



FSUG Position Paper on the

“Study on means to protect consumers in financial difficulty: personal bankruptcy, *datio in solutum* of mortgages, and restrictions on debt collection abusive practices”.

The Financial Services User Group (FSUG) is an expert group set up by the European Commission following the core objective “to secure high quality expert input to the Commission’s financial services initiatives from representatives of financial services users and from individual financial services experts”. The mandate of the group is to:

- advise the Commission in the context of the preparation of legislative acts or other policy initiatives affecting users of financial services, including consumers, retail investors and micro-enterprises;
- provide insight, opinion and advice concerning the practical implementation of such policies;
- proactively seek to identify key financial services issues which affect users of financial services;
- where appropriate, and in agreement with the Commission, liaise with and provide information to financial services user representatives and representative bodies at the European Union and national level, as well as to other consultative groups administered by the Commission, such as the European Consumer Consultative Group, the Payment Systems Market Expert Group, the European Securities Markets Expert Group and the Expert Group on Financial Education.

In 2011 the FSUG drafted Terms of Reference for external research to be carried out in the area of the protection of consumers in financial difficulty, which it identified as a key area of concern. The aim of the study was to identify all the different legal techniques and best practices to enhance as much as possible the protection of the consumers in financial difficulty in three selected areas - personal bankruptcy, *datio in solutum* of mortgages, and restrictions on debt collection abusive practices - by carrying out a detailed mapping and analysis of the legal framework and of practices in 17 selected Member States. The findings of this research are intended to be a valuable tool for the Commission to take stock of the current factual and legal situation which millions of European consumers are facing as a consequence of the on-going financial and economic crisis. The legal findings are meant to help to determine if legal action is needed - and if so what actions are recommended - to protect consumers in financial difficulty, or at least to mitigate the microeconomic effects caused not only by the current high unemployment levels but also by the various other macroeconomic restrictive measures that have been imposed on people by different governmental bodies.

The study has been commissioned to the research company London Economics (LE), which has submitted the attached final report. The FSUG has worked closely with LE and monitored the progress of the research study. It has engaged in discussions and directed the research company, and it has submitted comments and inputs on a regular basis.

The FSUG supports most of the conclusions drawn by London Economics, but especially the followings:

1. As over-indebtedness has become more common, there has been an increasing recognition that over-indebtedness caused by a change in the consumer's state (e.g. becoming unemployed) has led many countries to move from a position where the law is there to uphold agreed contracts, towards one where lenders who have lent too much are viewed to be as responsible as consumers who have borrowed too much.
2. Only a handful of countries still preserve the concept of *pacta sunt servanda* and attach absolute primacy to ensuring that consumers honour their contractual obligations.
3. Many countries have moved away from court-based to administrative processes, if only because of the costs associated with judicially led processes when many clients are unable to meet these costs. For example, Sweden and France, the most advanced countries in this regard, no longer have a role for the judiciary in their debt solutions, aside from appeals to decide whether the process/law has been correctly applied.
4. Council Regulation (EC) 1346/2000 did not attempt to impose a common system on different European countries, but instead to ensure that bankruptcy/insolvency proceedings opened in one Member State would be recognized in all other Member States. Any European consumer who meets the qualification criteria (such as residency for set periods, etc) of a country which does permit consumer bankruptcy does presently have the ability and right to access this, effectively making their domestic legislative position irrelevant, as the regulation outlines that the domestic law of the country where the case is opened is applicable, as long as the individual has established a "centre of main interest" (COMI) in the relevant jurisdiction.
5. Debt cancellation is not, and should not be, an automatic right, but it should be presumed that someone applying should have access to it unless a lender can demonstrate objective evidence of "bad faith" by the borrower. The application process should give lenders a time-limited opportunity to raise concerns about an applicant's behaviour.
6. The creditor must be protected when the debtor has acted in bad faith, but in return creditors must accept the responsibility where inappropriate lending has helped cause the problem of over-indebtedness they should bear some of the costs of resolving this problem. Best practice requires a compromise between the debtor and creditor; the debtor must pay what he can and the creditor must accept it as

the best resolution they can receive, so it is better for them to cut their losses, stop paying legal fees and allow a rapid discharge of un-payable debts.

7. *Datio in solutum* - defined as the provision in some jurisdictions of the possibility to provide that borrowers who cannot repay their mortgage loans are released in full from the underlying debt by handing their mortgaged property over to the lender - delivers greater benefits to consumer than no debt cancellation system, but the best practice debt cancellation model described into the study and a model of mortgage forbearance applied by all lenders appear to deliver even greater benefits to consumers.
8. At the point where the consumer is informed that the lender wishes to move to enforcement, being able to evidence its efforts to agree and deliver a viable restructuring and the borrower's failure to comply with this, all consumers, irrespective of income should be able to apply for *datio in solutum* immediately.
9. The model of a lead agency or department with responsibility for the enforcement of debt, requiring that agency to publish and maintain up-to-date comprehensive guidance on what is permitted and what best practice looks like offering significant benefits in terms of clarity, both for debt collectors and debtors. Equally the model deployed in many countries where those to engage in debt collection are registered to allow the lead agency to ensure that those who should be following this guidance are doing so appears best practice. The guidance offered in the UK in relation to debt collection by the Office for Fair Trading could be considered as best practice.

FSUG recommendations

Based on the findings of the research, the FSUG makes the following observations and recommendations to the European Commission:

From its inception, the FSUG has recognised and recommended the importance of having robust measures at European Union level for the protection of consumers in financial difficulty. The Report confirms such views. Indeed, the Report shows that the current economic crisis has reinforced the value and need for every Member State having a regime for the protection of consumers in financial distress and for the treatment of the insolvency of natural persons.

At the same time, it is clear from the Report that currently there are individual, but uncoordinated regimes or many initiatives under way in the various Member States, which expose the absence of common, harmonized and/or appropriately resourced strategies at EU level.

The FSUG believes and recommends that action on the subject is required at EU level under the competence attributed to it by Article 2(2), falling within the areas detailed in Article 4 TFEU of (a) internal market, (b) (c) social and economic policy and cohesion, and (f) consumer protection.¹

¹ Under Article 2(2) TFEU the Union and the Member States may legislate and adopt legally binding acts in such areas, but the Member States shall exercise their competence to the extent that the Union has not exercised its competence or has decided to cease exercising its competence.

In the approach for the legal treatment or solutions to the distressed condition of consumer debtors, the FSUG recommends that an appropriate legal regime should address all the stages that lead to their financial difficulty. It recognises that the financial distress of natural persons is intertwined with social, political, and cultural issues. Nonetheless, a number of areas and common principles may be identified.

An appropriate legal regime at EU level should address all stages of financial difficulty:

1. Pre-emption: interventions to pre-empt problems and prevent people from getting into financial difficulties or over-indebtedness in first place;
2. Mitigation and early intervention: measures to prevent at the first signs of distress the deterioration of the financial position of people in objective difficulty, giving the opportunity to people to recover their financial position before it aggravates to a stage of proper insolvency;
3. Debt management, enforcement, and collection at the stage when people are clearly in financial difficulty and are unlikely to be able to recover their position in the short-medium term. Consumers need measures, such as independent debt advice and counselling, to help them manage the situation. They also need protection or some form of intermediation to prevent lenders taking advantage of their vulnerable position, and protection from lenders/agents enforcing debt collections. Robust protocols and consumer protection measures are needed to ensure fair treatment of borrowers - for example, in agreeing repayment plans under set conditions;
4. Cancellation/bankruptcy/restructuring/relief/adjustment/discharge: at this stage it is recognised that there is no 'way back' and the best option is to cancel/ write off the debt. People need protection through the use of robust protocols and consumer protection measures especially if lenders try to sell the debt onto third parties;
5. Recovery and rebuilding: if other measures are effective, people will need support, such as advice or counselling, to help them recover from their financial position and build financial resilience against future shocks;
6. Post restructuring and post-recovery: policymakers should be sensitive to the stigma attached by society to financial failure of individuals that may prevent the effective recovery and fresh start of debtors, putting them on equal footings with the other members of society. For example, insolvency or financial data, and other affecting information, should be cancelled and not retrieved in the economic or financial system, and public campaigns of education and awareness should support the whole insolvency/restructuring system re-habilitating the image of those who go through it, dissociating debt and debt relief from failure or assumptions of predictive future behaviour, thus paving the way for access to financial services.

The FSUG does not consider legal regimes for consumers in financial difficulty as a form of social assistance but rather a social insurance protecting individuals and society from ruin and degradation, as well as counterproductive and destructive debt management and enforcement practices. The FSUG also recognises that household over-indebtedness is a public concern and holds systemic consequences, as recognised only recently by the Financial Stability Board.

Therefore, the principles that would govern such regime should include:

1. Respect of dignity of individuals and fundamental rights: recognised fundamental rights and the dignity of human beings should be at the core of any insolvency/restructuring regime;
2. Recognition of the human element and sufferings of human beings, not just the economic element;
3. Fairness and equity: the resolution of any problem should be fair and equitable to the borrower. It should also be fair to the lender if the lender has demonstrated to have behaved fairly when making the loan and throughout its lifetime;
4. Debt relief and restructuring should be provided to those debtors objectively in need, such as in circumstances of unexpected life events or intervened objective mismatch between disposable income and debt service (such as those due to severe changes in the economy);
5. Functionality and practicality: it should be workable and effective;
6. Affordability and financing: it should protect the core income of borrowers and not leave the borrower worse off. Financing schemes should be provided to access the system, as absence of financial support may undermine the possibility of relief;
7. Accessibility: it should be easy to access, be visible, with early referral built into the system, with clear and objective entry requirements (see #4 above);
8. Intelligibility: it should be simple, transparent, and easy to understand for consumers;
9. Efficiency: it should allow borrowers and lenders to resolve problems efficiently to avoid prolonging problems and waste.
10. Promptness: the procedure should be brief and it should provide relief quickly, not gradually or over an extended period of time;
11. Innovative debt solutions: policymakers should begin to consider new solutions to old problems. For example, the Report shows that *datio in solutum* could be a beneficial measure worthy of exploration;
12. Independency: it should be operated and monitored by independent institutions;
13. Confidence and trust: borrowers should be able to trust the scheme, institutions (such as Courts or public officials in administrative systems), and intermediaries (for example debt advisors, counsellors, lawyers and accountants);
14. Enforceability: unenforceable or un-enforced laws are no law;
15. Access to justice: any regime should not compromise the ability of borrowers to take legal action.

Finally, the FSUG stresses that possible concerns for moral hazard of fraudulent exploitation of a debt solution regime should not discourage and put the EU legislator off. The implementation of a legal system properly designed for the protection of consumers, embracing the above stages and principle, does not necessarily offer improper incentives for debtors to act irresponsibly, either by taking excessive risks or behaving fraudulently. On the contrary, a just and properly designed system, implementing proper access requirements for entry and discharge, isolates and excludes debtors taking excessive risks and behaving irresponsibly, as demonstrated by the regimes currently in place or under way at national level mapped in the Report. Also, personal bankruptcy tourism may be eliminated and a level playing field be created.