ a lawyer to put the arguments for them (though they are not prevented from doing so).

The ombudsman will look into the circumstances of the case and see if it is possible to mediate a fair settlement that both the consumer and the business accept. If not, the ombudsman will take account of all the evidence and the arguments and issue a decision/recommendation.

In deciding whether or not to uphold the consumer's complaint, the ombudsman will take into account the law, any industry code and good industry practice. But the decision/recommendation will be based on equity – what the ombudsman considers to be fair in the circumstances of the case.

The ombudsman will give reasons for the decision/recommendation. If the ombudsman upholds the consumer's complaint, the ombudsman will go on to say what the financial business should do to put things right.

Best practice is for financial ombudsmen to be free to consumers – so that cost is not a barrier. And their method of working, and the fact the parties do not need lawyers, means that financial ombudsmen are very much cheaper than the courts for financial businesses.

Ombudsmen usually go beyond just deciding individual cases. They handle enquiries from both consumers and financial businesses and they proactively feedback information from their work, in order to make things better for the future.

Many of the contacts financial ombudsmen receive from consumers are enquiries. Some financial businesses are not good at explaining things to their customers, even when those customers complain.

An independent explanation from the financial ombudsman can often sort things out straight away.

So, by handling enquiries effectively, ombudsmen can prevent many of them turning into full-blown complaints as well as playing a role in consumer financial education. And financial ombudsmen receive enquiries from financial businesses as well. A business may receive a complaint and accept that it has not treated the customer well – but be unsure what redress would be fair. Advice from the ombudsman can often settle things there and then.

By reporting regularly on the trends that they see in their work, financial ombudsmen can provide independent insight – enabling governments and regulators to supervise financial services more effectively, and enabling financial businesses and consumers to avoid problems.

The reports can be used by consumer advisers and the media to help improve the financial capability of the public – by explaining to consumers in plain language: what financial issues to be careful about; what their rights and liabilities are; and how they can seek redress.

The existing European Commission Recommendation 1998/257/EC sets standards for ombudsmen/ADRs that provide out-of-court settlement of consumer disputes by proposing or imposing solutions. The text of the Recommendation is set out in annex A to this report. It sets out seven principles, which are summarized below.

**Independence principle:** The decision-maker must be independent, to ensure impartiality.

**Individual decision-makers must:** have the necessary abilities, experience and competence; and have security of tenure for a period sufficient to ensure independence. An individual paid or appointed by a professional body must not have worked for the professional body (or any of its members) within the last three years.

Alternatively, decisions can be made by a body with equal membership from consumers and professionals.

**Transparency principle:** Anyone is entitled to ask for information about: the types of disputes that are covered; the rules and procedures that apply; how decisions are made; whether decisions are based on strict law or on fairness; whether decisions are binding; and any provisions about costs. An annual report must be published, showing the nature of disputes and the results obtained.

**Adversarial principle:** The parties must be allowed to present their viewpoint and to know the arguments and facts put forward by the other party, and know the contents of any reports from experts.

**Effectiveness principle:** The ombudsman/ADR must take an active role in investigating the complaint, so that the consumer does not need legal representation, and the ombudsman/ADR must provide a prompt decision. The procedure must be free for the consumer, or of moderate cost.

**Legality principle:** Decisions must be communicated to the parties in writing (or other suitable form) giving the grounds on which they are based.

The consumer must not be deprived of the mandatory protections in the law of the state in which the ombudsman/ADR is established, nor (in cross-border cases) in the law of the state where the consumer lives.

**Liberty principle:** Consumers cannot be forced to use the ombudsman/ADR if they prefer to go to court instead. Where decisions are binding, the parties must have been told of this in advance.

**Representation principle:** The procedure must not prevent parties being represented or assisted by a third party if they wish.

The dominant kind of financial ADR in western Europe is the ombudsman, where final decisions or recommendations are issued by a single ombudsman or one of a panel of ombudsmen. Ombudsmen provide the main form of ADR in:

form of ADR in:

- Austria ..... for banking
- Belgium ..... separate for banking and investments, insurance
- Finland ..... combined for all financial sectors
- France ..... separate for banking, insurance
- Germany ..... separate for banking, insurance
- Greece ..... for banking and investments
- Ireland ..... combined for all financial sectors
- Italy ..... separate for banking, bank-sold investments
- Luxembourg ..... for insurance
- Netherlands ..... combined for all financial sectors
- Switzerland ..... separate for banking, insurance
- United Kingdom ..... combined for all financial sectors

Most ombudsmen started covering a single sector (such as banking or insurance). The number of combined

ombudsmen, covering all sectors, has grown over time – first in the United Kingdom and then Ireland, Netherlands and Finland – with others considering moving in that direction.

As described in the previous chapter – European dimension – the member state of the European Union where consumers have the highest level of confidence is the United Kingdom, which was the first of the current member states of the European Union to have a cross-sector financial ombudsman.

An insurance ombudsman was established by the UK industry in 1981 (following a lead from Switzerland and Finland) and a banking ombudsman soon afterwards. Twenty years later, after investment ombudsmen had been established as well, all the UK financial ombudsmen were combined into a single Financial Ombudsman Service – established by law. So the UK can provide case studies of both: a banking/insurance ombudsman established by the industry; and a combined financial ombudsman established by law.

In the area that consumers identify as ‘banking’, there are regulatory differences that are almost impossible for most consumers to understand:

- Banks are involved in both deposit-taking and lending (or credit). Indeed, a current account with an overdraft facility may move backwards and forwards between deposit-taking and lending, depending on whether it is in credit or debit at a particular time.

- Bank lending may be in various forms, including ordinary loans and also credit cards. But, in many countries, loans and credit cards are also provided by financial businesses that are not banks. Consumers may find it difficult to understand the distinction, especially if the lending is arranged through an intermediary.

- There is also an increase in other forms of ‘money’ (such as electronic money) and transactions in ‘money’ (such as payment services – moving money from one place to another, or from a consumer to a business). Electronic money and payment services are neither deposit-taking nor lending. Some are provided by banks, and some are provided by businesses that are not banks. And, though many consumers have one or more plastic cards, few fully understand the differences among:

- a debit card (debiting an account that may be in credit or authorised overdraft);
- a charge card (a short-term facility that does not count as credit for many purposes);
- a credit card (which is a loan, maybe short-term or longer-term); and
- a stored-value card or ‘electronic purse’ (which is electronic money).

So, consumers are unlikely to know whether or not they are covered (and where to go if they have a problem) unless the financial ombudsman or ‘banking’ ombudsman covers all deposit-taking, lending (credit), electronic money and payment services – even if not provided by a bank. In those countries where there are organizations that record the credit history of consumers (and are consulted by financial businesses before they provide credit), consideration should

be given to whether these organizations also should be covered by the financial ombudsman.

#### Complainants covered

It is usual for complaints to be accepted from consumers – people who use a financial service primarily for private purposes. Consideration should be given to whether the consumer has to be a customer of the financial business. Some financial ombudsmen also cover prospective customers, and can deal with complaints about wrongful refusal to provide a service (perhaps involving unlawful discrimination).

Some financial ombudsmen also accept complaints from smaller businesses, on the basis that their capabilities are likely to be similar to those of consumers. They are usually defined in relation to turnover and/or staff numbers. The European definition of ‘micro-enterprise’ or ‘small and medium enterprise’ may be used.<sup>56</sup>

Where businesses are allowed to complain, it is quite common to exclude disputed transactions between two financial businesses in relation to financial services – for example, a dispute between an insurance broker and an insurer.

It is also necessary to consider any time limits for consumers to refer disputes to the ombudsman:

- Should the financial ombudsman cover disputes about events that happened before the ombudsman was set up, or only cover events from the date the ombudsman was established?

- Should there be a time limit from the date of the event that caused the dispute? Should the length of the time limit reflect what is usual in that country’s courts?

- If the consumer could not have known about the event at the time, should the time limit run instead from when the consumer should have known he/she had grounds for complaint?

- Should there also be a time limit from the date on which the financial business rejected the consumer’s complaint (if the business’s decision warned the consumer of that time limit)?

- Should the ombudsman have discretion to extend time limits where, for example, the consumer was prevented by illness from complying with the time limit?

In some countries, the time limits for taking a case to court may be interrupted whilst an ombudsman considers the case. And European Directive 2008/52/EC on mediation provides for this in the case of pure mediation, but not in the case of an ombudsman.

Taking into account the democratic traditions of the EU, especially the role of NGOs in the regulation of market processes to resolve disputed issues in the banking sector is a necessary introduction in Ukraine arbitrator banking institutions that is ombudsman authorized to deal with complaints. Currently, disputes between customers and banks are resolved by the courts and the Appeals Board of the National Bank (review addresses the financial and banking institutions on the application of the National Bank of Ukraine measures on violators of banking laws) and Committee of Banking Ethics (fostering a competitive environment, to

prevent incorrect actions of banks and violation professional ethics in the banking and currency markets). The functions of these institutions do not have similar problems to the banking ombudsman in the EU. [2].

Nowadays in Ukraine is a problem “vulnerability” of bank customers, their dependence on banks as a stronger party of legal relationships. Consumers of financial services are not able to fully exercise their right to apply for protection of their rights. New and promising means of protecting the rights and interests of bank customers, given the above analysis; we consider Institute of Banking (financial) ombudsman or commissioner to protect the rights of bank customers.

There are two ways of introducing the commissioner of bank customers in Ukraine. The first model is the creation of financial institution (banking) Ombudsman which is part of the National Bank of Ukraine that will be financed by it but to be functionally independent and have the immunity when making decisions. This model is now almost acceptable for Ukraine for several reasons. First, during the economic downturn there is a shortage of public funds. Therefore, funding another financial structure will be an unbearable burden for the economy. Second, the situation seems rather questionable independence of this institution.

Another model is the Financial Ombudsman Institute created by the Association of Ukrainian Banks and functions as its structural unit on a voluntary contractual basis between banks. This model is more acceptable for Ukraine. Activities of the Ombudsman should pay contributions from members. Additional funding will come from to pay for the proceedings. At the same individuals who submit an application to the assumed charge a small amount till 10 000 UAH (\$ 500). The Ombudsman will examine the case only small amounts of claims up to 10 000 UAH. (\$ 500).

One of the key principles of the Ombudsman work, on a proposal of NABU, is accepting of applications only from population and only after the expiry of the complaint by the bank. Banks which will have more number of complaints will pay large contributions to the Institute. The initiative to create Ukraine banks and financial functioning of the ombudsman will indicate the desire to solve disputes without going through the courts and during 60 days only.

In both models the competence of financial (banking) ombudsman should include not only the complaints of citizens having contractual relationship with the bank but also work to develop standards and rules of banking activities, resolve conflicts within legal norms and inform consumers of financial services of this, providing them necessary clarification and consultation on issues of banking services.

Thus, the institution of financial ombudsman as an independent body for resolving disputes between customers and financial institutions will provide an opportunity to renew consumer confidence in the domestic financial market and support its development for the long term prospect. Thus, it is necessary to examine the experience of legal regulation of financial ombudsmen and abroad to develop the legal status of ombudsman determine its competence, work order, but always taking into account the characteristics of the legal system and social relations in Ukraine.

#### 4. Conclusions

1. Taking into account the experience of Eastern European countries, there are some advantages in both systems of financial ombudsman (German and British). But on our opinion for Ukraine it is more perceptible German non-state system. It is less bureaucratic, less expensive and more convenient for the banks, their clients and for legal system. Especially for resolving disputes concerning small amounts which are of great number in Ukraine.

2. Ukrainian banks are interested in supporting the creation of such institution. It is investigated that it can be done quite quickly on the basis of Independent Association of Banks of Ukraine (by analogy with the Union of German Banks).

3. It was proposed to support the financial institution of the ombudsman legally. In NABU there is already development of law project “About Financial Ombudsman”.

4. The benefits of the Financial Ombudsman activity are determined: the ability to defend and protect its interests without going through the judicial system; a simpler procedure for resolving such disputes; Ombudsman consultation will help to increase the level of financial literacy.

5. Introduction of the Financial Ombudsman Institute is a significant step towards European standards of the banking system and financial civilized market in Ukraine. Adapting the banking sectors of new EU member states and candidate countries to European standards must be preceded by entry in the “euro zone” to prevent the loss of effectiveness of regulatory mechanisms. The implementation of this institute will improve the procedure of financial disputes between banks and customers, increase consumer protection from arbitrary individual banking institutions, and banks will be protected from nonobjective customers’ complaints.

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