

Reform Forum Note

PROTECTING THE RIGHTS AND INTERESTS OF CONSUMERS OF NON-BANKING FINANCIAL SERVICES: IS AN ALTERNATIVE COURT POSSIBLE?

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ABSTRACT

This article considers the existing methods of protecting the rights and legitimate interests of consumers of non-banking financial services. Based on the current EU legislation, it is proposed to create the institution of a financial ombudsman as one of the possible alternative ways to protect the rights and interests of the relevant entities. It is emphasised that the financial ombudsman should be at the level of a state body in order to ensure the reliable protection of investors and consumers of financial services and faster response and resolution of problematic situations in disputes of individuals by public authorities.

The authors used the following special legal methods: conceptual-legal, comparative-legal, formal-legal, and others. For example, the comparative-legal method helped the authors compare the existing approaches to consolidation at the regulatory level of ways to protect the rights of consumers of non-banking financial services.

Based on the analysis of existing mechanisms for protecting the rights and legitimate interests of consumers of non-banking financial services and taking into account the experience of the countries of the EU, this article emphasises the relevance and expediency of implementing this suggestion in Ukraine, along with the judicial remedy of subjects of non-banking financial services markets and alternative remedies. In particular, attention is focused on the advantages of the financial ombudsman institution.

1 INTRODUCTION

The National Bank of Ukraine regulates the activities of non-bank financial services market participants: insurers, credit unions, financial companies, and lessors. The regulation of the market of non-banking financial services is carried out in order to comply with financial market participants' legal requirements, ensure equal access to financial services, protect the rights and interests of customers, and control the transparency and openness of the market. The National Bank develops and implements new regulations, taking into account the best international standards and practices.

The regulation of the non-banking financial services market is carried out by the National Bank of Ukraine, taking into account the principles defined by the Law of Ukraine 'On Financial Services and State Regulation of Financial Services Markets'⁴ and other Laws of Ukraine. It should be noted that during martial law, the actions of the National Bank of Ukraine as a regulator have been aimed at deregulating the market, the purpose of which is to support market participants and provide an opportunity to focus on core activities.

The consequences of the financial crisis in Ukraine testified to the fact that the level of state regulation in the financial services markets proved to be insufficiently efficient and reliable. Despite the long period of time that has passed since then, the issue of the state's creation and development of systemic and quality regulation in the financial sector of Ukraine remains relevant and problematic.

The global financial crisis, on the one hand, proved to be a 'test for the strength' for Ukraine's financial sector, but on the other hand, it revealed its problems, which were not given enough attention even in the conditions of economic growth. First of all, we will discuss the following negative factors: 1) the low level of capitalisation of financial institutions; 2) the presence of

4 Law of Ukraine 'On Financial Services and State Regulation of Financial Services Markets' No 2664-III (12 July 2001) <<https://zakon.rada.gov.ua/laws/show/2664-14#Text>> accessed 11 June 2022.

risks and the difficulty neutralising them; 3) the non-compliance of the principles of financial institutions with international standards; 4) the insufficient level of protection of the rights of investors and consumers of financial services.

Ukraine did not have time to recover from the financial crisis, as the war with russia overtook it, significantly complicating the working conditions of non-bank financial service providers.

One of the conditions for the uninterrupted development of any legal relationship is the establishment of the rights and obligations of the subjects of such legal relations, together with the consolidation of guarantees and ways to protect their rights.

It should be noted that the issue of the protection of the rights and legitimate interests of participants in financial services markets is quite relevant. Currently, the national legislation of Ukraine provides various ways to protect the rights and interests of these entities. The protection of the rights and legitimate interests of the parties to the relevant legal relationship is enshrined in the current regulations of each of these participants to take action or apply to the competent state authorities to take action to ensure the inviolability of its rights and legitimate interests, the termination of their violation, and the elimination of the consequences of these violations. Usually, when studying the question of methods of protecting the rights of the subjects of certain legal relations, scholars conclude that rights can be protected both in court and in administrative (pre-trial) orders.

Based on the analysis of various methods of protecting the rights of the subjects of the respective legal relations, we conclude that it is possible to distinguish several groups of methods. These are methods aimed at: (a) recognising the right of the latter, changing or terminating the legal relationship; (b) terminating an act that infringes the right of the subject and enforcing the obligation; (c) restoring its pre-infringement status and making good any damage caused. In fact, there is a classification of methods of protecting rights depending on the purpose of each method and its aim. At the same time, from our point of view, the methods of protecting the rights of non-banking financial services enshrined in the current legislation have a single purpose – to protect the violated right or legitimate interest.

Due to the current situation involving russia's large-scale aggression against Ukraine, the main focus for non-bank financial services market participants is supporting their activities and mobilising resources to quickly address key issues and continue working. To facilitate work in such a difficult situation, the National Bank of Ukraine and the National Commission on Securities and Stock Market of Ukraine have relaxed a number of regulations.

The non-banking financial sector is an important part of the national mechanism for the formation of the country's financial resources, the main component of the entire financial services market. The corresponding development of the market of non-banking financial services in Ukraine is due to the creation and functioning of the current system of control and supervision through the implementation of global financial market standards. At the same time, the problem of developing a comprehensive model of control and supervision in the financial services market and the adaptation and implementation of European legislation to the legislation of our country are insufficiently covered and studied. The financial services market is constantly changing, and this situation requires regular research to address the problem of control and supervision. One of the main problems of control is the integration of Ukraine into the EU.

The problem of control as a form of state regulation of the financial services market, especially in the field of private pension provision, is extremely important, and its solution is necessary and urgent in the current conditions of economic crisis. The study of the forms and means of this type of state control, in our opinion, will solve a number of issues that arise when the relevant public authorities apply the law.

Therefore, the current financial services market of Ukraine needs immediate reform through the introduction of effective control mechanisms, the protection of the rights of investors and consumers of financial services, and the formation of a competitive national financial services market by eliminating disparities in the regulation and development of individual financial services markets.

The most effective way to protect the rights of participants judicially. This conclusion is based on the fact that administrative (pre-trial) procedure does not always allow us to observe the legal rights and interests of plaintiffs. In particular, the Decision of the Zaporizhia District Administrative Court No. 86265431 states that failure to comply with these procedural requirements eliminates the right of the person prosecuted to protect his/her rights and interests in an administrative pre-trial procedure and causes the illegality of the decision of the supervisory authority adopted as a result of the administrative offence.⁵ A similar legal position is set out in the decision of the Supreme Court of 28 February 2018 in case No. 826/10418/16.

According to the Recommendations of the Committee of Ministers of the Council of Europe No. R (80) 2 concerning the exercise by the administrative authorities of discretionary powers adopted by the Committee of Ministers at its 316th meeting, the term 'administrative act' means any individual act or decision taken in the exercise of public authority of a nature directly related to the rights, freedoms, or interests of individuals. The term 'discretionary power' means a power that confers on an administrative authority a degree of discretion in its decision-making and enables it to choose from several legally acceptable decisions that it considers most appropriate. The exercise of such authority must take due account of the requirements for effective and efficient management, as well as the interests of third parties and the essential public interests.

Discretionary powers, in a narrower sense, are the ability to act at one's own discretion, within the law, and the ability to apply the law and take specific actions (or actions) among others, each of which is relatively correct (legal).⁶

A similar legal position is contained in the decision of the Supreme Court of Ukraine of 21 May 2013 in case No 21-87a13 and the decision of the Supreme Court of Ukraine of 19 September 2018 in case No. 815/4569/17.⁷

In modern conditions, the need to strengthen the protection of the rights of consumers of non-banking financial services in Ukraine is urgent. The financial crisis that affected the non-banking financial services markets in 2008-2009, the coronavirus pandemic, which began in March 2019, and the hostilities of 2022. The negative consequences of such events indicated the imperfection of consumer protection of financial services in Ukraine. In 2009, the Concept for the Protection of Consumers' Rights of Non-Banking Financial Services in Ukraine was developed, adopted, and approved by the order of the Cabinet of Ministers of Ukraine dated 3 September 2009 No. 1026,⁸ which formed the basis for protecting the rights of non-banking financial services consumers. The purpose of this

5 Decision of the Zaporizhia District Administrative Court No 86265431 (10 December 2019) <<https://youcontrol.com.ua/ru/catalog/court-document/86265431/>> accessed 30 May 2022.

6 Resolution of the Supreme Court on the Cassation Appeal of the National Commission for State Regulation of Financial Services Markets in Case No 818 / 163/16 (22 January 2020) <<https://youcontrol.com.ua/ru/catalog/court-document/81816316/>> accessed 30 May 2022.

7 Resolution of the Supreme Court in Case No 815/4569/17 (19 September 2018) <<https://youcontrol.com.ua/ru/catalog/court-document/815456917/>> accessed 30 May 2022.

8 Order of the Cabinet of Ministers of Ukraine Concept for the Protection of Consumers' Rights of Non-Banking Financial Services in Ukraine No 1026 (3 September 2009) <<https://zakon.rada.gov.ua/laws/show/1026-2009-%D1%80?lang=en#Text>> accessed 11 June 2022.

Concept is to improve the system of consumer protection and ensure its effectiveness, which is implemented by:

- 1) the improvement of the legal framework on the scope and procedure for mandatory disclosure of information by non-bank financial institutions;
- 2) the adaptation of national legislation on consumer protection to EU legislation;
- 3) the coordination of the work of public authorities that regulate the market of financial services for the protection of consumer rights and the introduction of a procedure for assessing compliance with non-banking financial institutions of consumer rights;
- 4) the implementation of EU norms on consumer protection infrastructure (creation of consumer protection associations, the introduction of the ombudsman institution, and other mechanisms for pre-trial consideration of complaints and dispute resolution);
- 5) the introduction of a compensation mechanism in the financial services markets;
- 6) the improvement of the mechanism of state regulation of activity financial intermediaries;
- 7) the implementation of state-targeted training programs on consumer protection of state bodies' regulation of financial services markets;
- 8) the formation of separate units for the protection of consumer rights in the structure of public authorities that carry out state regulation of the financial services market;
- 9) the introduction of educational programs for consumers;
- 10) informing the public via public authorities;
- 11) providing information to the population through the media information on services of non-banking financial institutions and possible risks to consumers;
- 12) the introduction of international accounting and reporting standards;
- 13) the disclosure of information about the real, ultimate owners of non-bank financial institutions.

As noted by R.Y. Bacho, the current practice of non-banking financial services markets emphasises the insufficient level of consumer protection, imperfect mechanisms for the implementation of the rights of the latter, and their low financial and legal education.⁹

The system of protection of the rights of consumers of financial services in the EU occupies a leading place in the economic policy of these countries. A proper protection mechanism is a guarantee of public confidence in the financial market as a whole. The key principles of consumer protection in the EU are: 1) the principle of responsible and fair treatment of all categories of consumers of financial services; 2) the creation and implementation of an effective mechanism for pre-trial dispute resolution in the financial services market; 3) providing and disclosing the appropriate amount of information in the provision of financial services.

2 THE FINANCIAL OMBUDSMAN: ESSENCE AND SIGNIFICANCE IN RESOLVING DISPUTES

One of the main means of protecting the rights and legitimate interests of financial services clients in the non-banking financial services market of Ukraine is through the introduction of a financial ombudsman.

The term 'ombudsman' (a person authorised to deal with complaints) originated in 1809 in Sweden, when the Swedish parliament created an institution to protect the rights of

9 RJ Bacho, *Markets of non-banking financial services: development regulation (institutional and analytical aspects)* (RIK-U LLC Publishing House 2016) 282-283.

citizens who opposed the government in the courts. The idea of introducing the position of ombudsman gradually spread to many other states, belonging to the systems of both continental and common law.¹⁰ Today, the institution of national ombudsmen is an integral part of the legal system in more than 100 countries, including the European Community, Australia, New Zealand, Great Britain, and others.

The ombudsman's out-of-court dispute resolution procedure was first introduced in Germany in July 1992 by the Union of German Banks (VdB). Since then, the fast and unbureaucratic procedure for dealing with customer complaints by the ombudsman has not only gained a recognised authority in society but has also become an integral part of the overall concept of working with customers of German private banks. Subsequently, institutes modelled on the German ombudsman became widespread in other countries, and not just European ones. Today, the institution of a financial system ombudsman operates in many countries (Germany, Britain, France, the Netherlands, Denmark, Sweden, Norway, Portugal, Italy, Ireland, Belgium, south Africa, Lithuania, Hungary, Poland, Pakistan, Sri Lanka).

The first institution of the financial system ombudsman in the CIS countries was established on 24 January 2009 in the Republic of Armenia in accordance with the law 'On the conciliator of the financial system'. In 2009, the Office of the Financial Ombudsman of Armenia received 378 complaints about financial institutions. Of the requirements accepted for consideration, 61% were resolved in favour of consumers, and financial institutions compensated customers more than 26 million drams (about 2 million roubles). In addition, in the Republic of Kazakhstan, there is an insurance ombudsman.

The main features of the German system are the following: the institute operates in the banking or other financial (e.g., insurance ombudsman) sector; there is only one ombudsman; the position is funded by the banks or other associations at which it is established; the ombudsman is appointed by the Board of the German Banks Union; the ombudsman only deals with consumer complaints; the ombudsman's decision is binding to the parties of the dispute if the amount of the dispute is under EUR 10,000.¹¹

An ombudsman in the financial sphere (financial ombudsman) is an independent person who resolves out-of-court disputes between organisations providing financial services and their clients. Most often, ombudsmen resolve disputes that have arisen in the banking sector, the securities market and insurance services. The ombudsman, also considered a consultant who facilitates the settlement of claims, has the right to refuse to consider the case and, when accepted for consideration, to investigate the problem, provide explanations and recommendations and, as a result, make a decision.¹²

It should be noted that at one time, there were concerns about the proper functioning of the ombudsman. For example, I. Bezzub emphasises that the introduction of a financial ombudsman and the consideration of cases and appeals against decisions in this manner may lead to the substitution of court proceedings for disputes by the 'financial ombudsman', which is a direct violation of the Constitution of Ukraine and procedural codes. In particular, Bezzub equates the 'weight' of the financial ombudsman's decisions with the decisions of such bodies as courts, notaries, state executors, etc., which, unlike the ombudsman, are criminally liable for the decisions made. There may also be a disregard for the basic principle of the division of the parties to the dispute into the defence, the prosecution, and the body

10 G Zhukovskaya, R Oleynyuk, 'Banking ombudsman: the need for today' (2005) 8 (114) Bulletin of the National Bank of Ukraine 32-33.

11 R Khanyk-Pospolitak, 'Financial Ombudsman: Towards an Effective Customers Rights' Protection in Ukraine' (2019) 3 (2) Access to Justice in Eastern Europe 54.

12 NV Tkachenko, 'Organization of the ombudsman in ensuring the financial stability of the insurance market' (2009) 1 (20) Economy and Region 198.

dealing with the dispute. The financial ombudsman is an attempt to combine the functions of both the court and the bar.¹³

However, we believe that providing an effective, fast, and accessible way to resolve disputes with consumers of financial services will help restore consumer confidence in the financial market and its growth; reduce the burden on the judicial system of Ukraine; reduce the costs of consumers and financial institutions to resolve disputes, compared to litigation; strengthen the protection of the rights of consumers of financial services and increase their level of financial awareness; increase lending and create a basis for economic growth.

In the law of developed countries regarding the mechanism of protection of citizens' rights, the main tasks of the institution of ombudsman for financial markets are: (a) the prompt resolution of disputes between financial service providers and their consumers (recipients), (b) the development of recommendations to financial institutions on procedures and best practices, (c) explaining to consumers the terms of contracts and the practice of enforcing them; (d) identifying the main unfair terms of contracts that are frequently applied and stating the legal consequences of such contracts.

As for Ukraine, it should be noted that the institution of the ombudsman in our country is underdeveloped and is far from the level of European countries; therefore, it needs further development.

Only the Concept of consumer protection of non-banking financial institutions, approved by the order of the Cabinet of Ministers of 3 September 2009 No. 1026 stressed the need to create a modern infrastructure for consumer protection, taking into account the practice of EU countries: the creation of consumer protection associations, the introduction of the ombudsman, other mechanisms for pre-trial complaints and dispute resolution, etc. This mechanism should be 'one of the tools for out-of-court settlement of disputes in the relationship between consumers of financial services and professional market participants'. Support for the establishment of the institution of a 'financial ombudsman' was also mentioned in the 'Strategy of the development of the financial sector of Ukraine until 2015'.¹⁴

The main purpose of creating such an institution in Ukraine is to consider consumer complaints to financial institutions without the use of complex and lengthy court proceedings. This simplifies, speeds up, and, most importantly, reduces the cost of solving financial problems. In addition, the introduction of this institution will significantly reduce the burden on the judiciary and increase the population's level of confidence in the financial services market. This is an alternative to litigation and makes it easier and cheaper to protect the rights of consumers of financial services. The main directions of state policy and key measures for the development of the financial sector of Ukraine in accordance with the 'Strategy of the financial sector of Ukraine until 2025' are strengthening the protection of the rights of consumers and investors of financial services.

In our opinion, such tasks show that, along with consumer protection, the financial ombudsman will help increase confidence in financial institutions. Regarding the determination of the place in the system of consumer protection bodies, the institution of the ombudsman is considered as an additional but not an alternative means of legal protection in the system of mechanisms of human rights activities.¹⁵

13 I Bezzub, 'What financial ombudsman does Ukraine need: European experience' (2018) 8 (152) Public Opinion on Lawmaking 17.

14 Project of the 'Strategy of the development of the financial sector of Ukraine until 2015' <<http://www.kbs.org.ua/files/dpee1>> accessed 30 May 2022.

15 Tkachenko (n 12) 199.

For example, the main goals of the financial ombudsman in the regulations of some countries are the following, which do not exhaust all measures of state regulation in the field of legal relations:

- to provide an accessible, simple, and fair out-of-court procedure for resolving civil disputes between credit institutions and their customers;
- to provide advisory assistance to clients and explain their rights and responsibilities;
- to form a reasonable practice of application of norms of the legislation;
- to form customs of business turnover, including for the purpose of further improvement of the legislation;
- to conduct public outreach on the application of financial services legislation.

Therefore, the financial ombudsman should be a body whose main purpose is to protect consumers of financial services out of court, whose members should be elected, in our opinion, in the current context of building financial services markets, from the Department of Supervision, and the supervision of non-bank financial institutions created in the future. It would be appropriate to introduce a provision that the consideration of disputes by the financial ombudsman is possible only in relation to those financial institutions that have officially joined the institution. Joining the institution of the financial ombudsman can be voluntary for financial institutions and be formalised in a special document, as is the case in some countries.

In our opinion, the introduction of the institution of an ombudsman in Ukraine as a body that has the right to decide cases out of court, where one of the parties is a consumer, will allow customers to acquire a faster binding solution but also the opportunity for the free and safe resolution of differences with financial service providers. Out-of-court settlement of a dispute is particularly attractive if the value of the dispute is insignificant and recourse to the court makes no economic sense.

Thus, our study confirms the need to introduce such an institution as a financial ombudsman in our country at the state level to ensure reliable protection of investors and consumers of financial services and the faster response and resolution of public authorities in problematic situations in disputes of individuals.

According to R. J. Bacho, currently, the only possible mechanism for consumers to protect their violated rights in the event of bankruptcy of a non-bank financial institution is to go to court. Despite the high probability of winning in court, the plaintiffs do not receive real material compensation due to the lack of liquid assets of bankrupt non-bank financial institutions, especially in the case of long-term delays in litigation. As a result, a large number of consumers lose their money and incur losses, which negatively affects the confidence in non-bank financial institutions and the services they provide. It is the loss of consumer confidence in non-bank financial institutions that is one of the biggest negatives that caused the crisis of 2008-2009.¹⁶

Taking all the aforesaid into consideration, it should be noted that in most countries of the world, more and more attention has been paid not so much to the development of systems of guarantees for clients of financial institutions but to the increase in financial literacy and financial security, which provides a conscious choice of non-bank financial services. Complex financial products and services (especially in the area of private pension provision) that are incomprehensible to clients may create additional risk factors and not be beneficial.

Another alternative for relieving the judiciary in Ukraine and resolving disputes related to the financial sector is the creation of a specialised financial court. More than 130,000 lawsuits – a quarter of all lawsuits in Ukraine – are disputes related to the financial sector. According to

¹⁶ Bacho (n 9) 284.

banks, today, the amount of debt that is the subject of litigation with borrowers is UAH 144 billion, more than UAH 18 billion for depositors and UAH 81 million for investors. The total amount of collateral for such lawsuits is about UAH 14 billion, and the amount of deposits is UAH 18 billion.¹⁷

In this context, it should be emphasised that the National Bank of Ukraine has a dual mandate to protect the rights of creditors and consumers of financial services. It is necessary to find the right balance to solve problems. In particular, it is not only about the workload of the judiciary but also about law enforcement, the unanimity of judicial practice, and the effectiveness of enforcement of court decisions to protect the rights and interests of the parties to the dispute. As can be seen, the development of an effective mechanism is an extremely urgent and timely issue, one of the solutions to which may be the creation of both a specialised financial court and a separate court for financial disputes.

It is evident that the practical solution to this issue should be approached carefully, taking into account the experience of foreign countries on this issue. After this analysis, in our opinion, the National Bank should conduct an open dialogue with market participants and public authorities on the prospects for the establishment and operation of such a court. As a result of such a discussion, it should initiate questions on specific changes to the legislative mechanisms related to the judicial protection of the rights and interests of creditors violated by unscrupulous debtors, as well as the implementation of the decisions received.

CONCLUSIONS

Given the study of judicial and alternative ways to protect the rights and interests of consumers of financial services, a number of conclusions were made, in particular:

- 1) Judicial protection of the rights and legitimate interests of participants in legal relations that arise in the market of non-banking financial services is the most reliable and effective. At the same time, given that there is an ongoing socio-economic crisis in Ukraine, which has become even more widespread and exacerbated by the imposition of martial law, as well as the workload and understaffing of the courts, the use of alternative dispute resolution protection of rights is relevant.
- 2) Based on a study of existing EU acts, it is established that the system of protection of the rights of consumers of financial services through the financial ombudsman already operates in more than forty developed countries. This system was implemented with the participation of the World Bank, which has significant experience in this area. Therefore, in Ukraine, to help solve consumer problems out of court, the World Bank and other reputable international organisations are proposing to create a system of a financial ombudsman. The fulfilment of this requirement will hasten the final and full integration of domestic financial markets into world capital flows, expand opportunities for cooperation with foreign funds and financial institutions, and strengthen partnerships with other countries in financial relations.

In our opinion, the introduction of the institution of a financial ombudsman in Ukraine as one of the possible alternative ways to protect rights should be assessed positively. Providing an effective, fast, and affordable way to resolve disputes with consumers of financial services will help restore consumer confidence in the financial market and its growth; reduce the

17 The NBU explained the expediency of creating a financial court <<https://finclub.net/ua/news/nbu-poisniyv-dotsilnist-stvorennia-spetsialnoho-finansovoho-sudu.html>> accessed 30 May 2022.

burden on the judicial system of Ukraine; reduce the costs of consumers and financial institutions to resolve disputes, compared to litigation; strengthen the protection of the rights of consumers of financial services and increase their level of financial awareness; increase lending and create a basis for economic growth.

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