



Responsible consumer credit lending

FSUG opinion and recommendations for the review of
the Consumer Credit Directive

About FSUG

The Financial Services Users Group (FSUG) is composed of 20 experts who represent the interests of consumers, retail investors, micro-enterprises and include individual experts in financial services from the consumer perspective. FSUG's tasks include: advising the European Commission in the preparation and implementation of legislation or policy initiatives affecting the users of financial services; proactively identifying key issues affecting users of financial services; advising and liaising with financial services user representatives and representative bodies at the EU and national level.

Abstract

Since the introduction of the EU Consumer Credit Directive more than 10 years ago, important developments have taken place in Europe, such as a major financial and economic crisis which resulted in high unemployment rates and lower household income in many Member States, historically low interest rate environment which gives further incentive to consumers to borrow for consumption, and digitalisation that has led to widespread online distribution of credit as well as the emergence of new business models such as peer-to-peer lending. This paper analyses trends in the EU consumer credit markets and examines major drivers of irresponsible lending that may cause consumer detriment. Those elements include inappropriate product design, misaligned sales incentives, unsolicited credit offers, risks related to online distribution of credit, inadequate creditworthiness assessment by creditors, product cross-selling, lack of a harmonised EU personal bankruptcy scheme, and lack of effective supervision and enforcement by competent authorities. On the basis of that analysis, the FSUG addresses its recommendations to EU policy-makers in view of the upcoming review of the Consumer Credit Directive. The recommendations are aimed at ensuring a well-functioning EU consumer credit market in which creditors and intermediaries act responsibly and treat consumers fairly; and prevention of excessive debt levels and over-indebtedness.

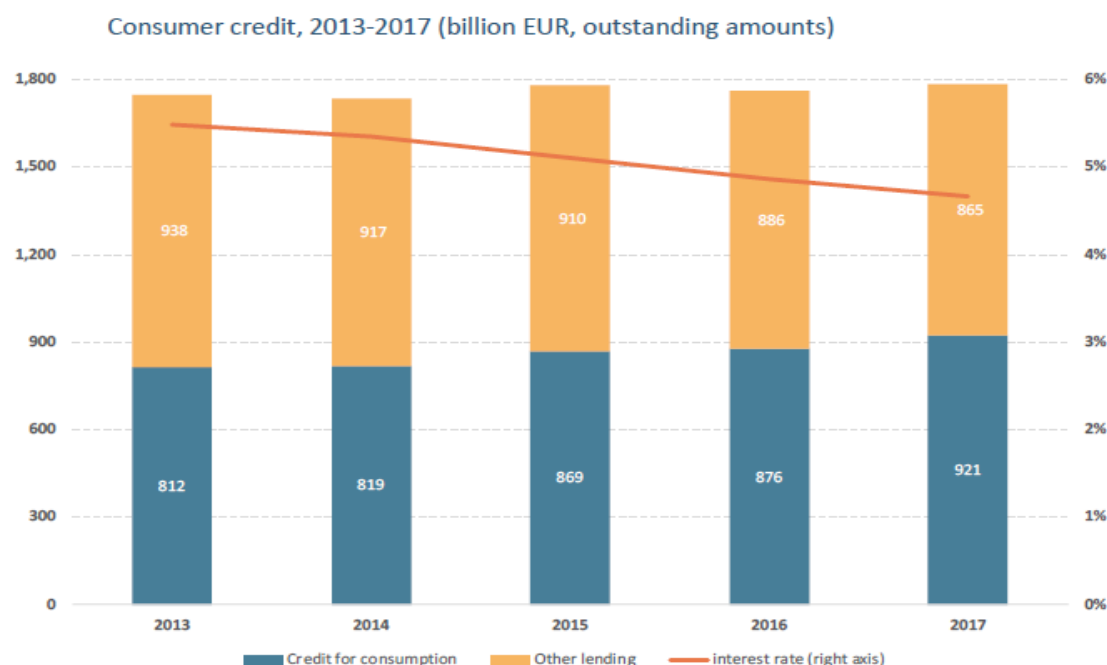
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I. Background

Consumer credit is a contract not guaranteed by a mortgage, whereby a creditor grants or promises to grant credit to a consumer in the form of a loan or other financial accommodation. Consumer credit is divided into two classifications: instalment credit and non-instalment (revolving) credit. Instalment credit requires consumers to repay the principal amount and interest within an agreed period of time in equal periodic payments, usually monthly. Types of consumer credit include credit card, charge card, personal loan, overdraft, high-cost short-term loan, credit linked to the acquisition of a new good or service, leasing and hire purchase¹.

Over the past decades, household debt in Europe increased significantly: between 1997-2017, from 39.3% to 50% of nominal GDP². Mortgage credit and consumer credit contribute to increasing the volume of debt. In 2017, the outstanding amount of consumer credit in EU28 was around EUR 1,800 billion (see table below). In terms of market size, 10 biggest EU markets are UK, Germany, France, Italy, Spain, Poland, Greece, Belgium, Austria and Netherlands³.



Source: EBA Consumer Trends Report 2018/19

Credit allows consumers to pay for goods and services that they are unable or unwilling to immediately pay for in full, such as a car or new furniture. A well-functioning consumer credit market benefits households, manufacturers and sellers of goods and services, and stimulates economic growth.

But if credit is misused and creating a debt burden and it becomes unsustainable, resulting detriment for borrowers, lenders and economic stability may be huge. Credit mis-selling and over-indebtedness can deteriorate consumers' financial health, result in social exclusion, psychological and health

¹ See Article 2 of the DIRECTIVE 2008/48/EC on credit agreements for consumers (The Consumer Credit Directive)

² Household debt is defined as all liabilities that require payment or payments of interest or principal by household to the creditor at a date or dates in the future. <https://www.ceicdata.com/en/indicator/european-union/household-debt-of-nominal-gdp>

³ Overview of the consumer credit market in Europe in 2015, Credit Agricole: https://www.creditplus.de/fileadmin/03_Ueber_Creditplus/Newsroom_und_Pressebereich/Verbraucherindex/CA_CF_consumer_credit_o_verview_in_Europe_in_2015.pdf

problems. A recent Commission study⁴ estimated that, in 2016, total financial detriment for EU consumers in the market for loans, credit and credit cards was EUR 12.8 billion (see table below).

Market	Sample countries			Rest of the EU			EU28		
	Total financial detriment (in millions of Euro)		Total time loss (in millions of hours)	Total financial detriment (in millions of Euro)		Total time loss (in millions of hours)	Total financial detriment (in millions of Euro)		Total time loss (in millions of hours)
	Pre-redress	Post-redress		Pre-redress	Post-redress		Pre-redress	Post-redress	
Mobile telephone services	3,229.73	2,781.15	284.10	4,692.40	4,040.68	346.96	7,922.13	6,821.83	631.05
Clothing, footwear and bags	1,750.17	880.35	126.26	2,639.62	1,327.75	160.12	4,389.80	2,208.09	286.38
Train services	1,309.72	952.34	67.01	1,297.22	943.25	59.72	2,606.94	1,895.59	126.73
Large household appliances	5,587.78	3,092.02	127.37	7,356.67	4,070.83	144.78	12,944.45	7,162.85	272.16
Electricity services	2,434.85	2,148.72	101.53	4,781.12	4,219.28	153.08	7,215.97	6,368.00	254.61
Loans, credit and credit cards	4,566.77	3,145.36	111.68	8,238.00	5,673.92	188.54	12,804.77	8,819.29	300.22

Source: Study on measuring consumer detriment in the European Union, European Commission, February 2017.

Note: 'Sample countries' in the first column are France, Italy, Poland and UK.

As reported by EBA, from the total number of consumer complaints reported by national competent authorities in 2017, on average 17% relate to consumer credit. The top reasons for consumer complaints were the level of fees, various issues related to pre-contractual and contractual information, debts and debt collection, levels of interest rates and management issues⁵.

At micro and macroeconomic level, high volumes of unpaid debt (non-performing loans) may endanger the stability of financial institutions, slow down economic growth and drive the economy into recession. It is worth mentioning that in March last year the European Commission proposed a package of measures to reduce the high volume of non-performing loans on banks' balance sheets and prevent their future occurrence⁶.

Thus, a well-functioning EU consumer credit market in which creditors and intermediaries act responsibly and treat consumers fairly, and prevention of excessive debt levels and over-indebtedness is in the interest of consumers, financial institutions and the economy at large.

The central piece of EU legislation governing the provision of consumer credit is the 2008 Consumer Credit Directive⁷. Its aim is to create a single market for consumer credit and to achieve a level playing field for consumer credit across the EU. The directive, inter alia, specifies the information to be mentioned in advertising, the information to be provided to the consumer prior to the conclusion of the credit agreement, the information to be included in the credit agreement, the information to be provided during the contractual relationship between the creditor and the consumer and the right to withdraw from the agreement within 14 days of signing and to repay the loan or credit at any time. The directive applies to unsecured loans between EUR 200 and EUR 75,000. Certain types of loans are excluded from the scope, e.g. overdrafts which have to be repaid within one month and credit granted free of interest and without any other charges, etc.

⁴ Study on measuring consumer detriment in the European Union, European Commission, February 2017:

<https://publications.europa.eu/en/publication-detail/-/publication/b0f83749-61f8-11e7-9d8e-01aa75ed71a1/language-en>

⁵ EBA Consumer Trends Report 2018/19: <https://eba.europa.eu/documents/10180/2551996/Consumer+Trends+Report+2018-19.pdf>

⁶ EU initiatives in the area of non-performing loans: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/managing-risks-banks-and-financial-institutions/non-performing-loans-npls_en

⁷ Directive 2008/48/EC on consumer credit agreements:

<https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:133:0066:0092:EN:PDF>

Since the introduction of the CCD more than 10 years ago, important developments have taken place in Europe. First, major financial and economic crisis resulted in high unemployment rates and lower household income in many Member States. Second, for several years now the EU has been in an era of historically low interest rates, which gives further incentive to consumers to borrow for consumption. Third, digitalisation has led to widespread online distribution of credit as well as the emergence of new business models such as peer-to-peer lending.

In June last year the European Commission published a Roadmap⁸ on the evaluation of the Consumer Credit Directive. The aim on the evaluation is to assess the functioning of the directive in its totality and in particular, regarding the following aspects: CCD scope, design and distribution phases of credit products; cross-selling of credits with other financial products; creditworthiness assessment; credit registers; information disclosure; right of withdrawal; right of early repayment. In addition, national regulatory practices on e.g. usury or predatory lending, authorisation and supervisory requirements will be covered by the evaluation. As part of the evaluation process, the Commission launched a public consultation⁹.

The following sections of this paper will introduce the concept of responsible lending, analyse main drivers and symptoms of irresponsible lending, and make recommendations in view of the upcoming review of the Consumer Credit Directive.¹⁰

Additionally, a very important perspective is often ignored in this debate on the functioning of consumer credit markets. Many millions of European citizens are in need of short-term credit to supplement the poor and exploitative pay regimes that they are experiencing in the work place.¹¹ The way that many businesses operate needs to change. Many people are stuck in insecure employment, which forces them into “debt slavery”. This is supported by all the research, which clearly shows the growing problem of income inequality through employment contracts that are exploitative. For example, in the UK an estimated 4.5 million workers are on temporary or zero hours contracts.¹² Most of these jobs are in the service sector and reflect society’s needs and demands. The need for care of the elderly, the demand for fast food and direct selling from warehouses, for example, all rely on the gig economy.

II. Introducing the concept of responsible lending

The idea behind the concept of responsible lending is that lenders should not act solely in their own interests but that they should also take into account the borrowers’ interests and needs throughout the relationship in order to prevent consumer detriment, but also prevent social, societal and economic detriment, at macro-level, when indebtedness reach high levels. This refers to both pre-contractual and post-contractual stages of relationships between lenders/intermediaries and borrowers, and encompasses the whole life cycle of credit products, from their inception through marketing and until the borrower has repaid the loan.

An important prerequisite for responsible lending is that **consumer credit products are designed in a responsible way** so as to reduce potential risks of detriment for borrowers, that can be foreseen and

⁸ Evaluation of the Consumer Credit Directive: https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2018-3472049_en

⁹ https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2018-3472049/public-consultation_en

¹⁰ The FSUG study on “Irresponsible consumer credit lending across the EU in the post-crisis era” has contributed to this position paper.

¹¹ <https://theconversation.com/wongas-collapse-and-what-it-means-for-the-people-who-rely-on-payday-loans-102419>

¹² 4.5 million in insecure work, reveals Citizens Advice, June 2016: <https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/media/press-releases/45-million-people-in-insecure-work-reveals-citizens-advice/>

therefore avoided¹³. The importance of financial product design from a consumer protection perspective has been increasingly recognized in the post-crisis era which has witnessed the introduction of the so-called product governance regimes across different areas of financial services¹⁴. Such regimes generally relate to the organisational conduct of business rules that should be observed by financial institutions when developing financial products.

When it comes to lending practices in the process of distributing consumer credit products, the thrust of responsible lending is that prior to the conclusion of a credit agreement the lender should not only assess whether he will recover his money in case of the borrower's default on a loan – that is credit risk. As stated in the UK FCA's guidance on assessing creditworthiness in consumer credit, *"Most firms have a strong commercial incentive to assess credit risk, including the probability of default, but may have less incentive to assess the risk that the credit will impact negatively on the customer's wider financial situation in particular where these customers will still be profitable for the firm"*¹⁵.

In addition, the lender should also determine whether the borrower is likely to be able to repay without incurring substantial financial harm and whether a credit product and any related products are actually suitable for him or her¹⁶. The creditors' and credit intermediaries' responsible lending obligations in the distribution process thus include three major duties aimed at preventing consumer detriment:

- the duty to assess the consumer's creditworthiness;
- the duty to assess the suitability of a credit or related product to the consumer;
- fair treatment of borrowers in payment difficulty.

The duty to assess the consumer's creditworthiness implies the need to conduct the borrower-focused creditworthiness check. While this assessment may also include the assessment of credit risk, it may by no means be limited thereto. The borrower-focused creditworthiness assessment should primarily be designed to prevent the consumer from ending up in a problematic repayment situation that may result in over-indebtedness. A problematic repayment situation may arise if the consumer is not able to repay the debt within a reasonable time, and/or the consumer is only able to repay it in an unsustainable way, for example, by cutting back on essential living expenses or by defaulting on other loans. In these circumstances, the consumer may feel the need to take out more credit in order to meet the existing repayment obligations.

The duty to assess the suitability implies the need to check what type of consumer credit product better suits the borrower's interests, objectives and characteristics. For example, choosing between instalment credit and revolving credit to finance new furniture may have different implications for the borrower, so credit providers/intermediaries are well placed to recommend the most suitable option (in terms of costs and convenience) to the consumer. Another example would be choosing between paying with credit or cash, especially when purchasing goods or services which are not first necessity, e.g. holiday package. Also, credit providers/intermediaries are expected to assess whether annex products, such as insurance, are adapted to the consumer's needs and expectations, i.e. whether they are good value for money.

¹³ Cf. European Coalition for Responsible Credit, *Principles of Responsible Credit*, in particular Principle 1: 'Responsible and affordable credit must be provided for all'.

¹⁴ EBA Guidelines of product oversight and governance arrangements for retail banking products, March 2016: <https://eba.europa.eu/documents/10180/1141044/EBA-GL-2015-18+Guidelines+on+product+oversight+and+governance.pdf> MiFID and IDD requirements on product oversight and governance.

¹⁵ "Assessing creditworthiness in consumer credit", FCA feedback on CP17/27 and final rules and guidance, August 2018: <https://www.fca.org.uk/publication/policy/ps18-19.pdf>

¹⁶ Cf. I. Ramsay, 'Consumer Credit Regulation after the Fall: International Dimensions' (2012) 1 *Journal of European Consumer and Market Law*, p. 33; I. Ramsay, 'Changing Policy Paradigms of EU Consumer Credit and Debt Regulation', in D. Leczykiewicz & S. Weatherill (eds), *The Images of the Consumer in EU Law: Legislation, Free Movement and Competition Law*, (Oxford: Hart Publishing), p. 159, 162.

Fair treatment of borrowers in payment difficulty refers to the lender's obligation to detect, as early as possible, consumers going into payment difficulties; engage with those consumers at an early stage to identify the causes for those difficulties and provide the necessary information; help the borrower to address temporary financial difficulties and return to normal situation (forbearance measures).

III. Drivers and symptoms of irresponsible consumer credit lending

In this section, practices related to responsible and irresponsible lending are analysed in more detail. In this context, the paper points to various shortcomings of the Consumer Credit directive, plus refers to good regulatory practices, where relevant.

a. Product design

Responsible lending must encompass the whole life cycle of credit products, from their inception through marketing and the post-contractual stage. Design of credit products bears significant importance for their performance and impact on consumers. Credit manufacturers who act responsibly must take due account of consumer interests and needs in the process of designing their products. Failing that, the risk is that certain product features are designed not to serve consumer interests but to deceive them, for example, by specifically targeting low income people and charging high and non-transparent fees and penalties, or nudging consumers to keep using a credit product as long as possible and pay interests that could be avoided. The high costs of a credit product may result from a variety of sources, including but not limited to the basic interest, costs associated with the conclusion of a credit agreement, charges or penalties triggered by non- or late repayment of loans, and fees for going overdrawn.

Possible consumer detriment resulting from inappropriate product design is illustrated below through two examples: high-cost short-term credit (payday loans) and revolving credit (credit cards).

A **payday loan** is a relatively small, high-cost instalment loan that has to be repaid over a short term, or until 'payday'. Given these characteristics, it can be categorised as a high-cost short-term credit. For some time, payday loans have been offered in many EU countries and have been associated with quick and easy access to credit. Many payday loan customers are vulnerable consumers who do not have credit alternatives available to them when taking out a payday loan¹⁷. It is therefore not surprising that payday loans have raised major concerns about their potential to negatively impact the consumers' financial health.

In the UK, for example, the average amount borrowed in 2013 was between GBP 265 and GBP 270 and the payback period was usually a month¹⁸. On an annual basis the interest rate could, however, go up to 5853 %¹⁹. In the Netherlands, where a payday loan is known as '*flash credit*' (*flitskrediet*), the average amount borrowed in 2011 was EUR 200 and the annual percentage rate of charge (APRC)²⁰, including but not limited to the annual interest rate, could go up to several hundred percent²¹. In Finland, consumers were charged an annual interest of nearly 1000 % on average²². Similar products

¹⁷ See e.g. UK Competition and Markets Authority, Payday Lending Market Investigation: Final Report, 24 February 2015, p. 10.

¹⁸ Office of Fair Trading, Payday Lending: Compliance Review Final Report, March 2013, p. 9.

¹⁹ See A. Fejős, 'Achieving Safety and Affordability in the UK Payday Loans Market' (2015) 38 Journal of Consumer Policy, p. 186, who refers to ASA Adjudication on WDFC UK Ltd t/a Wonga, 9 April 2014.

²⁰ Annual Percentage Rate of Charge (APRC) is the total cost expressed as an annual percentage of the total amount of credit

²¹ See also the 2011 statement of the Dutch Authority for the Financial Markets (Autoriteit Financiële Markten (AFM)); <https://www.afm.nl/nl-nl/consumenten/nieuws/2014/feb/markt-flitskrediet>.

²² European Parliament, Consumer Protection Aspects of Financial Services: Study, February 2014, p. 58.

with very high interest rates were also offered to consumers in many Central and Eastern European countries, in particular Estonia, Czech Republic, Slovakia, Slovenia, Poland, and Romania²³.

Apart from excessive interest rates associated with payday loans, a consumer who does not repay the initial debt on time is often confronted with high additional costs. In the UK, for example, one lender charged GBP 179 on average in the 35 days after a missed payment, which included an initial missed payment fee, a further non-payment fee after seven days, a default fee after 35 days as well as additional charges for issuing debt collection letters²⁴. Notably, the UK's OFT concluded in 2013 that rollover practices in this country provided 50 % of lenders' revenues and that 19 % of revenues came from the 5 % of loans which were rolled over or refinanced four or more times²⁵.

It is important to recall that loans below EUR 200 fall outside the CCD scope, which means that many payday loans are currently not subject to the provisions on pre-contractual information, advertising, APRC calculation, right of withdrawal, etc.

A **credit card** is a form of non-installment credit which allows the consumer to make use of credit reserve within the agreed limits and period of time without having to repay the outstanding amount in a fixed number of payments. The terms of a credit card agreement may require that the consumer repays a certain percentage of the outstanding amount on a regular basis (e.g. each month) or only pays interest throughout the duration of the contract and repays the total amount borrowed upon expiration of the contract. Credit cards are valued by consumers because of their flexibility, which allows consumers to defer payment and spread its costs over a number of months. At the same time, credit card facilities may operate to the disadvantage of consumers, in particular because the providers of such facilities tend to exploit consumer behavioural biases²⁶. Among such biases are overoptimism (overestimating one's ability to maintain a zero balance on one's credit card), myopia (overvaluing the short term-benefits of a credit transaction at the expense of the future) and cumulative cost neglect (neglecting the cumulative effect of a large number of relatively small borrowing choices).

In the first place, credit card credit is one of the most expensive types of credit in terms of interest rates. In February 2018, for example, on average credit card providers in the Euro area charged an interest rate of 16.86 % to consumers²⁷. High interest rates on credit cards have been identified as causing financial distress for consumers in the EU²⁸. Moreover, in some countries, such as Italy, in case of a delay in credit card payments, providers often dramatically increased interest rates not only on the payments overdue, but also on the residual credit on the card²⁹.

Furthermore, consumer detriment is often associated with the flexible nature of credit card credit³⁰. As credit card holders are usually allowed to redraw credit after making minimum payments on their credit card debt for an indefinite period, they have continued access to this expensive credit product.

²³ U. Reifner et al., Study on interest rate restrictions in the EU: Final Report for the EU Commission DG Internal Market and Services, Brussels/Hamburg/Mannheim, 2010, p. 124.

²⁴ Office of Fair Trading, Payday Lending: Compliance Review Final Report, March 2013, p. 24.

²⁵ Office of Fair Trading, Payday Lending: Compliance Review Final Report, March 2013, p. 2.

²⁶ E.g. C.R. Sunstein, 'Boundedly Rational Borrowing' (2006) 73 University of Chicago Law Review, p. 249; O. Bar-Gill, 'The Behavioural Economics of Consumer Contracts' (2008) 92 Minnesota Law Review, p. 749; O. Bar-Gill, 'Seduction by Plastic' (2008) 98 Northwestern University Law Review, p. 1373; Y.M. Atamer, 'Duty of Responsible Lending: Should the European Union Take Action?', in S. Grundmann & Y.M. Atamer (eds), Financial Services, Financial Crisis and General European Contract Law: Failure and Challenges of Contracting (Alphen aan den Rijn: Kluwer Law International, 2011), p. 179, 183 et seq. See also U. Reifner et al., Study on interest rate restrictions in the EU: Final Report for the EU Commission DG Internal Market and Services, Brussels/Hamburg/Mannheim, 2010, p. 119.

²⁷ European Central Bank, Statistical Data Warehouse; <http://sdw.ecb.europa.eu/reports.do?node=1000005691>.

²⁸ European Parliament, Consumer Protection Aspects of Financial Services: Study, February 2014, p. 62.

²⁹ Ibid., p. 55.

³⁰ See Financial Conduct Authority, Credit Card Market Study: Persistent debt and earlier intervention remedies – feedback on CP17/10 and further consultation, December 2017, p. 4.

As a result, consumers can accumulate and sustain debt over a long period without having to make a significant effort to get out of credit card debt. This may lead to '*persistent debt*' which, following the UK's FCA, can be defined as a situation where, over a period of 18 months, a consumer pays more in interest, fees and charges than he or she has repaid of the principal on his or her card balance³¹. Consumers who have persistent credit card debt or only make systematic minimum repayments on their card without making significant contributions to repaying the outstanding balance tend to be highly profitable for creditors.

Some Member States have adopted preventive policy measures related to the cost and other credit design issues described above, e.g. interest rate ceilings are in place in FR, BE, DE, IT, NL, PT, etc. In France, interest rates ceilings are calculated quarterly by the national bank on the basis of the market rates for different categories of credits. In January 2019, maximum APRC for consumer loans below EUR 3000 was 21.2%; for amounts between EUR 3000-6000 – 12.49%; for amounts above EUR 6000 – 5.96%³².

In Portugal, the maximum APRC regime is in place since 1 January 2010³³. The maximum rates for the different types of credit correspond to the average of APRCs contracted by all credit institutions in the previous trimester, added by one fourth. In addition, none of the APRCs can exceed in 50% the average APRC of all consumer credit contracts in the previous trimester. In the 2nd quarter of 2019, the maximum rate for credit cards, credit lines and overdraft facilities applicable is 16.1%; for car loans, the maximum rate is 9.7%.

The UK's FCA recently proposed new rules on the treatment of customers whose credit card debt persists over 18 to 36 months³⁴. Under these rules, financial firms are required to monitor a credit card customer's repayment record and any other relevant information held by the firm and take appropriate action where there are signs of actual or potential financial difficulties³⁵.

b. Unsolicited consumer credit

Unsolicited credit offers can take various forms: bank, credit card company or a credit intermediary calling/visiting consumers to offer an instalment or revolving credit; credit card proposed to the consumer in a retailer shop; retail point-of-sale instalment credit bundled with credit card that consumer did not request; non-requested credit card sent to the consumer by post; consumers approached by a bank's or a credit card company's sales desk set up in a shopping centre; consumer's overdraft/credit card spending limit increased without their prior request and permission; aggressive marketing of payday loans.

These kinds of practices push consumers to borrow more and spend beyond their means, instead of incentivising consumers to save and better manage their finance. This could result in unsustainable levels of indebtedness (high debt-to-income ratio) and over-indebtedness. According to Citizens Advice, in 2017, 28% of UK credit card holders (8.4 million people) received a credit limit increase.

³¹ Ibid., p. 5.

³² Taux d'usure, 2019T1, Banque de France: <https://www.banque-france.fr/statistiques/taux-et-cours/taux-dusure>

³³ Decree Law n.º 133/2009, with the changes set in Decree Law n.º 42-A/2013

³⁴ Financial Conduct Authority, *Credit Card Market Study: Persistent Debt and Earlier Intervention Remedies – Feedback on CP17/10 and Further Consultation*, December 2017.

³⁵ See Financial Conduct Authority, *Credit Card Market Study: Persistent Debt and Earlier Intervention – Feedback to CP17/43 and Final Rules*, Policy Statement PS18/4, February 2018. The new rules entered into force on 1 March 2018.

However, only 1 in 4 credit card holders who were given a rise actually asked for it – the remaining 3 in 4 limit raises were initiated by credit companies³⁶.

In some Member States, unsolicited practices are restricted and banned. For example, the Irish Consumer Protection Code prohibits the offer of unsolicited pre-approved credit to consumers; allows credit providers to increase a consumer's credit limit only with the agreement of the consumer³⁷. In Belgium, unsolicited marketing is strictly regulated – it is forbidden, among others, to set up credit sales desks in public places such as railway stations, shopping centres³⁸.

At the EU level, the Directive on distance selling of financial services contains limited provisions related to unsolicited services and communications, which are not specific to consumer credit³⁹. The CCD does not touch upon the unsolicited credit issues.

c. Risks related to online distribution

Digitalisation has had a profound impact on all sectors, including the consumer credit area. Since the CCD adoption in 2008, many developments have occurred in that respect.

First, many traditional credit providers and intermediaries have adopted digital tools to diversify their distribution channels through internet and smartphone apps. Second, new FinTech providers offer traditional consumer credit through online channels. When looking for a credit, many consumers use internet to search for information and compare products and their features. And increasingly many people purchase credit online without physical contact with credit providers. In 2015, across 10 EU countries, 40% of consumers searched for personal loans online and purchased offline, while 20% both searched and purchased online.⁴⁰

Third, new types of credit and business models have emerged, such as crowdfunding, and more specifically peer-to-peer lending (P2PL). It connects those who give, lend or invest money directly with those who need financing. P2PL, also known as debt-based or lending-based crowdfunding, with platforms like Zopa, Funding Circle and Kreditech, accounts for the largest share of this emerging market⁴¹, with peer-to-peer consumer lending being its biggest segment⁴². In general terms, P2PL can be defined as *'the use of an electronic platform that matches lenders/investors with borrowers/issuers in order to provide unsecured loans, including consumer lending, as well as lending against real estate'*⁴³. These services are usually provided by new market entrants known for the heavy digitalisation of their processes, including technological support for credit analysis and payments settlement⁴⁴.

The above developments present both opportunities and risks for financial services users. Among the claimed benefits one can mention convenience of an immediate online access to credit, financial inclusion of vulnerable consumers who cannot obtain credit from conventional lenders.

³⁶ Credit card companies pushing credit on millions of people who can't pay, Citizens Advice, November 2017: <https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/media/press-releases/credit-card-companies-pushing-credit-on-millions-of-people-who-cant-pay/>

³⁷ Consumer Protection Code 2012, Central Bank of Ireland, p.11: <https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/brokers-retail-intermediaries/supervision-process/consumer-protection-code-2012.pdf?sfvrsn=4>

³⁸ Cr dit   la consommation: le consommateur mieux prot g , Test-Achats, April 2015: <https://www.test-achats.be/argent/emprunter/news/credit-a-la-consommation-le-consommateur-mieux-prot ge>

³⁹ Directive 2002/65/EC, Art 9 and 10: <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32002L0065>

⁴⁰ Consumer Credit, Digitalisation and Behavioural Economics: Are new protection rules needed?, ECRI, Sept 2018

⁴¹ European Commission, Legislative Proposal for an EU Framework on Crowd and Peer to Peer Finance: Inception Impact Assessment ((2017)5288649 - 30/10/2017), p. 1.

⁴² B. Zhang et al., Sustaining Momentum – The 2nd Annual European Alternative Finance Industry Survey, 2016, p. 20.

⁴³ International Financial Consumer Protection Organisation (FinCoNet), Report on the Digitalisation of Short-Term, High-Cost Consumer Credit, November 2017, p. 20.

⁴⁴ Ibid.

The risks include the non-respect of responsible lending obligations by online credit providers, aggressive and unsolicited marketing, luring consumers into quickly accessible loans using advertisement such as “*your loan available within 5 minutes*”. Internet and widespread adoption of smartphones offer speed, convenience, 24/7 availability of services to financial services users. Credit products are permanently at the consumers’ “doorstep”, a click away. The key questions here are: how to reconcile this with the time that a potential borrower needs to shop around and choose the right product; how to avoid unsolicited advertising and pushing consumers to take loans through tracking them online and profiling.

The CCD offers consumers a right to withdraw from the credit contract within 14 days without giving any reason. This right is equally important in the context of offline and online credit contracts. However, right of withdrawal alone cannot tackle the above issues as in this case liability for acting is shifted to the borrower. When assessing the effect of the right of withdrawal, the specificity of financial services and behavioural insight must be duly considered. Most financial services are experience goods where the quality of the service can only be judged after the experience is made. More specifically, in the area of credit, there is usually a time lag between the moment the contract is signed and its possible negative impact on the borrower, i.e. when debt burden becomes unsustainable. Thus, the importance of properly calibrated preventive measures should not be underestimated. In this context, it seems obvious that strict responsible lending obligations should apply to all credit providers and intermediaries, irrespective of their distribution channel and business model.

Referring specifically to P2PL, it presents risks for both consumer lenders and borrowers. Consumer lenders may lose the amount borrowed following either the consumer borrower’s or the platform’s default⁴⁵. They may also be unaware of such risks, relying on misleading advertisements or unverified information, in particular about the consumer borrower and his or her project. It is notable that current data reveal an increase in defaults and business failures in P2PL markets⁴⁶. It appears that defaults have risen across the P2PL market, largely among riskier borrowers with higher interest rates⁴⁷. Importantly, in responding to a sector survey, the platforms have identified their own malpractice and borrowers’ defaults/failures as the main current risks in Europe⁴⁸. Consumer borrowers, in turn, may end up in a problematic repayment situation due to the lack of or insufficient assessment of their creditworthiness⁴⁹.

Therefore, in contrast to the traditional financial sector where irresponsible lending practices may only affect consumer borrowers, in P2PL both consumer lenders and consumer borrowers can become a victim of such practices. At present, P2PL platforms are not regulated at the EU level, and existing national regulatory and non-regulatory regimes are fragmented.

d. Creditworthiness assessment

The Consumer Credit Directive does not contain specific responsible lending obligations for lenders and credit intermediaries, and in this sense, clearly lags behind the standards set by the Mortgage Credit Directive.

⁴⁵ Ibid., p. 12 et seq. See also E. Macchiavello, ‘Financial-return Crowdfunding and Regulatory Approaches in the Shadow Banking, FinTech and Collaborative Finance Era’ (2017) 14 European Company and Financial Law Review, p. 662, 669.

⁴⁶ B. Zhang et al., Sustaining Momentum – The 2nd Annual European Alternative Finance Industry Survey, 2016, p. 21, 47; B. Zhang et al., Pushing Boundaries: The 2015 UK Alternative Finance Industry Report, 2016, p. 34.

⁴⁷ http://www.altfi.com/article/5157_p2p-lending-is-still-enjoying-double-digit-growthbut-losses-are-rising

⁴⁸ Ibid.

⁴⁹ European Banking Authority, Opinion of the European Banking Authority on Lending-based Crowdfunding, 26 February 2015, p. 16, 20. See also International Financial Consumer Protection Organisation (FinCoNet), Report on the Digitalisation of Short-Term, High-Cost Consumer Credit, November 2017, p. 21.

First, the CCD does not make clear what kind of creditworthiness test – creditor-focused or borrower-focused – is envisaged by it. As a result, Member States have a large margin of manoeuvre as to how to perceive and design the creditworthiness assessment required by the directive.

Second, the CCD does not address the issue of what the creditor should do in case of the negative outcome of the creditworthiness test. Member States have a wide margin of discretion as to the consequences of the negative outcome of the creditworthiness test. Some Member States, such as the Netherlands⁵⁰, have introduced an explicit statutory prohibition on granting credit in such a case. But most EU countries' national laws transposing the CCD do not address the consequences of the negative outcome of the creditworthiness assessment.

By way of comparison, the Mortgage Credit Directive obliges lenders to conduct a thorough assessment of the borrower's creditworthiness, including making prudent allowances for potential negative scenarios in the future, and to make "*...the credit available to the consumer where the result of the creditworthiness assessment indicates that the obligations resulting from the credit agreement are likely to be met in the manner required under that agreement.*"⁵¹

Another serious concern related to the creditworthiness assessment process is what types/sources of data are used by lenders to assess consumers' creditworthiness and how artificial intelligence algorithms analyse and interpret those data. With the development of new technologies, widespread use of big data technics, and the emergence of FinTechs, some lenders and lending platforms (P2P lending) have started using consumer data from external, non-traditional sources to build credit scores. These data may include the consumer's browsing history, log data, personal interests, financial and payment data, social network information, information from store cards/credit cards⁵².

These alternative data, combined with the use of automated tools (algorithms), raise the issue of relevance of data and trigger huge questions on privacy, fairness, and exclusion. For example, millions of data points might suggest interesting correlations between consumer's behaviour (e.g. their spending habits, on-line behaviour) and risk of defaulting on credit, but correlation does not mean causality⁵³.

There is also the risk that the choice of data used in the creditworthiness assessment process proactively shapes consumer's behaviour in order to manipulate the results. For instance, in countries such as the UK where data such as mobile phone plan payments or credit card repayments are used to calculate your credit score, consumers will choose to opt for mobile payment plans instead of prepaid cards and use their credit card even when they do not need to, just to build up a "credit CV" and ensure that they will get a lower interest rate when they need access to an important credit later in life (buying a car or a house).

Thus, it is important that only pertinent and well-founded data are used by lenders when assessing consumers' creditworthiness. In this context, the practices by private credit bureaus should also be closely investigated and regulated (what type of data they collect and for what purpose, whether and to what extent credit bureaus contribute to responsible lending and reducing over-indebtedness, whether they comply with the EU data protection legislation, etc.).⁵⁴

⁵⁰ Financial Supervision Act 2006 (Wet financieel toezicht 2006), art. 4:34 (2).

⁵¹ Mortgage Credit Directive, Art 18

⁵² ESAs Joint Committee Discussion Paper on the Use of Big Data by Financial Institutions, 2016, p.10:

https://www.esma.europa.eu/sites/default/files/library/jc-2016-86_discussion_paper_big_data.pdf

⁵³ BEUC position on big data in financial services, March 2017: https://www.beuc.eu/publications/beuc-x-2017-030_gve_beuc_bigdata_esaconsultation_publication.pdf

⁵⁴ See for example, BEUC study on "The never-ending European credit data mess", October 2017: https://www.beuc.eu/publications/beuc-x-2017-111_the-never-ending-european-credit-data-mess.pdf

For example, in Belgium, lenders ask relevant questions to potential borrowers and request supporting documents (account statements, salary slips, tax return) in order to assess their creditworthiness. Besides that, lenders have the obligation to consult the credit register run by the Belgian central bank, which contains only data on defaulted credit agreements (negative credit data), as well as running credit contracts (positive data). Lenders and intermediaries are not allowed to ask consumers questions about their race, ethnic origin, sexual orientation, political, philosophical and sexual views, membership to a trade union or mutual company⁵⁵.

e. Product cross-selling

Irresponsible lending across the EU is also associated with cross-selling. Cross-selling related to credit refers to the practice of selling a credit product together with another (financial) product, such as insurance. Cross-selling can take the form of a tying practice, meaning that another (financial) product is made mandatory to obtain a loan from a given provider. Alternatively, such a product can be offered to consumers as an optional extra (bundling). Cross-selling of financial products can result in a situation where consumers purchase products that they do not necessarily want or need and that entail additional fees and charges.

According to the 2017 EBA report, cross-selling has been identified as a problematic selling practice in a large number of Member States. The examples include the provision of a loan in combination with payment protection insurance (PPI), car insurance or life insurance, where consumers did not need the insurance or were unaware that they were taking it out when concluding a credit agreement⁵⁶.

Cross-selling of PPI deserves special attention in this context. PPI is an insurance policy that enables consumers to insure repayment of loans if the borrower dies, becomes ill or disabled, or faces other circumstances preventing him or her from meeting the obligations under the credit agreement. As with any other type of insurance, PPI may exclude or impose restrictive conditions on particular types of claimant (e.g. self-employed or contract workers) or claim (e.g. sickness related to pre-existing medical condition) and may be subject to other terms that limit the cover provided.

In the UK, for example, the cross-selling of PPI – mortgage PPI, personal loan PPI and credit card PPI⁵⁷ – has resulted in the largest mis-selling scandal in its financial history⁵⁸. In 2008, UK consumer organisation Which? reported that one in three PPI consumers had been sold a ‘worthless’ insurance against they would never be able to make a claim. Which? estimated at the time that as many as 2 million policies were sold to consumers who were not eligible for cover⁵⁹. As of January 2018, around GBP 30 billion were set aside by financial firms for compensation payouts⁶⁰.

Similar problems with the cross-selling of PPI have been reported in other parts of Europe. In Spain, for example, some consumers who bought PPI were misled to believe that they were protected in case of unemployment or temporary incapacity, whereas this was not always the case as the coverage depended on the specific situation of the insured person⁶¹. In Ireland, firms gathered insufficient

⁵⁵ <https://economie.fgov.be/fr/themes/services-financiers/credit-la-consommation/droits-et-obligations/droits-et-obligations-du-0>

⁵⁶ European Banking Authority, EBA Consumer Trends Report 2017, 28 June 2017, p. 22.

⁵⁷ Competition Commission, Market Investigation into Payment Protection Insurance, 29 January 2009, p. 22.

⁵⁸ European Parliament, Consumer Protection Aspects of Financial Services: Study, February 2014, p. 69. On this mis-selling scandal in more detail, see E. Ferran, ‘Regulatory Lessons from the Payment Protection Insurance Mis-selling Scandal in the UK’ (2012) 13 European Business Organization Law Review, p. 247.

⁵⁹ <https://www.which.co.uk/news/2008/05/one-in-three-with-ppi-may-find-it-worthless-144107/>

⁶⁰ Financial Conduct Authority, Monthly PPI Refunds and Compensation (last updated: 19 April 2018); <https://www.ft.com/content/d9f0050a-739c-11e7-aca6-c6bd07df1a3c>.

⁶¹ European Parliament, Consumer Protection Aspects of Financial Services: Study, February 2014

information on consumers in order to be able to ensure the suitability of PPI for each client. As of May 2012, refunds announced by the Irish banks exceeded EUR 4 million⁶².

In 2017, the Belgian Financial Services and Markets Authority (FSMA) concluded a study into PPI policies offered in conjunction with consumer loans⁶³. The study found that PPI products offered on the Belgian market tend to be “expensive considering the cover offered.” In particular, analysis by FSMA of claims made between 2011 and 2015, show that insurers only paid out on a claim in only 0.24% of the contracts in force. During that period, companies that were included in the study collected an average of 65 million euros in premiums per year, yet only 12% of this amount was used to pay claims. The terms and conditions of many PPI policies were also found to be overly complex (i.e. they often included a lot of exclusions).

Market investigation carried out by BaFin in Germany revealed that the contract features of PPI policies are very difficult to understand for consumers⁶⁴. The investigation revealed that the commissions that insurance undertakings pay to credit institutions is sometimes very high: 12 credit institutions said they received less than 50 percent of the insurance premium; at another 12 banks, the maximum rate of commission was 50 percent, while 7 institutions received more than 50 percent; In a few isolated cases, the commission exceeded 70 percent;

A mystery shopping was carried out by the French Authority DGCCRF in 2018 across 325 credit institutions and point-of-sale credit intermediaries. One of the findings was that the insurance option was pre-ticked by most credit sellers⁶⁵.

Irresponsible cross-selling appears to have been driven by consumer behavioural biases in financial decision-making being exploited by credit providers and intermediaries. Being motivated by remuneration arrangements that award volume-based sales, many creditors and credit intermediaries across the EU have failed to act in the interests of consumers.

Some Member States have taken a number of regulatory and non-regulatory initiatives in order to tackle problems associate with PPI. Following the UK’s PPI scandal, the UK regulator enacted several reforms to prevent mis-selling of PPI: prohibition of selling PPI at the point of sale - PPI cannot be sold until at least seven days after the loan was agreed; borrowers must be given a personalised quote, detailing costs and cover; customers have to be told in writing that PPI is an optional extra; PPI sellers have to state how many customers are successful in claiming on their policies.

In Germany, legislators added legal requirements for more advice, information and transparency for payment protection insurance policies to the German Insurance Contract Act⁶⁶. The new regulations only entered into force on 23 February 2018. Under these changes: banks are now subject to the obligations of an insurance undertaking to advise and inform the customer as the person insured (previously this was not the case); consumers have the option to review whether they really need PPI, and to do so after entering into the agreement; a legal requirement under which the customer as the person insured must again be reminded in text form of this right to withdraw from the contract one week after the policy declaration has been submitted; when this information is provided, the bank must also make another copy of the product information document available to the customer.

⁶² Ibid.

⁶³ <https://www.fsma.be/en/news/study-payment-protection-insurance-offered-conjunction-consumer-loans>

⁶⁴ https://www.bafin.de/EN/PublikationenDaten/Jahresbericht/Jahresbericht2017/Kapitel2/Kapitel2_2/Kapitel2_2_2/kapitel2_2_2_artikel_en.html

⁶⁵ <https://www.economie.gouv.fr/dgccrf/credit-a-consommation-loyaute-linformation-precontractuelle>

⁶⁶ https://www.bafin.de/EN/PublikationenDaten/Jahresbericht/Jahresbericht2017/Kapitel2/Kapitel2_2/Kapitel2_2_2/kapitel2_2_2_artikel_en.html

Portuguese regulators issued a guideline in March 2012 on the legal obligations regarding PPI with recommendations to insurers, focusing on product design, pre-contractual information, drafting language of the policies and underwriting practices: insurers should take the target market characteristics into account when designing the product; the necessity of sufficient, adequate and clear pre-contractual information.

In France, several reforms⁶⁷ were implemented related to PPI through the Lagarde Law that entered into force in 2010: lenders are not allowed to refuse equivalent cover by any insurer even when it does not belong to the same group as the bank providing the loan; when offering PPI with a consumer loan, the lender or credit intermediary must inform the borrower of the standard cost of insurance, using a numerical example in euros per month.

The above being said, in the majority of EU countries no specific actions related to PPI cross-selling with consumer loans have been taken. It is worth stressing that the Consumer Credit Directive is silent with regard to cross-selling practices.

f. Sales incentives and sales targets

The way financial product sellers and intermediaries are remunerated may have tremendous impact on consumer outcomes. When sales incentives and sales targets are ill-conceived and misaligned with consumer interests, financial providers and intermediaries usually engage in aggressive sales of products to consumers without proper assessment of their needs and expectations.

Sales incentives can be financial (bonus for reaching a particular target, commission on the sale of a particular product, sales competition, etc.) and non-financial (promotion and career development opportunities, trainings, vouchers and gifts, company cars, etc.). Sales commissions and targets may create systematic incentives for credit providers and intermediaries to focus on their own financial interest rather than serving the interests of consumers.

Information on remuneration schemes related to the sales of credit is scarce because banks, financial and non-financial intermediaries do not make this information public. Some evidence from across Europe about sales incentive and aggressive/misleading marketing of credit is provided by FinCoNet report in 2016. For example, Slovak authorities referred to conflicts of interest at mortgage intermediaries: *“The regulatory authority identified cases where mortgages recommended and provided by mortgage intermediaries were not the most advantageous to the consumer. According to the consumers who made complaints, mortgage intermediaries were not interested in recommending products by mortgage providers who paid lower commission rates. In some cases, the mortgage intermediary would also charge a service fee to the consumer in addition to the commission received from banks for the sale of the mortgage.”*⁶⁸

Latvian authorities referred to shady marketing tactics teasing people into taking loans: *“A firm released a media campaign promoting an incentive to consumers to sign up for a credit product, emphasising the additional benefits which had no relevance to the lending service (the incentive was a chance to win material prizes such as a new car, television, money etc.). However, Latvia’s National Normative Act prohibits an advertisement offering a consumer credit that influences or may influence a decision of a consumer on entering into a credit agreement by additionally offering to acquire goods or receive services or other advantages, if they have no direct relation to the use of the credit, or their receipt has or may have a significant meaning in the taking of the decision by the consumer on entering into the credit agreement. The firm in question was fined for this activity.”*

⁶⁷ https://eiopa.europa.eu/publications/opinions/eiopa_ppi_background_note_2013-06-28.pdf, p. 19

⁶⁸ “Sales incentives and responsible lending”, FinCoNet report, January 2016: http://www.finconet.org/Report_Sales_Incentives%20Responsible_Lending.pdf

Sales commissions have recently been in the spotlight in relation to PPI mis-selling linked to credit. Selling PPI has proved to be a highly profitable business, in particular as a result of such commissions. In the UK, for example, the commissions payable to loan brokers were typically between 50 and 80 % of gross written premium for policies sold in connection with a personal loan⁶⁹. Notably, these levels of commission were much higher than those payable for introducing the loan itself, which meant that a large proportion of the profits of loan brokers was derived from selling PPI policies. It is therefore not surprising that many consumers were even pressured into buying such policies⁷⁰. Similarly, in Germany, the commissions paid by insurance companies to credit institutions for selling PPI together with a personal loan were sometimes extremely high, in some cases amounting to 50 % or more of insurance premium⁷¹.

Sales incentives and targets can be detrimental not only to consumers, but they also put excessive pressure on sales staff of financial institutions and intermediaries. As reported by trade unions, finance employees work 15 days extra outside registered working hours to reach their targets. In parallel, they acknowledge the causal link between sales targets and consumer outcome: *“The best product/solution for the customer is not always the best for the adviser. We usually do our best for the customer, but it might lead to poorer achievement of targets for us, which in turn increases the pressure from the top.”*⁷²

The issue of misaligned sales incentives and conflicting interests is common to all retail finance sectors. Since many years this has been subject to heated debate at the EU and national level within Europe, as well as across the globe. Two EU countries (UK and the Netherlands) have taken strict measures in that respect. The Netherlands decided to ban sales commissions for mortgages and complex investment products (2013) and then extended the ban to all retail investment products (2014). The UK government banned sales commissions for retail investment products (2012).⁷³

At the EU level, sectoral retail finance legislation contains provisions aimed at mitigating the negative effects of sales incentives. But those measures mostly consist in disclosing to consumers the amount of commissions received by financial sellers. This raises the question of whether information disclosure reaches its objective of raising consumer awareness and changing their behaviour.

In this respect, the approach taken by the Mortgage Credit Directive can be considered as more interventionist. It provides that remuneration of lenders’ staff responsible for the creditworthiness assessment must not be contingent on the number or proportion of credit applications accepted. Further to that, where creditors, credit intermediaries or appointed representatives provide advisory services the remuneration structure of the staff involved cannot be contingent on sales targets. In addition, the directive allows Member States to ban commissions paid by the creditor to the credit intermediary.⁷⁴

In contrast, the Consumer Credit Directive does not at all deal with remuneration structure of credit providers, financial and non-financial intermediaries.

⁶⁹ Competition Commission, Market Investigation into Payment Protection Insurance, 29 January 2009, p. 2.

⁷⁰ See e.g. the Guardian, ‘Liverpool Victoria fined over £840.000 over PPI failings’, 30 July 2008.

⁷¹ BaFin, Ergebnisbericht zur Marktuntersuchung Restschuldversicherungen, 21 June 2017, p. 19, 33.

⁷² “Coping with compliance”, report by Nordic Finance Unions, January 2018: https://nordicfinancialunions.org/wp-content/uploads/NFU-study_Coping-with-Compliance.pdf

⁷³ “The price of bad advice”, BEUC position paper, June 2018: https://www.beuc.eu/publications/beuc-x-2018-055_the_price_of_bad_advice.pdf

⁷⁴ Art 7 of the Mortgage Credit Directive <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32014L0017>

g. High rates of credit default

In Q3 2018, the EU banks' average NPL (non-performing loans) ratio was at 3.4%. However, this ratio varies greatly between countries, and is linked to the overall economic situation of the country and other national specificities.⁷⁵

A more accurate picture of NPLs should thus take into account the NPL ratio by consumer risk pool within financial service providers' portfolios. So while any financial service provider may be within the average of 3.4% across the entire consumer base, it is important to look at what segmentation strategy each financial service provider uses. Banks always tailor the credit offer based on the data they collect from consumers, and have criteria to measure risk. For instance, a household with two incomes under a permanent employment contract which has over 40% of disposable income left after all incompressible expenditure and has 50% of the value of a real estate property they wish to purchase in savings, will get a much more interesting offer (interest rate) than a household with only one income as a permanent contract and a maximum of 20% of the value of the real estate property in savings. Thus, within a certain risk pool, especially for small and high-cost loans such as pay day lending, you can have very high rates of credit default, whereas in other risk pools, nearly no credit default. This means that financial service providers might lend out to customers within those risk pools knowing full well that the default rate is very high.

Public authorities have a mandate to step in when market mechanisms are deficient. In this case, competition between financial service providers leads to less risk socialization/mutualisation across the consumer base, an incentive to use ever more data to make smaller and smaller risk pools, personalized risk based pricing which is opaque and makes it impossible for consumers to compare financial products, and greatly increases the chances for vulnerable consumers to fall into over-indebtedness. Contrary to other financial products where increasing the premium is not correlated with increasing the consumers' risk (for instance, increasing a car insurance premium doesn't increase the likelihood of having an accident), increasing the interest rate to cover the risk of default actually increases that risk.

Policy makers should thus clearly define what is an acceptable default rate within a risk pool for all credit providers, which amounts to defining what is irresponsible lending. In other words, at which default rate within a risk pool is it considered irresponsible lending. Also, policy makers should set up a mechanism to monitor default rates across the industry and identify statistical outliers which may indicate predatory lending practices.

h. Lack of duty of care to treat borrowers fairly

In many circumstances, when borrowers encounter financial difficulties that lead to payment arrears or even default, they face consequences that are usually designed to punish rather than to support the borrower's financial recovery.⁷⁶ It is widely acknowledged that, the overwhelming majority of borrowers are willing to repay their credits. When they fail to do so, it is mainly because of financial

⁷⁵ Risk Dashboard, Data as of Q3 2018, EBA, p.3 <https://eba.europa.eu/documents/10180/2547788/EBA+Dashboard+-+Q3+2018.pdf>

⁷⁶ French law has defined and implemented this obligation: la loi du 26 juillet 2013 introduit dans son article 52 la notion de « population en situation de fragilité financière » en prévoyant pour celles-ci des règles protectrices particulières comme l'accès à une offre spécifique de nature à limiter certains frais d'incident. La détention de cette offre permet, pour une cotisation modeste, l'accès pour ses détenteurs à un ensemble de services de banque au quotidien, ainsi que la limitation d'une partie des frais bancaires en cas d'incident par un plafonnement spécifique des commissions d'intervention (décret n° 2014-738 du 30 juin 2014). Aux termes de l'article R. 312-4-3 du Code monétaire et financier, « la situation de fragilité financière du client titulaire du compte est appréciée par l'établissement teneur de compte à partir : 1° de l'existence d'irrégularités de fonctionnement du compte ou d'incidents de paiement ainsi que de leur caractère répété constaté pendant trois mois consécutifs ; 2° et du montant des ressources portées au compte. Dans son appréciation, l'établissement peut également prendre en compte les éléments dont il aurait connaissance et qu'il estime de nature à occasionner des incidents de paiement, notamment les dépenses portées au débit du compte ».

An annual report coordinated by la Banque de France is published to monitor and assess the impact of these protective measures.- https://publications.banque-france.fr/sites/default/files/media/2019/02/27/oib2017_livre-web_20180608.pdf

distress, which is independent of their will and is out of their control. In this situation, a supportive approach from the creditor, implemented as early as possible, to help the consumer to re-balance his/her budget and debts and limit the negative impact of life circumstances such as job loss, reduction in income, divorce, long term sickness, generates better results. When this supportive approach is implemented at an early stage, the borrower's default can be avoided. This helps the borrower not to become financially and socially excluded, maintain his/her capacity to return to a financially sustainable situation relatively fast and remain "profitable" for the creditor.

i. Lack of an effective personal bankruptcy procedure

At EU level, the policy and legal measures adopted concentrate on the prevention of behavioural causes of over-indebtedness. The EU has already affirmed competence in consumer credit and mortgage legislation under the rhetoric of delivering a responsible credit market which encourages competition, innovation and choice. By contrast, dealing with the intertwined situation of consumer defaults and insolvencies – the other side of that same credit market – has been left to the uncoordinated competence of national legislators.

On the one hand it looks evident that the law has limits to solve the unexpected major causes of consumer defaults, which are predominantly matters of wider social and economic policy. On the other hand, nonetheless, the law may address a palpable market failure by providing alleviating measures to repair or restructure the economic situation of the concerned persons, and allow them to return to a financially sustainable or sociably acceptable situation.

However, it may be argued that personal insolvency law has become the 'elephant in the room' in EU credit market law. Debt solutions and procedures once consumers become insolvent have been left to the competence of national legislation in a multi-level division of functions between the EU and the Member States, despite a clear interest of the EU in the matter evidenced by the many commissioned reports in this area.

The traditional parochial nature of personal insolvency law is well documented in legal scholarship. Endogenous systems have developed at various times in history depending on local social values, culture, and moral codes of conduct.⁷⁷ Long time has gone from the banishment or imprisonment of defaulting debtors, but different countries have addressed in their own way the long-established contract law principle of *pacta sunt servanda* and the degrees of primacy attached to ensuring that debtors honour their contractual obligations, as well as the stigmatisation of personal failure and/or value given to moral hazard deployed in their systems.

With the increase of over-indebtedness in the aftermath of the 2008 economic crisis, many Member States have moved towards brand-new or renovated national regimes for the protection of consumers in financial distress and the treatment of the insolvency of natural persons, with nearly all Member States now having a law in place.⁷⁸ However, these appear individual but uncoordinated legal initiatives in the Member States which expose the complete absence of common, harmonized or appropriately resourced strategies at EU level. Each Member State has developed its own legislation with own features and institutional infrastructure for the implementation of the law (including the availability and training of judges and trustees, administrative capacity, accounting, and valuation

⁷⁷ Ramsay, "Comparative Consumer Bankruptcy", 1 University of Illinois Law Review (2007), 241-273; Kilborn, "Two decades, three key questions, and evolving answers in European consumer insolvency law. Responsibility, discretion, and sacrifice", in Niemi, Ramsay, and Whitford (eds.), Consumer Credit, Debt and Bankruptcy. Comparative and International Perspectives (Hart Publishing, 2009), 307-329.

⁷⁸ London Economics, Study on means to protect consumers in financial difficulty: Personal bankruptcy, datio in solutum of mortgages, and restrictions on debt collection abusive practices, Final Report prepared for the Financial Services User Group, Contract No MARKT/2011/023/B2/ST/FC, (December 2012)

systems), but whose design has been driven by emergency and purely internal social policy considerations.⁷⁹

The result is that personal insolvency laws in the EU do not appear cohesive. Many substantive differences exist as far as it concerns the content-based notion of over-indebtedness, the institutional arrangements, the type of procedures (judicial or administrative), the prerequisites and impediments or exclusions *rationae personae* to access the procedure, the modalities or conditions and timeframe for accessing the procedures, the duration of payments and time to grant the discharge, the stay on enforcement actions, the involvement of creditors in the procedures, ranking of creditors' claims, the treatment of secured credits, the costs of the procedure, etc. Within such a fragmented legal framework, the EU has pursued the route of mutual recognition to ensure engagement between the Member States.

The legal instruments which have emanated from the EU concern procedural aspects and jurisdictional rules applicable to cross-border insolvencies mostly in the context of business insolvency.⁸⁰ To date, only soft law instruments of the EU have encouraged Member States to follow basic principles in designing national laws on personal insolvency. Recommendation CM/Rec(2007)8 focuses specifically on consumer over-indebtedness. It acknowledges the development of the consumer credit market and the increased debt problems caused by more lending as a driver of the market economy. In recognising the scale of the matter, it addresses the social and health problems of the over-indebted consumers, as well as their social exclusion. At the same time, however, it stresses the responsibility of the Member States for the effects of their economic and social policies.

The Recommendation is explicit in leaving the regulation of consumer debt solutions to the national law of the Member States. Nonetheless, it recommends them to take appropriate measures, among the others, to alleviate the effects of the recovery of debt by an efficient and unbiased enforcement system. At the same time, it demands the respect of the debtor's rights and human dignity, and the introduction of enforcement alleviation procedures (e.g. measures that include the protection of the essential assets of the debtor and his basic living needs). These are principled recommendations that do not attempt to converge the substantive laws of the Member States.

In 2016, the European Commission has proposed a directive on preventive restructuring frameworks, second chance and efficiency measures for entrepreneurs.⁸¹ Within the framework of the Capital Market Union, the proposal's key objective is to reduce barriers to the free flow of capital caused by differences in member states' restructuring and insolvency frameworks. It aims for all member states to implement key principles for effective preventive restructuring and second-chance frameworks for honest debtors, as well as measures to improve the quality and efficiency of all types of insolvency procedure by reducing their length and associated costs. It also aims to support efforts to reduce future levels of non-performing loans in the EU.

Critically, the Proposal applies to either legal persons or natural persons engaged in a trade, business or professional activity (entrepreneurs), thus excluding natural persons who are consumers.

⁷⁹ Liu and Rosenberg, "Dealing with Private Debt Distress in the Wake of the European Financial Crisis - A Review of the Economics and Legal Toolbox", IMF Working Paper WP/13/44 (2013)

⁸⁰ Council Regulation 1346/2000 replaced by The Recast Regulation 2015/848

⁸¹ Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU, COM(2016) 723 final.

j. Lack of supervision and enforcement

As explained in previous sections, the EU legislative framework for consumer credit contains gaps that need to be filled in the context of the upcoming CCD review. In fact, national consumer credit laws in some Member States are stricter than the CCD in many respects, e.g. rules on product design, distribution, treatment of borrowers in payment difficulty.

Proper regulatory framework must go hand in hand with effective public and private enforcement. Without effective supervision and enforcement, financial consumer protection risks being a dead letter. It is key to ensure that relevant national and EU public competent authorities are well-equipped (clear mandate, qualified staff, strong monitoring, investigation and sanctioning powers) to effectively oversee the business conduct of financial service providers and address consumer protection issues. However, the quality of public supervision and enforcement in retail finance across Member States varies greatly⁸², and EU level harmonisation of the quality of supervision is missing⁸³.

Available evidence shows that compliance with EU and national consumer credit legislation remains an issue. A study conducted by the European Commission in 2013 has shown serious shortcomings in the field of advertising and precontractual information. Only 22% of advertisements containing financial information that were analysed have fulfilled all informational requirements set by the legislation. Also, reviewed market practices in the pre-contractual stage have shown that consumers are likely not to receive key information on their rights and the cost of the credit or additional explanations on the credit conditions. The findings of the research vary considerably across the member states and across types of credit products. A further indicator of incomplete implementation was delivered by a consumer survey that has found substantial variations in frequency of consumers experiencing problems with credit between member states, from 3% in Sweden to 21% in Hungary⁸⁴. In another monitoring exercise of websites offering consumer credit, a coordinated effort of national market supervisors found out that only 30% of websites passed the compliance test⁸⁵.

In Spring 2018, the French supervisory authority DGCCRF (Direction générale de la concurrence, de la consommation et de la répression des fraudes) investigated 325 credit institutions and point-of-sale credit intermediaries to check their compliance with legal obligations when granting consumer credit. The mystery shopping covered both offline and online credit distribution. Among the main findings: quite often pre-contractual information is provided to the consumer after the signature of the credit contract, and this practice spreads more widely with the growing online distribution of credit; ambiguous and misleading advertising by retailers nudging consumers to use revolving credit; lack of assessment of the borrowers' creditworthiness; insurance option pre-ticked by credit sellers⁸⁶.

The CCD does not harmonise the powers of national competent authorities responsible for its enforcement. The directive merely provides that Member States must lay down the rules on effective, proportionate and dissuasive penalties applicable to infringements of its provisions. This means that the solutions adopted across the EU differ greatly. While administrative penalties are commonly used to sanction violations of consumer credit legislation, there are also Member States that have resorted to criminal sanctions for this purpose. In France, for example, exceeding the strict limits imposed by

⁸² For better supervision and enforcement in retail finance, FSUG position, October 2016:

https://ec.europa.eu/info/sites/info/files/file_import/1610-supervision-enforcement-retail-finance_en_0.pdf

⁸³ Proposal for the EU financial supervisory reform, FSUG letter, July 2018: https://ec.europa.eu/info/sites/info/files/fsug-opinions-180705-financial-supervisory-reform_en.pdf

⁸⁴ Study on the functioning of the consumer credit market in Europe, European Commission, 2014: <https://londonconomics.co.uk/wp-content/uploads/2014/05/Final-Report-CCD.pdf>

⁸⁵ EU investigates consumer credit websites - a market underperforming for consumers, European Commission, press release, 2012: http://europa.eu/rapid/press-release_IP-12-6_en.htm

⁸⁶ Cr dit   la consommation : loyaut  de l'information pr contractuelle, Enqu te de la DGCCRF, mars 2018 : <https://www.economie.gouv.fr/dgccrf/credit-a-consommation-loyaute-linformation-precontractuelle>

the legislation on an APRC in consumer credit contracts is punishable by criminal law (up to 2 years in prison and a fee of 300 000 euro).

By way of comparison, there are examples of EU measures that profoundly limit national procedural autonomy, in particular by harmonising administrative sanctions. The most notable example is the Markets in Financial Instruments Directive II (MiFID II) which specifies the range of administrative sanctions, including pecuniary penalties, which should be employed for certain types of breach and how the determination as to the appropriate sanction and level of sanction should be made⁸⁷.

IV. Recommendations for a well-functioning EU consumer credit market

The below recommendations are addressed to the European Commission, the Parliament and the Council in view of the upcoming review of the Consumer Credit Directive. They are aimed at ensuring: (i) a well-functioning EU consumer credit market in which creditors and intermediaries act responsibly and treat consumers fairly, and; (ii) prevention of excessive debt levels and over-indebtedness. Most of the proposals below are general principles that should be harmonised across all financial sectors and products.

a. Scope of the directive:

- Extend the scope to loans below EUR 200 in order to ensure that small amount loan providers act responsibly, and consumers enjoy their rights and protection under the directive.
- Review the list of credit products which are currently exempted from the CCD scope and ensure that there are as few exemptions as possible. In principle, all consumer credit products should be included in the scope. This would improve consumer protection across Member States and reduce opportunities for regulatory arbitrage. For example, credit granted free of interest can result in consumer over-indebtedness, as any other type of loans.
- Include peer-to-peer lending in the scope of the directive. Currently P2P lending is regulated in few EU countries and in a fragmented way. Harmonised EU-level framework is therefore warranted.

b. Product design and suitability:

Introduce rules on product oversight and governance for credit manufacturers and distributors along the lines of the 2016 EBA Guidelines on product oversight and governance⁸⁸:

- When designing consumer credit products, lenders should take consumer interests, objectives and characteristics into account; identify the target market; test products with consumers before launching them on the market; monitor products once they are brought to market and take timely corrective measures to prevent consumer detriment.
- Credit distributors should provide credit only to the relevant target market;
- Point-of-sale credit distributors should propose at least two different types of credit to consumers, e.g. revolving credit and instalment credit⁸⁹.
- Credit distributors should assess the suitability of annex products, such as insurance, to the consumer's needs and expectations.

c. Credit advertising and unsolicited credit:

⁸⁷ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, *OJEU* 2014 L 173/349 (MiFID II, Art 70-72).

⁸⁸ EBA Guidelines on product oversight and governance arrangements for retail banking products, March 2016: <https://eba.europa.eu/documents/10180/1141044/EBA-GL-2015-18+Guidelines+on+product+oversight+and+governance.pdf>

⁸⁹ See, for example, the French legislation in this respect: <https://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000022419094>

- Ensure that credit advertising, whatever its form and media channel used, contain a clear, visible, audible message such as “Borrowing money costs money”.
- Ban unsolicited credit sales based on good national practices.
- Ensure that personalized credit advertising is considered unsolicited sales attempt. Therefore, personalized marketing should be addressed to the consumer only after his/her explicit request.
- Ensure that consumers have sufficient time to make borrowing decisions, in particular, to consider whether and for what purpose they need to borrow. Such a measure is important in the context of the risks related to online marketing and distribution of credit.

d. Creditworthiness assessment:

- Align the CCD rules related to assessment of the borrower’s creditworthiness with provisions of the Mortgage Credit Directive. Notably, creditors should make prudent allowances for potential negative scenarios in the future and make the credit available to the consumer where the result of the creditworthiness assessment indicates that the obligations resulting from the credit agreement are likely to be met.
- Ensure that only pertinent and well-founded data are used by creditors when assessing consumers’ creditworthiness. In particular, investigate the practices by private credit bureaus (what type of data they collect and for what purpose, whether and to what extent credit bureaus contribute to responsible lending and reducing over-indebtedness, whether they comply with the EU data protection legislation, etc) and regulate them at the EU level.

e. Credit cost, fees and penalties:

- Introduce EU-level interest rate ceilings for consumer credit based on good national practices.
- Consider regulating abusive fees and charges that take advantage of consumer vulnerabilities, e.g. rollover charges, penalties for unauthorised overdraft, etc.

f. Sales incentives:

- Introduce rules on remunerations schemes for creditors and distributors (internal remuneration and third-party commissions). The remuneration should not incentive creditors and distributors to focus on volume-based sales to the detriment of consumers. The remuneration arrangements should be linked to the long-term performance of the credit contract for the borrower and the borrowers’ satisfaction level.

g. Fair treatment of borrowers in payment difficulty:

- Introduce obligations for creditors to detect vulnerable borrowers as early as possible, before any default.
- Introduce obligations for creditors to treat fairly vulnerable borrowers in arrears: engage with those consumers at an early stage to identify the causes for those difficulties and provide the necessary information; help the borrower to address temporary financial difficulties and return to normal situation (loan refinancing and restructuring).
- Prohibit creditors from imposing unfair or unreasonable charges on borrowers in arrears.

h. Personal bankruptcy procedure:

- Introduce a fast, cheap and easily accessible personal bankruptcy procedure at the EU level. Such a regime would have a disciplining effect on irresponsible loan providers and stifle their attempts to externalize negative effects of their activity and internalize profit at expense of the society as a whole. The Commission has already proposed a directive on preventive restructuring frameworks, second chance and efficiency measures for entrepreneurs. A similar policy instrument for consumers is therefore warranted.

i. Responsible lending indicators:

- Define what is an acceptable default rate within a risk pool for all credit providers.
- Set up a mechanism to monitor default rates across the industry and identify statistical outliers which may indicate predatory lending practices.

j. Supervision and enforcement:

- Ensure that national competent authorities competent authorities responsible for oversight and enforcement of the consumer credit legislation are well-equipped, i.e. have a clear mandate, qualified staff, strong monitoring, investigation and sanctioning powers.
- Harmonise the administrative sanctions, including pecuniary penalties, for infringement of the provisions of this directive.
- Bring the CCD into the remit of the European Banking Authority.