

# Consumer Credit Newsletter

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### REGULATORY ISSUES

#### **State of play in the Consumer Credit Directive saga**

#### *EU Commission to present a new CCD proposal*

After the release of the amended proposal on 28 October 2004, the EU Commission was supposed to work on its consolidated version. Yet, according to DG Sanco and DG Internal Market and Services, the Commission is working on a new proposal, which it expects to adopt in mid-May. This new proposal goes for minimum harmonisation in some key areas, taking the views of the EU Parliament and industry more into account. Thus, the new CCD draft represents a big step forward, as well a major change in the Commission's position.

After the release of the new proposal, discussions will start in the Council. According to Art. 251 of the Amsterdam Treaty, the Council can adopt the proposal by accepting all of the Parliament's amendments that have been endorsed by the Commission; in the case of disagreement the Council can adopt a common position and communicate it to the Parliament.

Thus, despite the movement in the Commission's position, the adoption of the CCD (and the speed with which it occurs) will depend on the future reactions of the Council to the Commission's modified proposal.

#### *UK launches CCD consultation paper*

Although the UK was aware that a new proposal was being drafted, on 25 February 2005 it launched a

consultation process on the EU's revised CCD proposal adopted in October 2004. The document sets out the UK's position and invites industry, consumer bodies and regulators to comment by 22 April.

Through this consultation process the government is seeking to ensure that the CCD is compatible with the UK's ongoing reform of its own consumer credit market. Moreover, the government can in this way gather valuable contributions aimed at shaping future British negotiations on the CCD.

The consultation documents describe the UK's position as supportive of the Commission's objectives with regard to:

- *Overdrafts*

The UK agrees that overdrafts should be governed by light regimes (Art. 6). In fact, the CCD provisions concerning overdrafts do not go much further than the current provisions of the 1987 Directive.

- *Licensing requirements*

Licensing requirements (Art. 28) in the Directive allow member states to decide how creditors and credit institutions are regulated or supervised. The Commission does not introduce strict requirements for regulation or supervision, and only very broadly states that "Member States shall ensure that creditors and credit intermediaries are supervised by a body or authority independent from financial institutions or regulated". Thus, the Directive allows the UK to maintain and develop its own licensing regime.

- *Maximum harmonisation*

The UK sustains the application of maximum harmonisation to the APR calculation (Art. 7), databases (Art. 8) and both pre-contractual and contractual information (Arts. 6 and 10). The consultation document underlines that maximum harmonisation in these areas is a key

requirement for the achievement of a single market for consumer credit.

Nevertheless, the UK is critical of the Commission's objectives in other areas and requires some substantial amendments on several issues, including the following:

- *Maximum vs. minimum harmonisation*

The UK argues that the maximum harmonisation approach does not take into account the differences characterising EU credit markets (except in the previously-mentioned areas). Having one of the most buoyant consumer credit markets in the EU, the UK holds that full harmonisation could lead to the loss of important consumer protection – particularly in highly complex and innovative markets. Thus, the UK is seeking minimum harmonisation in most parts of the Directive.

- *Scope of application*

While the UK welcomes the Commission's progress in reducing the scope of the Directive, it is still considered insufficient. The UK asks for further cut-backs in the scope on:

- *secured lending on property* (Art. 3). The UK supports the exclusion of this form of lending from the CCD, citing that mortgages have different characteristics from consumer credit loans.

- *specific credit agreements that relate to student loans and credit unions* (Art. 7). The UK argues that *student loans* should be excluded from the CCD as these differ significantly from commercial loans in terms of eligibility, interest and repayment. As *credit unions* tend to be based locally, it is unlikely that they will be involved in cross-border provision and thus agreements with credit unions should also be excluded. But if these are included in the CCD, then the Directive should only set

down the minimum information requirements.

There is one area, however, in which the UK feels that the **scope of application is too narrow**. It argues that *small loans* of less than €300 (Arts. 3 and 7) should be regulated by the Directive in the same way as other forms of credit, by removing them from Art. 7. Here the government asserts that consumers of this part of the market are more vulnerable and hence require protection. The UK's Consumer Credit Act of 1974 regulates loans of less than €300, and only offers specific exemptions from obligations to loans of less than £50 (around €70), which are termed 'small agreements'.

- *Advertising*

The consultation paper highlights the need for more sophisticated requirements concerning the provisions on advertising (Art. 4). The UK is of the opinion that the requirements do not aid transparency, which is one of the main objectives of the UK's Consumer Credit (Advertising) Regulations, which came into force in October 2004. Requirements for the clarity of information presented to consumers are likely to be less strict under the EU Directive than under domestic legislation. Thus the UK suggests the introduction of certain minimum requirements as well as the principle of mutual recognition.

- *Responsible lending and the duty to advise*

The UK stresses that the provisions concerning responsible lending (Art. 6) and the duty to advise (Art. 6) consumers on appropriate credit products should be removed. The document explains the UK's principal objection to the provisions on responsible lending, which is based on the view that the decision on how to best assess creditworthiness

should remain with creditors. With regard to the duty to advise, the UK notes its understanding that the purpose of this article is to minimise over-indebtedness. Yet it recognises that the main causes of over-indebtedness are unexpected life events (e.g. losing a job or separation from a partner). Lack of financial awareness is only one of the reasons why consumers may become over-indebted.

- *Joint and several liability*

The current definition of linked credit agreements (Art. 19) in the CCD is more restrictive than that in the UK, which also includes credit cards (section 75 of the Consumer Credit Act, 1974). The CCD definition would limit joint and several liability from its present application in the UK to only those cases where the supplier has acted as a credit intermediary – thereby no longer covering credit cards. Seeking to retain its approach to regulating joint and several liability, the UK proposes minimum harmonisation in this area, to allow individual member states to increase consumer protection if they wish.

## **EU issues guidelines for terminated merchant databases**

After two years of negotiations with industry, the EU's Committee of Data Protection Authorities (the 'Art. 29 Data Protection Working Party') endorsed guidelines in January on the collection and processing of data held by merchants whose contracts to accept payment cards have been terminated.

The guidelines are in the nature of best practice and apply without prejudice to the provisions of the applicable national legislation. The aims are twofold:

- 1) *To prevent fraud by facilitating the exchange of information*

As member states across the European Union have not applied the EU's Data Protection Directive in the

same way, fears about breaking national rules have prevented banks in certain member states from reporting fraudulent merchants to these databases. The guidelines set out the conditions under which payment systems, banks and other payment service providers may operate national or cross-border databases on merchants whose contracts to participate in their systems have been cancelled. The listing of merchants' names must be based on objective criteria related to specific irregularities or risks, mostly linked to fraud.

2) *To ensure that merchants' privacy is better protected*

The guidelines include a comprehensive catalogue of data protection rules, including how long data can be kept, how and when merchants should be informed, as well the correction or deletion of information.

The Working Party is responsible for monitoring the implementation of the guidelines, which are to be reviewed in early 2006. The European Commission estimates that the savings derived from the prevention of fraud will amount to €200 million.

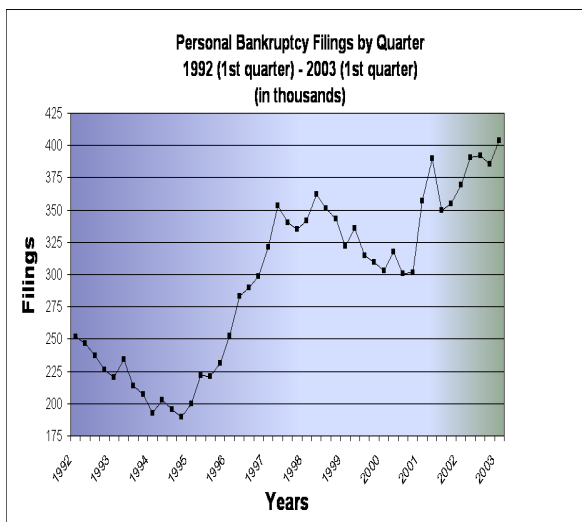
**US Bankruptcy Reform bill set to pass**

The US Senate passed the Bankruptcy Reform bill on 11 March. The House of Representatives is due to vote on it in early April and send it to the President for signature.

The foundation of the legislation is a provision that would limit the access of individuals to Chapter 7 of the bankruptcy code. This chapter enables individuals to limit payments on their obligations and get a 'fresh start'. The Bankruptcy Reform bill will set up an income test that measures debtors' ability to repay debts. Debtors with incomes above the state median and who can pay at least \$6,000 over five years will instead be subject to Chapter 13, which requires a repayment plan.

According to the American Bankruptcy Institute, bankruptcy filings have increased sharply. During the last 10 years, filings have risen from approximately 250,000 in 1992 to over 400,000 in 2003. The new legislation would disqualify between 30,000 and 210,000 annual cases (in percentage terms ranging from 3.5 to 20%) filed by persons who are seeking to dissolve their debts through bankruptcy.

Sponsors of the legislation argue that



Source: American Bankruptcy Institute.

the US bankruptcy system has been heavily abused and that the reform will restore the system's legitimate use. Moreover, the new legislation will lower the costs of goods and services for consumers by making it easier for companies and credit issuers to collect unpaid debts rather than passing these costs on to everyone else.

Opponents argue that the measure was the result of hard lobbying by banks and credit card companies and that the high rate of bankruptcies is largely owing to hidden fees for late payments of credit card debts and loans. They also stress that the Bankruptcy Reform bill would impose new obstacles on many middle-class families seeking protection from creditors. This view is confirmed by a recent Harvard study published in the journal *Health Affairs* (Vol. 24, No. 1, [www.healthaffairs.org](http://www.healthaffairs.org)), which finds that half of all US bankruptcies are caused by soaring medical bills. The study finds

that even middle-class families with insurance often fall victim to financial catastrophe as a result of illness.

### **New Italian code of conduct for credit reference agencies**

On 1 January 2005 the new Italian code of conduct and professional practice for credit reference agencies entered into force. The code must be implemented by 30 June 2005. Relevant aspects regulated by the code include: the purpose of data processing, data quality and transparency, data registration by credit bureaus, data collection and data retention, access and exercise of other rights by data subjects and credit scoring.

The code has been elaborated by the Italian Data Protection Authority in consultation with relevant industry and consumer associations.

One of the main changes introduced by the new code concerns the period in which data can be registered with and held by credit bureaus. The code establishes that the maximum period that data can be retained in a database is 36 months, as opposed to the 60 months in the previous legislation. More particularly, in the case of a default, information cannot be retained for longer than 36 months from the time the information was last updated or the relevant relationship was terminated. When the information retained is positive, it cannot be held for longer than 36 months from the date of termination/or expiry of the relevant contractual agreement.

On the one hand the reduction of the data retention period does increase consumers' privacy; but on the other hand it makes it more problematic to obtain information on debtors. Thus, it could become more difficult for financial institutions to evaluate risks in lending and have a negative effect on both the availability of credit and its costs.

## MARKET ISSUES

### **Banking industry shows strong interest in retail financial markets**

#### *Credit Agricole acquires remaining stake in Finaref*

Credit Agricole signed an agreement with Pinault-Printemps-Redoute (PPR) in January to acquire PPR's remaining 10% stake in the consumer credit subsidiaries Finaref S.A. and Finaref Group A.B. (which provide credit and financial services in Scandinavia). The acquisition of Finaref Group A.B. and Finaref S.A. by Credit Agricole was completed through several transactions that started with the acquisition of a 69% stake in 2002, followed by the acquisition of a further 29% stake during 2004, leaving PPR with only a 10% stake.

Finaref is one of the most important consumer credit businesses, as well one of France's largest, private label card issuers. Credit Agricole has the aim of reinforcing its position in consumer credit, which is one of its primary strategic areas for development in the French and international markets.

#### *Swedbank and Barclays announce joint venture*

Swedbank announced a joint venture with Barclays in February. The aim of the joint venture is to distribute and sell credit cards in the Scandinavian market. In a recent statement, Barclays said that the Scandinavian market has excellent potential for growth with average incomes among the highest in Europe, low credit card penetration and a strong economic outlook. In Sweden and Norway there are currently about 2-3 million credit cards, whereas the market potential for credit cards is envisaged to be up to 10 million (source: BankEcon, February 2005, [www.bankecon.com](http://www.bankecon.com) ).

### *Commerzbank plans acquisitions to boost retail sector*

Commerzbank, the fourth largest bank in Germany, announced in February that it plans to boost its retail sector through acquisitions. Commerzbank is planning acquisitions in Germany as well as in Eastern Europe. At present, German private banks are suffering from over-capacity and state banks are the lead providers of retail banking services, with 27% of market share in 2003 (source: Datamonitor). The German legal framework still prevents mergers between the country's cooperative, private and state-owned savings banks. Until now, most of the consolidation actions in Germany have taken place among smaller institutions, especially with the sale of private banks.

### *BBVA sets out growth strategy for key retail markets*

BBVA set out a growth strategy in February for three key retail markets: Spain, Latin America and the US. Its aim is to increase the group's customer base in its main retail markets through products and services for growth-oriented segments that have low banking penetration.

More particularly, in Spain BBVA will focus on the immigrant population, in Latin America on the underserved banking population and in the US on three core business areas: remittances, immigrant banking, second-generation immigrants and SMEs.

### UPCOMING ISSUES

#### **Post-FSAP Green Paper anticipated in May**

The Commission is to release a Green Paper in May focussing on the post-FSAP agenda, including retail financial markets. Retail issues are increasingly at the centre stage of internal market policy. More specifically, while there has been significant progress in the integration of EU wholesale financial markets, integration of the retail

financial market is still very poor. The consultation paper will also put emphasis on mortgage credit, given its primary share of retail financial services (see ECRI Newsletter No. 15).

#### **New legal framework for payment systems**

The Commission is working on a proposal for a new legal framework for payments in the internal market, and expects to release a related directive later in 2005.

Technical and legal barriers still prevent EU citizens, companies and payment service providers from benefiting from a truly integrated area for non-cash payments. For instance, although there has been some progress towards a single euro zone payment area – particularly through the EU regulation on cross-border payments (Regulation 2560/2001 EC) that came into force in July 2003, the underlining structures have remained fragmented.

In a recent speech (EUROFI – Banking and Finance in Europe, Luxembourg, 10 March 2005), Charlie McCreevy, EU Commissioner for the Internal Market and Services, stressed that the self-regulation of banks in this area has led to little progress. Thus, the draft legal text could make some of the agreed industry standards mandatory and include a roadmap for a single European payments area.

### ECRI NEWS

#### **2nd Consumer Finance Network meeting**

ECRI is organising the second Consumer Finance Network meeting to be held on Friday, 15 April. The discussion will focus on possible and appropriate indicators of indebtedness and over-indebtedness. The definition of a common indicator and a method of measurement will form the basis for a cross-European study in this field. (For further information see the ECRI website [www.ecri.be/HTM/network/network.htm](http://www.ecri.be/HTM/network/network.htm)).