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Update on Regulatory Affairs in Europe

Council approves Parliament's amendments on Consumer Credit Directive

Brussels is taking the final steps towards finalising the new Consumer Credit Directive. Almost a year ago, in May 2007, the EU institutions announced for the first time that an agreement had been reached on the new Consumer Credit Directive (CCD). But it was not until April 7th 2008 that the legislative process (which was started back in 2002 by a Commission proposal to the European Parliament and Council) finally came to an end. Two weeks ago, the Council approved the amendments voted by the European Parliament earlier this year. This paved the way for the repealing of the Council Directive 87/102/EEC, the forerunner to the new piece of legislation that was widely regarded as outdated and in need of modernisation and further harmonisation. Due to a complicated legal procedure known as *co-decision*, the Parliament still had to agree on what in May of last year was considered as a final agreement on the new CCD. However, in January of this year, a list of the Parliament's amendments was brought forward. These had to be discussed, thereby prolonging the procedure that could have concluded sooner by a straight-forward adoption of the Council's common position.

The amendments sent the process into a second Council round, which prompted ECRI researcher Filipa Figueira to ask in a Commentary "*The Consumer Credit Directive – Still lost in the labyrinth of EU policymaking?*" The new text is now deemed to be adopted and the CCD is claimed to be the adequate framework for the growth of the market for consumer credit, together with the development of more and increasingly complex financial products. Moreover, European policymakers hope to further integrate the fragmented European internal market for consumer financial services, which is primarily national and even local.

Covering personal loans between EUR 200 and EUR 75,000, the main issues of the new directive comprises, among other things, the *provision of standardised pre-contractual and contractual information*, allowing consumers an easy comparison between several products on the European market. In addition, the consumer is granted a *14 day right of withdrawal*. During this time period, the customer may withdraw from a credit agreement without giving a specific reason. Laying down certain rules fixing the maximum amount of

compensation, the client will also be given the *right of early repayment*. According to the text, the amount of compensation to be paid by the customer in case of early repayment may not exceed the amount of interest payment that would have been due if the contract had not been concluded earlier than originally agreed. Further, a clear indication of the *annual rate of charge* is demanded from the creditors, specifying the borrowing rate plus charges, as well as the percentage rate of charges.

The Directive will enter into force once published in the Official Journal of the EU, giving the member states two years to transpose the Directive's provisions into national law. The Directive will thus be applicable from 2010.

Further information:

The text adopted by the Parliament can be found at: <http://www.europarl.europa.eu>

ECRI Commentary: Figueira, F. (2008) *The Consumer Credit Directive – Still lost in the labyrinth of EU policymaking?*, ECRI Commentary No. 3 January 2008, www.ecri.eu

Jentzsch, N. and Lannoo, K. (2007). *Much Ado About Little? Agreement on the Consumer Credit Directive Reached*, ECRI Commentary No. 2 (23. May 2007), www.ecri.eu

Irish regulation on consumer information

Commentary by CEPS Associate Researcher Almudena de la Mata

Regulators around Europe are becoming increasingly interested in how consumers inform themselves before taking up financial services. But how do consumers really get informed? Research conducted by the Irish Financial Regulator in November 2007 revealed that 32% of consumers would never ask for a list of fees and charges before buying a product. Further, consumers also often lose the overview of costs when choosing a financial product. They tend to decide on the basis of their assessment of the initial cost, without looking at the additional ongoing fees and charges that could apply. Different pricing structures also make it difficult if not impossible for consumers to compare products and service providers when making their choice.

In order to enhance consumer protection, the Irish regulator has taken a twofold initiative with regard to consumer information. While stating the firm's duties to correctly inform clients about fees and charges, it also encourages consumers to make a better assessment of such costs before acquiring financial products.

Under the Irish Financial Regulator's statutory Consumer Protection Code, firms must give consumers all the relevant information about a product or service before they sign a contract, including the terms and

conditions and details of any fees and charges that apply. Mainly, firms must:

- tell consumers what the charges are before providing a service;
- make sure that each statement they send shows all the charges they applied during the period covered by that statement;
- give at least 30 days notice if they plan to increase the charges or plan to introduce any new charges that will affect the consumer;
- if charges are built up and then charged at regular intervals, tell the consumer at least 10 business days before they are taken from his/her account (unless they are for €12.70 or less); and
- correct any mistakes in any charge or price quickly, efficiently and fairly.

Consumers should fully understand the product they are buying. For this purpose they should receive proper explanations and all printed information that they receive from financial services firms must be clear and in a print size that is easy to read. Charges and other specific terms can often be hidden in small print that is difficult to read. Equally, consumers are also encouraged to ask the service provider when they do not feel fully confident in understanding the product. With this approach the financial authority is (while setting the framework and minimum standards for financial services information to consumers) also stressing the need to promote consumers' responsibility when acquiring financial products.

Certainly, the best starting point for achieving high standards of consumer protection is to improve the assessment capacity of consumers themselves. Regulation imposing information duties on financial service providers is positive, but only useful if it is accompanied by a broader plan that aims to increase consumers' financial literacy.

While the Consumer Credit Directive also includes some provisions to improve the level and quality of the information given to consumers, the effectiveness of such provisions will always need to be complemented by other measures that aim at developing a consumer's capacity to evaluate the convenience of a financial decision in a broader context.

Local cultural and education backgrounds play a role in this respect. The commitment of local authorities and consumers associations is essential to achieve the full efficiency of any measure promoting the enhancement of consumers' information.

Further information:

Website of the Irish Financial Regulator: <http://www.ifsra.ie/>

European and US News



New financial services ombudsman network

Just recently the *International Network of Financial Services Ombudsman Schemes* was established, unifying financial services ombudsman schemes from around the world, which operate as out-of-court dispute resolution mechanisms in the financial sector.

As stated on the homepage of the network itself (www.networkfso.org), “Internal Ombudsman schemes operating within companies, representatives of regulatory or self-regulatory bodies, and Ombudsman schemes in other consumer sectors, may be admitted as Associate Members of the Network.”

Drawing on the expertise in dispute resolution of its members, the network enables and encourages the exchange of technical information in areas such as Codes of Conduct for Financial Services Ombudsman schemes, as well as the Ombudsman schemes’ structures and functioning, information technology application and cross-border referral of complaints, among other matters. With the co-operation of its members, the Network seeks to organise conferences and workshops, support training and education as well as conduct joint research.

Consisting of a chairman, a deputy chairman, a treasurer and two committee members, this Network Committee is in charge of the control and management of the Network.

Further information:

See the network’s homepage, currently still under construction: www.networkfso.org.

Events

WSBI conference on optimal consumer information and education

On April 16th, the World Savings Banks Institute (WSBI) together with the European Savings Banks Group hosted a high-level conference entitled *Optimal consumer information and education in a competitive retail banking environment* in Brussels. The event brought together various stakeholders who are active in financial education, such as senior policy officials from the European Commission and the European Parliament as well as representatives of consumer organisations and the industry.

In her keynote speech, Commission official Jacqueline Minor from the Directorate General Health and Consumer Protection (DG Sanco) emphasised the need to “put the consumers at the heart of evidence-based policy making”. The 500 million customers of the largest internal market of the world needed to be given the “freedom to choose the best products” while at the same time being guaranteed “high level protection”, she continued. This could be achieved, among other means, by offering pre-selection services to clients, confining their irrational behaviour in choosing a product, as consumers tended to be overwhelmed by greater numbers of ever more complex products offered on the market.

Swedish MEP Olle Schmidt (Group of the Alliance of Liberals and Democrats for Europe, ALDE) referred to statistics highlighting the lack of basic understanding of financial products and services among many consumers. He cited a recent survey in Northern Europe that showed that “75% of the people do not know the options available among financial products”, and another survey that revealed that in Hungary “70% of the interviewees did not know the meaning of inflation”.

Due to the importance of financial education, especially in the light of the current financial turmoil caused by the US subprime crises, the European Commission is stepping up efforts to tackle the issue of financial literacy. According to Dirk Staudenmayer, Head of Unit of DG Sanco of the European Commission, the EU’s executive branch will launch a one million Euro project in the near future to expand the existing online education tool “dolceta” (www.dolceta.eu), which has until now been focusing on the financial education of adults. With the extension of the services offered by the dolceta site, the European Commission aims to address ‘consumers’ still in primary or secondary education, also enabling teachers to include financial issues in the schedule on a voluntary basis. This should account for the different financial interests of young people and adults, which are subject to change with age.

Moreover, the European Commission is also in a preparatory and organisational phase of setting up ‘lab testing’, as Eric Ducoulombier, Deputy Head of Unit of DG Internal Market and Services of the European Commission stated. The goal of the testing, which is to be conducted this year, is to find “a bedrock for all consumers” of the type and amount of information that should be included in contracts for financial services. Early results of the testing can be expected for the end of this year or the beginning of next year.

Further information:

Programme and more information on the WSBI and ESGB can be found on their website: www.savings-banks.com.

George Soros on the 2008 Credit Crisis



George Soros, one of the most popular speculators worldwide, recently visited CEPS in Brussels to present his latest book, *The New Paradigm for Financial Markets: The Credit*

Crash of 2008 and What It Means. The book is an account of Soros' views on the current financial crisis, its causes and solutions. According to Soros, the crisis emerged with the bursting of the US housing bubble and has its origins in the dominance of the current paradigm of 'efficient markets,' (the 'efficient market hypothesis' was coined by Eugene Fama in the 1970s). In his view, this assumption is incorrect from a philosophy of science standpoint. Market fundamentalism assumes that markets function efficiently, move to the equilibrium, and therefore work in everyone's best interest. The equilibrium assumption is derived from physics, which for some time was inspirational to economists. However, Soros claims that as a social science cannot rely on natural science assumptions.

Natural phenomena operate according to the law of cause and effect and humans use their cognitive abilities to understand them. But humans do not only observe but play a participative-manipulative role in social science phenomena. Soros focuses on the concept of reflexivity, where individuals with their perception and create disequilibrium rather than equilibrium when they enter into market transactions.

Soros draws on historical developments to support his thesis. For instance, he states that in practical terms, the crisis started in the 1970s, when the oil crisis led to imbalances between oil importers and producers, which had to be covered by the banks. This resulted in a bank crisis in the early 1980s under Reagan and Thatcher, when banks were given greater management freedom, relying on the market to take care of things. According to Soros, the credit expansion towards a bubble was reinforced by the misperception of a self-correcting market, which in turn reinforced the bubble.

Usually, when signs of a possible bubble are forming, there is a testing/twilight period, where individuals evaluate the economic situation. If the situation is evaluated in a positive way, the misperception prevails and the bubble grows. If this test is not passed, policy is adapted and no bubble develops. For the current crisis, the test would have had to be failed and the authorities would have been obliged to regulate the financial market. However, on the contrary, the test was passed and the housing bubble burst in August 2007, exposing all the accumulated weaknesses based on market fundamentalism. One of those weaknesses was that

instead of financial regulation, moral hazard was created, whereby the institutions causing the financial risk were not the ones to fully bear it.

The current financial crisis, which is characterised by a situation of uncertainty, liquidity shortages and solvency problems (where counter-parties cannot deliver), offers a strong argument in favour of a paradigm shift away from market fundamentalism towards more financial market regulation. In Soros' opinion, an international financial regulation agreement, for example a Basel III Accord, would be suitable. He proposes to regulate every aspect of financial market, encompassing capital, derivatives and currency markets.

Soros suggests that the authorities have not understood the necessity of a paradigm shift and thereby deny any responsibility for this current crisis. Instead of regulating the financial market, for example, he expects the Fed to react in conventional ways: to increase the money supply by lowering interest rates to counter the effects of the crisis until even this strategy fails. The US may face a recession and inflation, which might in turn have a global impact due to the globalisation of international financial markets. He observed that the ECB had limited its actions to keeping the interest rate at 2%. There will definitely be global effects but they will affect different sectors in different parts of the world to a different degree.

The prediction is that 'everything will be fine, it is just a question of time'. Concerning the dollar as a strong or weak currency, Soros thinks that the euro will not replace the dollar as a global reserve currency and that the dollar will eventually recuperate. For the moment, there is a general flight from cash towards real assets until the dollar becomes the reserve currency again.

A Hungarian journalist proposed to Soros that he should fund the creation of modern think-tanks to research his theories and propose regulation. Soros replied that research can be like finance: the higher the risk, the higher the possible return. In other words, the more risky the theory defended, the higher the return when the theory turns out to render the best predictions.

Further information:

George Soros, *The New Paradigm for Financial Markets: The Credit Crash of 2008 and What It Means*, Public Affairs, 2008.

EC conference on financial inclusion

On May 28th, the European Commission will hold a high-level conference on "Financial inclusion: improving access to basic financial services". The event will take place on Commission premises, in the room Alcide de Gaspari of the Charlemagne Building, from 10.00 to 17.45hrs. The conference will present and discuss the results of a study commissioned by the European

Commission to a consortium consisting of the Réseau Financement Alternatif (Brussels), the University of Bristol (Personal Finance Research Centre), the University of Milan (Department of Economics, Business and Statistics) and the Warsaw School of Economics (Center for Financial Services Market Research and Institute of Social Economy). According to the Commission, the study aimed at “identifying and analysing the most effective policy measures in the area of financial services provision and prevention of financial exclusion of people facing poverty or social exclusion.”

Further information:

The programme of the conference as well as a presentation of the study can be found at: http://ec.europa.eu/employment_social/spsi/events_en.htm#financial_exclusion.

News about ECRI



ECRI invited to PARFIC conference in China

ECRI has been invited once again to China to discuss the latest credit reporting issues. Peking University hosted an international academic conference on the Personal Credit System in China. Nicola Jentzsch, associate CEPS Research Fellow, presented a paper with an economic analysis of China’s credit reporting system. Officials from the People’s Bank of China were also present at the conference. They stated to international visitors, among whom were many industry officials, that there are no plans to open the market on credit reporting soon. The international credit reporting industry has lobbied in China for years to gain access to the credit information pooled by banks. Despite international advice to open the market, China has pursued just the opposite policy, by creating one of the world’s largest databases on individuals.

Mrs Jentzsch stated to stunned listeners that by May 2007, the database had stored information on 540 million consumers, of which 78 million had an established credit relationship with a bank. An incredible 350,000 requests and inquiries are made each day. The database will have the effect of broadening access to credit and of decreasing default rates. However, it also presents a considerable privacy risk for individuals and may lead to

increasing economic discrimination. PERC, along with the Peking University-ACOM Financial Information Research Center (PAFIRC) in Beijing, organised the conference.

ECRI staff changes

February and March 2008 brought some staff changes at ECRI. Nicola Jentzsch has become CEPS associate Research Fellow and also pursues other studies in Berlin as guest at the DIW (German Institute for Economic Research). The DIW is one of CEPS international partners. Mrs Jentzsch will also teach at the Technical University of Berlin and act as adviser to the World Bank. After one year and four months, Filipa Figueira left ECRI, where she was working as a Research Assistant in the areas of retail finance, household over-indebtedness and consumer financial capability. As a PhD candidate at the Utrecht School of Economics of the University of Utrecht, Filipa will remain affiliated to CEPS as Associate Researcher, working on issues related to the EU budget.

ECRI recruits new researcher

ECRI is currently in the process of recruiting a new researcher. The popularity and level of awareness that the European Credit Research Institute has generated in the past as well as its ‘mother organisation’, the Centre for European Policy Studies, are manifest in the keen interest of young academics to join the organisation.

Publications

Index on consumer financial vulnerability to be published soon

ECRI and its research partner the Personal Finance Research Centre (PFRC, University of Bristol) have now finalised an international survey on consumer financial vulnerability. This survey, conducted with an independent research grant, lays the foundations for the future Genworth consumer financial vulnerability index. Genworth had contracted ECRI and PFRC to conduct research on this topic a year ago.

The index will mirror the feelings of European consumers in ten countries in relation to their personal finances, and how well they are doing financially. It will start to be calculated from 2008 in a regular manner at least once a year. The final feedback rounds were conducted recently and the study will be published in the coming weeks.