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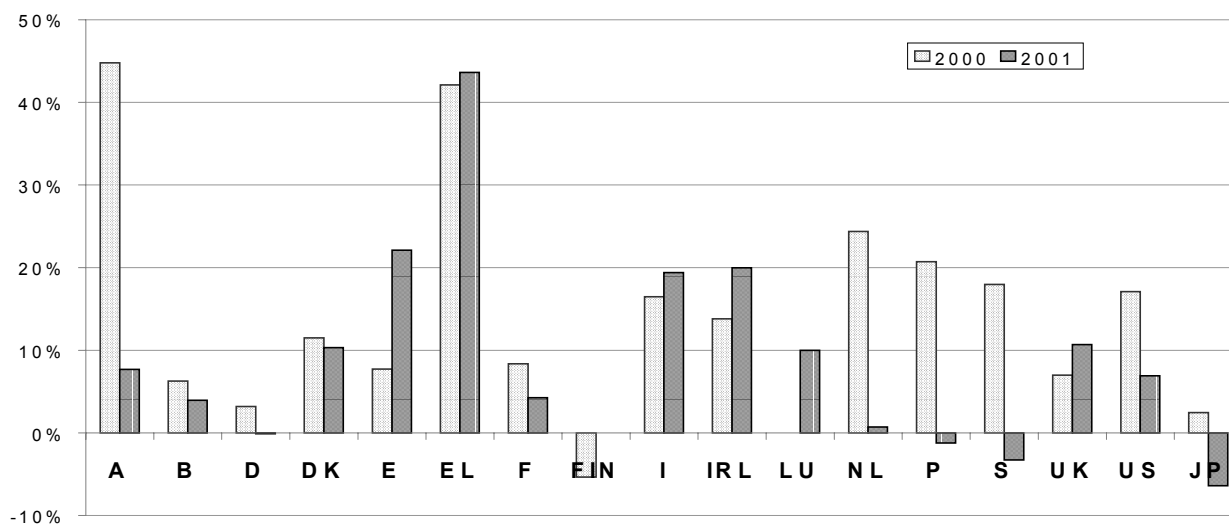
STATISTICAL UPDATE

After a period of strong economic growth, most European countries experienced a marked economic slowdown during the past year. With respect to the deterioration in consumer confidence and the downshift in private consumption growth, consumer credit increased somehow less in 2001 compared to the previous year.

This tendency was particularly pronounced in Austria, the Netherlands, Portugal and Sweden, whereas, at the same time, in other countries such as Spain, Italy and Ireland, the contrary was observed. In fact, slackening in monetary conditions at the end of the year allowed cuts in bank lending rates to individuals in the euro area, which in turn stimulated household demand for long-term consumer loans.

Thus, although economic growth weakened, consumer credit growth was maintained at a high level. Nevertheless, the uncertainty about future economic developments as well as the higher volatility on stock markets resulted in an increase of precautionary savings of households.

Chart 1. Consumer credit evolution (2000-01)

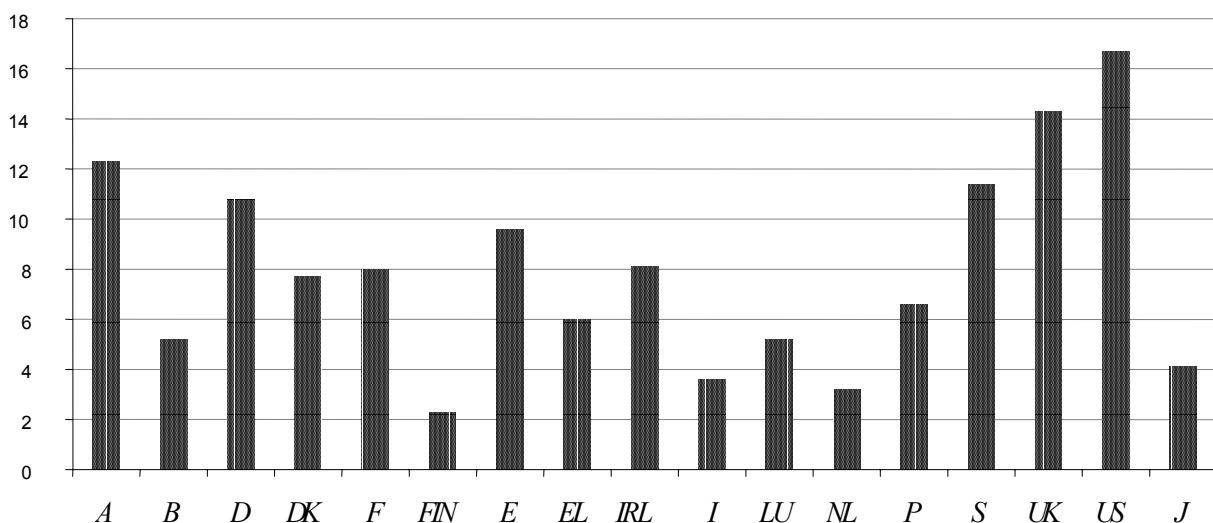


Source: ECRI.

In addition, consumer credit evolved more rapidly than GDP in the majority of the EU member countries. It is noteworthy that consumer credit as a percentage of GDP picked up to a greater extent in those countries where consumer loans represented a smaller part of the total lending to households (such as Italy, Ireland and Spain).

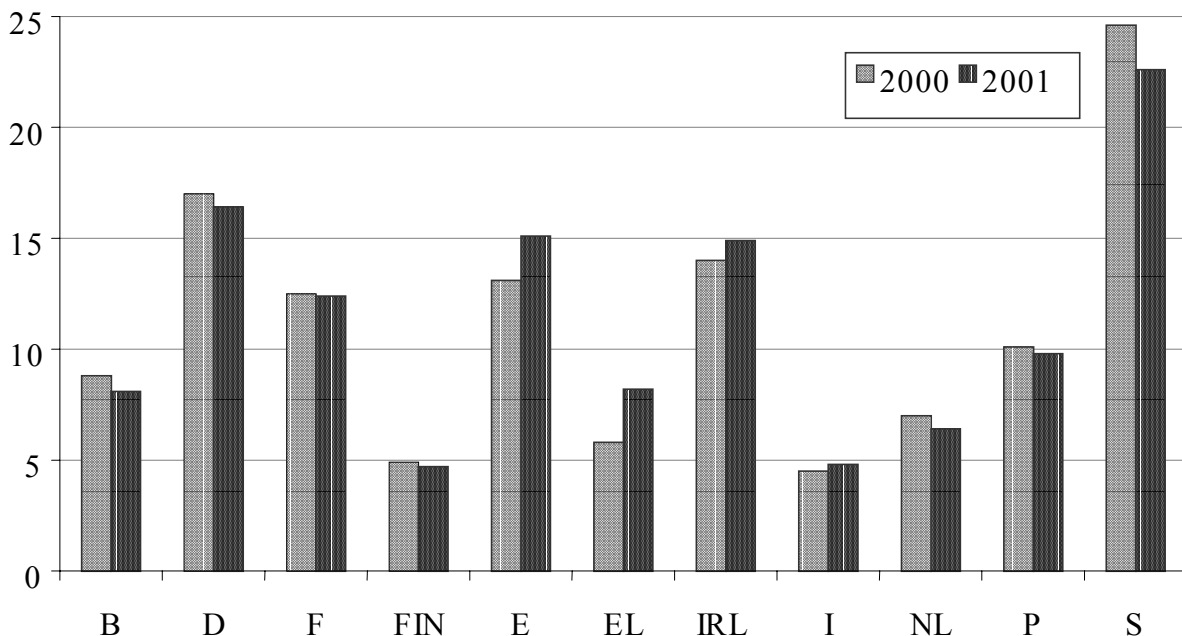
One may conclude that the evolution of the latter ratio reflects some structural developments. But, more generally, the consumer credit evolution tends to follow closely the fluctuations in GDP growth, as seemed to be the case for Belgium, Germany, France and Finland for the past year.

Chart 2. Consumer credit as a percentage of GDP (2001)



Source: ECRI.

Chart 3. Consumer credit as a percentage of disposable income



Source: ECRI.

Finally, an increase in disposable income usually boosts consumer credit demand by improving the ability of households to meet interest payments. In 2001, disposable income growth accelerated, somehow counterbalancing the negative effects of dropping consumer confidence and allowing households to maintain their borrowing from banks. Nevertheless, the slight decrease of the ratio consumer credit/disposable income was consistent with the increasing concerns of households about their future financial situation.

As shown in the chart above, there were some exceptions. For example, credit expansion in Greece was faster than in the euro area, surpassing the annual growth of disposable income. Although disposable income continued to rise in Ireland and in Spain, consumer credit growth was stronger, in part because of the easing of lending conditions and low interest rates. In the rest of the European countries, the ratio stabilised.

For more statistics see: www.ecri.be
 Full set of data available to ECRI members in:
www.ecri.be/membersonly

THE LEGAL OBSERVATORY

Comments on the proposal for a consumer credit directive by Marc Dassel, Professor at the Free University of Brussels (ULB)

The following article analyses the new status of credit intermediaries under the proposed Directive on the harmonisation of the laws, regulations and administrative provisions of the Member States governing credit for consumers [COM(2002)443 final, dated 11 September 2002].

I. What is a credit intermediary?

The definitions of “creditor”, “consumer” and “credit agreement” have undergone few changes in the proposed Directive compared with the text of the current Directive (87/102/EEC). There is one exception, however, regarding the definition of a credit agreement. Namely, the concept of “agreement promising to grant credit” is made clearer. All credit transactions are covered, including promises to conclude agreements. Credit agreements for the supply of services are also covered.

The definition of “credit intermediary” found in Art. 2 of the proposed Directive is a general concept which is intended to cover several types of activity and several categories of intermediary, namely:

- An agent who is delegated and authorised to sign, exclusively on behalf of the creditor;
- A credit broker, that is, a self-employed person working under his own name who submits credit applications to a number of different creditors; and
- A “supplier of goods or provider of services”, that is, a person (such as a salesman) who can be either a delegated agent or credit broker, or even a creditor who immediately transfers his rights to another creditor/principal finance provider who will (co) decide on the granting of credit and whose role as broker is no more than an activity supporting his principal one, namely the sale of products or services.

As stated in the Explanatory Memorandum,

the definition proposed covers any person who assists in the conclusion of a credit agreement, in other words, not only the credit broker but also the delegated agents or bank agents as well as the supplier of goods and the providers of services, main or subsidiary business undertakings, including marketing assistants.

In a nutshell, the proposed Directive covers any person who provides a creditor with information to

identify a consumer and directs the latter, *for a fee*, to a creditor for the conclusion of a credit agreement.

Under the proposed Directive, this fee may take the form of cash or some other agreed form of consideration, “such as computer support, access to the creditor’s business network or overdraft facilities for example”.

Even lawyers and notaries can come into the field of application of the proposed Directive, if they do not limit their role to providing legal advice but, in addition, direct their clients to particular creditors.

Critical remark: Blurred demarcation line between creditor, credit intermediary and ancillary credit intermediary.

A parallel may be made in this connection with the Commission’s interpretative Communication of 20 July 1997 on freedom of establishment and provision of cross-border services under the second banking directive (OJ C 209, 10 July 1997, p. 6).

Namely, pursuant to that Communication, if an intermediary acts exclusively for one credit institution based in another member state and can bind it, then that intermediary will be viewed as an extension of that credit institution. In other words, one will take the view that that credit institution is providing services, or has an establishment in the other member state in the person of the credit intermediary.

On the other hand, if the credit intermediary does not meet these conditions, for example, if he works for several credit institutions, or does not have the power to bind them, then that intermediary will not be viewed as an extension of the credit institution itself.

However, the proposed new Directive on consumer credit provides that member states may exempt from registration credit intermediaries who are also authorised as credit institutions. Thus, depending on the changing business circumstances of a credit intermediary, he may or may not come within the scope of application of the proposed Directive.

II. Joint and single liability

To quote from the Explanatory Memorandum,

the wording used in the current Directive 87/102/EEC, namely ‘subsidiary responsibility’ is a compromise with provision for the consumer under certain circumstances being able to claim payment from the creditor in case his complaint against the vendor is justified and the latter refuses to pay. A number of member states simply transposed [the relevant article of Directive 87/102/EEC] and created legislation that was

ineffective. Other member states went beyond the requirements of the provision of the current directive and deleted the concept of 'exclusive link' in relation between the creditor and the supplier or provider.

In response to this incoherent situation, the proposed Directive suggests the comprehensive adoption of the "joint and single liability solution when the credit supplier and the supplier of goods or services are joint market operators. A case in question would therefore be where the supplier has acted, even in an ancillary capacity, as a credit intermediary".

As a result, Art. 19.2 of the proposed Directive reads as follows:

If the supplier of goods or services has acted as credit intermediary, the creditor and supplier shall be jointly and singly liable for indemnifying the consumer where the goods or services, the purchase of which has been financed by the credit agreement, are not supplied, or are supplied only in part, or are not in conformity with the contract for their supply.

Clearly, the authors of the proposed Directive take a very strict view of the joint and single liability of the supplier of goods or services, even if he has only acted as "ancillary credit intermediary" in such circumstances.

Namely, the Explanatory Memorandum states the following:

An effective check by the creditor can be taken for granted in such cases and the consumer should not be required to provide proof. This possibility covers not only the credit that has been assigned in the strict sense but also any other form of credit availability or debit that the supplier proposes to the consumer on the occasion of the first purchase. It will be remembered in this respect that this proposal for a directive contains a provision requiring the identity of the intermediary to be shown in the credit agreement.

Potentially, this provision can thus have far-reaching implications, for example for large department stores.

III. Best advice obligation

Paragraph 15 of the proposed Directive reads:

In view of the technical and legal complexity of credit instruments, it is necessary to impose a general obligation on the credit intermediary and creditor to provide advice so that the consumer can choose in full knowledge of the facts among the types of credit offered. Similarly, it is a responsibility of the creditor, in accordance with

the principle of 'responsible lending', to check whether the consumer and, where applicable, the guarantor are in a position to meet new commitments.

In addition, the proposed Directive (p. 33) provides as follows:

- If the supplier of goods or services acquired under the credit agreement can be regarded as a credit intermediary, the consumer must be able to enforce rights against the creditor which go further than his normal contractual rights against the supplier of goods or services.
- In addition, the transfer of the creditor's rights under the credit agreement must not have the effect of placing the consumer or guarantor in a less favourable position [than if the assignment had not taken place].

IV. Obligation to provide a full guarantee of repayment in the case of credits linked to equity products

According to Article 20 of the proposal,

If payments made by the consumer do not give rise to an immediate corresponding reduction of the total amount of the credit, but are used to constitute capital during periods and under conditions laid down in the credit agreement, such constitution of capital shall be based on an ancillary agreement attached to the credit agreement.

The ancillary agreement referred to above shall provide for an unconditional guarantee of repayment of the total amount of credit drawn down. If the third party providing constitution of capital fails to comply with his obligations, the creditor shall assume the risk.

V. Registrations, Status and control of creditors and credit intermediaries

V.1. The proposed Directive provides as follows for the compulsory registration of creditors and credit intermediaries:

Member States shall ensure that creditors and credit intermediaries apply for registration (Article 28).

However, the obligation to register "does not apply to credit intermediaries for whom a creditor or another credit intermediary assumes responsibility under the terms of his home registration. This assumption of responsibility must be made clear in a notice on the premises of credit intermediaries not required to register.

No doubt, the professional liability insurers of many potential ancillary credit intermediaries, among them first and foremost vendors of goods and services, will be eager to make use of this provision.

Art. 28, paragraphs 2 and 3 of the proposed Directive further provides as follows:

Member States shall:

- a) ensure that the activities of creditors and credit intermediaries are subject to inspection or monitored by an institution [which term is not further defined by the proposed directive] or official body;
- b) establish appropriate bodies to receive complaints concerning credit agreements, surety agreements and credit and surety conditions, and to provide consumers and guarantors with relevant information or advice on the subject.

In addition, member states may provide that registration shall not be necessary “when the creditor or credit intermediary concerned is a ‘credit institution’ [as defined by the coordinated Banking Directive 2000/12/EC] that is authorised in accordance with the provisions of that directive”.

Where a creditor or credit intermediary is both registered under the provision of Art. 28, paragraph 1 as a credit intermediary, and as a credit institution under the provisions of the Banking Directive 2000/12/EC, and the latter authorisation is subsequently withdrawn, the competent authority which has registered the creditor or credit intermediary pursuant to Article 28 Paragraph 1 “shall be informed and shall decide whether the creditor or credit intermediary may continue to grant or arrange credit or whether his registration should [also] be cancelled.”

V.2. Art. 29 lays down the following obligations for credit intermediaries

Member States shall ensure that a credit intermediary:

- a) indicates in advertising and documentation intended for clients the extent of his powers, in particular whether he works exclusively with one or more creditors or other independent brokers.
- b) communicates to all creditors contacted, the total of other credit offers he has requested or received for the same consumer or guarantor during the two months preceding conclusion of the credit agreement.
- c) does not receive, directly or indirectly, any fee, in whatever form, from a consumer who has

requested his services, unless all the following conditions are met:

- i. the amount of the fee is stated in the credit agreement;
- ii. the credit intermediary does not receive the fee from the creditor;
- iii. the credit agreement for which he has acted is actually concluded.

In addition, Art. 8.1 provides that “creditors must consult the database prior to any commitment of the part of the consumer or guarantor”. Conversely, creditors must of course notify the central database, which must be set up by member states pursuant to Art. 8, of the granting of any credit, if the database is of the “positive” type, or of any default, if the database is only of the negative type.

Critical remark: Absence of a single passport.

The Council has recently adopted the proposed Directive relating to insurance intermediaries (so-called “insurance mediation directive”). (Document PE/COMS3639/02 – 2000/0213 (COD)).

One of the key features of that directive is the grant to insurance intermediaries of a so-called “single passport”. In effect, this gives an insurance intermediary having his head office (and being registered) in member state A the right to provide his services on a cross-border basis in all other member states subject, as a rule, to the supervision only of his home member-state supervisor.

Surprisingly, even though the proposed new Directive on consumer credit puts forward as one of its main justifications the need to encourage the free provision of consumer credit services on a cross-border basis by credit intermediaries, it does not provide them with a single passport. At the same time, however, it provides that credit intermediaries must henceforth be registered in their home member state and be subject to supervision, as is the case for insurance intermediaries.

One wonders what are the reasons for this difference of treatment.

In addition, this difference of treatment is likely to result in a number of difficulties. There are two reasons for this:

- A financial product in one member state may be categorised as an insurance product, yet be categorised as a consumer credit product in another.
- A number of intermediaries are active not only in the consumer credit field but also in the insurance services field.

The new consumer credit directive: A feasible attempt at harmonisation? by Amparo San José, CEPS Research Fellow

The European Commission has recently presented (11/09/2002) a proposal for a Directive on the harmonisation of the laws, regulations and administrative provisions concerning credit for consumers. The Directive intends to "... pave the way for a more transparent market, a more effective market and to offer such a degree of protection to consumers that the free movement of offers of credit can occur under the best possible conditions both for those who offer credit and those who require it".

The previous Directive (87/102/EEC) was targeted at the two most common products at that time, namely "hire-purchase" agreements and "instalment credit", in the context of a cash-based society. Today's credit industry bears little resemblance to the retail credit situation in the 1980s. Existing directives were judged to offer insufficient consumer protection by governments, which added new provisions, which in practice laid down a minefield for consumers in search of credit in other member states and distorted competition between creditors in the internal market. Therefore, the case for a new directive is well established and all parties involved agree on the need to update the existing legislation.

The scope of the new Directive is extended to all credit and surety agreements including guarantors, with a few exceptions: housing credit for the purchase or transformation of property and credit and any advance granted occasionally by an employer to his or her staff. The Directive establishes a new framework to redress the sharing of responsibilities between consumers and lenders, including intermediaries. Such harmonisation of laws is likely to benefit consumers by covering all aspects of credit and the enhancement of the information to be provided. It will also assist lenders by facilitating the marketing of their products cross-border under the same conditions that exist in their home country.

The proposal, however, seems not to have fully pleased any of the parties involved. Financial institutions regard the proposal in its present state as a threat to the development and expansion of their business, along with an important interference in the way they operate. Consumers on their side have welcomed the proposal but remain sceptical about the effect on the level of consumer protection it will afford.

The text spells out a comprehensive set of provisions that will impact the way the industry and the market function. We comment next on three essential aspects of the proposed Directive: the novel concept of *responsible lending*, the inclusion of *joint and several liability* between distributors and creditors and certain issues concerning the *maximum harmonisation* approach of this proposed Directive.

The proposal introduces the principle of responsible lending, based on the requirement that financial institutions act as "good creditors" (Art. 9). This rather philosophical concept is aimed at ensuring that the creditor does not grant further credit to consumers who might be in a difficult position to repay new debt contracted. In practice it represents an obligation to consult centralised credit databases and to examine responses provided by the consumer and the guarantor, as well as data supplied by intermediaries. However, the proposal does not include any elaboration on the consumer's responsibility regarding the application for, and management of credit in case of breaching his responsibility to provide truthful information. Acting as good creditors also means offering the best possible form of credit to the borrower, while the consumer very often has preference over one form of credit. This requirement leaves the field open to all kind of legal disputes between lender and borrower if default occurs.

From a cross-border perspective, conflicts might arise due to the different reporting scenarios within the EU. The provisions enforcing the exchange of information between national reporting agencies, or credit bureaus, is certainly well received by the industry as a key element to promote the single market. However, what will happen in the case of a lender from a negative reporting country (where registries only record information on payment defaults) lending to a client in a positive reporting country (all credit outstanding is recorded by the registry), but in the light of reciprocity exchanges only receives negative information? Will these foreign lenders be judged as neglecting their credit assessment responsibilities?

Furthermore, since the burden of proof rests on lenders, the proposal creates uncertainty about how responsibilities can be cleared if lenders are obliged to destroy any records obtained from the credit registry immediately after the conclusion of the agreement (Art. 7). Would credit registries be forced to keep records that offer a static picture of an individual's finances at a given point in time to assist in any litigation that might take place years after the

credit is agreed? This will oblige credit bureaus to keep a copy each time its database is consulted. These records must be kept for a non-defined period of time, which will require additional resources and associated costs. It has to be kept in mind that more than 2 million credit reports are sold everyday in the US. This requirement also raises data protection concerns, since outstanding liabilities have to be erased from the file once they are paid, and negative records also have to be erased after a certain period.

Although welcomed by consumers as a tool to reduce over-indebtedness, in practice, responsible lending provisions are far from solving such problems since they do not reflect the reality of the causes of over-indebtedness. As an ECRI study¹ has recently illustrated, over-indebtedness is in most of the cases caused by the unanticipated occurrence of economic and personal events (unemployment or divorce) that reflect on the financial health of the individual or household altering the capacity to face debts contracted, and not by the simple accumulation of credit. (See p. 11 of this Newsletter for a full description of this new study). The phenomenon is therefore difficult to predict on the basis of information available at the time of granting the credit. Moreover, the weight of consumer credit in the indebtedness of households varies significantly across EU member states. Consumer credit represents on average 15% of household indebtedness, while the rest is mainly mortgage credit. For instance in Austria, housing credit and consumer credit represent respectively 43.7% and 41.3% of household debts, whereas it is 88% and 4.7% respectively in the Netherlands.

The proposal will exacerbate differences between US and EU credit markets in this area. In the US there is a combination of flexible lending practices that have contributed to the expansion of credit to less-favoured social sectors, and a body of legislation that provides a soft approach to individual bankruptcy. The EU proposal will introduce elements that would restrict the granting of credit without offering any advantage to creditors, since the responsibilities of borrowers remain unchanged. In the US over-indebtedness and default are considered part of the economic cycle and its consequences are mainly borne by lenders.

Another novelty of the proposal is the introduction of *joint and several liability*. The existing Directive provides for subsidiary responsibility, by which the

¹ Amparo San José Riestra, *Credit Bureaus in Today's Credit Markets*, ECRI Research Report No. 4. Sept. 2002.

consumer is able to claim reimbursement from the creditor if his complaint against the vendor is justified and the latter refuses. This is certainly a step forward for consumers in that it forces lenders to monitor the good business practices of the retailers with whom they cooperate. It is already in place to a certain extent in Europe, with the most consumer-friendly case in the UK, where credit card issuers are liable for all damages related to the purchase of the good. The Commission has adopted this model in the new proposal.

A long-standing discussion concerns maximum and minimum harmonisation. Traditionally, regulation close to the field of consumer protection has followed the principle of minimum harmonisation, leaving to member states the prerogative of establishing more restrictive provisions that ensure the existing level of consumer protection in a country. However, given the few advances in the completion of the single market in these areas, the Commission seems, at present, to favour maximum harmonisation, such as the distance marketing of consumer financial services Directive, whereby member states may not adopt provisions other than those laid down in the Directive for the harmonised fields.

Banks have long sought maximum harmonisation that allows them to market financial products cross-border without further adaptation to the legal environments. However, they might be underestimating the risk of adopting the highest level of protection in every country that the maximum harmonisation approach entails. And conversely, consumers are afraid of losing the high degree of protection existing in some countries for the purpose of maximum harmonisation. The search of common standards in consumer protection can result in the adoption of the lowest common denominator, and member states will not be able to establish additional provisions. The concept of "optimal protection", often-mentioned as the best approach, has not been yet developed into a practical set of recommendations.

The outcome is uncertain to foresee, since credit to consumers and consumer protection are politically sensitive issues and all elements of the proposal are therefore bound to be extensively discussed. For instance, it is very unlikely the UK consumers and policy-makers will renounce the pure joint liability system for credit cards, whereas lenders in most of the member states are radically opposed to this provision. The outcome might therefore be that important areas are left outside the harmonised field,

hampering the establishment of an effective single market for credit to consumers.

Surprisingly, the proposal fails to clear the way for the development of on-line financial services. It demands the signature of the contract in paper or other durable medium, diverging from the e-commerce directive, which recognises electronic signatures as valid but does not apply to financial contracts.

Nevertheless, the proposal introduces elements that will enhance transparency and benefits to consumers, including further provisions of advertising and harmonisation of the APR (annual percentage rate), information to be provided prior to the agreement, the right of withdrawal and a clear assertion of the right to early repayment.

Some reflections on the proposals for a new Directive on Consumer Credit by David Rees, Chairman of the Law Committee, Consumer Credit Association, UK

The proposals for the review of Europe's consumer credit laws have finally emerged (COM (2002) 443 final).

What do this aim to achieve? The Explanatory Memorandum sets out a series of worthy objectives. The list includes:

- a boost to the internal market
- more competition
- more transparency
- more consumer protection

Will the proposals deliver what they promise? They will inflict great damage on the more advanced credit industries that exist in some member states. But what if no benefit accrues and this sacrifice is in vain? The proposals describe credit as "a driving force for economic growth and the well-being of consumers" (para. 1.2). So what if the net overall effect is to harm the credit industry and to depress lending? If this happens, the Commission will have scored a dramatic own goal, damaging the industry, the EU economy and the well-being of EU consumers too.

So what is missing from the Commission's analysis? First, the draftsmen confused over-regulation and bureaucracy with the consumer interest. In fact, the truly empowered consumer is the one who can get credit quickly and easily, not the one who is refused because the law makes it too risky or too costly to lend to him.

The Eurobarometer surveys asked about "rights" and "redress". They omitted some much more important questions. They did not ask, for example, whether consumers would prefer to be able to get credit than not. Nor did they ask whether consumers would prefer to have quick, straightforward application processes rather than bureaucracy and delay. Recent focus group research for the UK DTI showed (perhaps not surprisingly) that the consumer preference is for efficiency and minimal bureaucracy.

Secondly, the Commission comes from the position that the credit industry is to blame for over-indebtedness. This is a populist view tirelessly promoted by much of the media and by some consumer groups. If only the industry can be "reined in", over-indebtedness will surely reduce.

Serious evidence and research points in the opposite direction. In the UK, for example, with its "open market" credit law and dynamic credit industry, county court judgements have fallen for the last 10 years, as have mortgage repossessions. And UK credit reference bureau figures show arrears levels that have stayed at the same percentage levels over that same 10-year period.

Even a recent study for DG SANCO by OCR Macro points to the same conclusion: where there is more credit, there is usually less over-indebtedness. In short, credit is generally "a good thing". This is not a newsworthy headline and is an uncomfortable conclusion for the industry's critics. But it is easy to see why it is right. Problem debt (e.g. rent arrears, family debts, unexpected car repairs and so on) can arise without any use of commercial credit. Consumer credit – with its ability to smooth out "lumpy" expenditure – can solve these liquidity problems.

So what does cause over-indebtedness? Serious research shows that in most cases, the answer is a sudden, unexpected fall in income. The most common cause is job loss, but sometimes divorce, accident or illness is to blame. A policy of trying to solve these problems by attacking lending practices is unlikely to succeed.

One should also briefly look at Belgium, because many of the proposals are based on that country's law. Has Belgium's credit law eradicated its over-indebtedness problem? The short answer is no.

So let us return to the Commission's stated aims and see whether the proposed changes will achieve them.

Aim: to boost the internal market. The proposals will fail to achieve this. There are two reasons, neither of

which seems to have been considered by the Commission.

First, debt recovery mechanisms vary hugely across the EU. For example, the wage assignment system is well known in Belgium but unheard-of in the UK. These differences translate into wide disparities in lending risk. Nothing in the proposals seeks to harmonise these recovery systems. Therefore the risk disparities will remain.

Secondly, the proposals will punish so-called “irresponsible lending” (Arts. 6, 8, 9 and 31). Attacking risk-taking in this way is unlikely to encourage a lender to take an even greater risk and lend to a consumer in a different state.

So overall, rather than encouraging cross-border trade, the proposals will discourage it.

Aim: to promote competition. Businesses compete by advertising, marketing and innovating. The more they can do this, the more competition there will be. The less they are allowed to do this, the less competition there will be.

A number of the proposals seek to impede the competitive process. Consider, for example, the ban on unsolicited doorstep selling (Art. 5), the prohibition on marketing to existing customers from a database (Art. 7), the right of withdrawal (Art. 11) and the ban on reducing charges (Art. 15(c)). Similarly, by granting a high credit limit to a customer, a lender will be able to rely on the “responsible lending” rules (Art. 9) to “insulate” that customer from any approach by a competitor.

The outcome will be closed, protected markets where the position of the incumbent supplier is merely reinforced. Breaking into a market will become much more difficult. This will be an uncompetitive and unhealthy result.

Aim: greater transparency. There are two limbs to the proposal’s drive for transparency. First, many of the exemptions in 87/102/EEC will go. Most of these made little sense (apart from those relating to PPI and the upper and lower financial limits) and were arguably not in the consumer interest.

However, 87/102/EEC was “light touch” and there was little risk an exemption would distort the market much. By contrast, the high impact of the new proposals on any credit business now guarantees that any exemption would set up immediate market distortion.

The second limb of transparency is via contract and pre-contract disclosure. Some of this does make sense, particularly cost disclosure. However, this

writer thinks that some of the ideas go too far and fail to achieve a balance between informing and confusing the consumer. For example, why is a pre-contract document required (Art. 6)? Is the contract itself not enough? Why is an amortisation table required? What will the customer make of the three different rates of charge he may see in an agreement? The UK focus group research (see above) suggests that the consumer will not be impressed.

There are also questions of cost and proportionality (see further below). Does someone borrowing €200 really need all this information and is it right to impose all this extra cost on such a small loan?

Aim: more consumer protection. The consumer protection credentials of the proposals are in serious doubt.

First there is proportionality. The Commission has produced a framework that perhaps makes sense for a €150,000 loan, where detailed investigation can be justified. But most credit is for less than €40,000 and much is for very small sums indeed. Where the legal regime is this complex, imposing the same rules on a €150 loan as for a €150,000 loan is, the writer suggests, disproportionate.

Secondly, there is the access question. Without access, consumer protection is a meaningless concept. The consumer who is best “protected” is the one with ready access to credit when needed. The law has a clear, but limited role to play. For example, it should ensure that, within reason, the consumer has a clear view of cost and that lenders behave properly in their dealings with their customers.

However, the proposals introduce new concepts of “duty to advise” (Art. 6) and “responsible lending” (Art. 9). These represent an attempt to intervene in normal market processes by fixing the lender with liability for the consumer’s risk.

Consumers will use these rules to walk away (legally) from their debts. The market will respond in two ways. It will increase prices to cover this new risk. It will also marginalise certain groups of consumers who will find it harder to get credit. Access to credit will reduce.

The consumers hardest hit will be those in the lower, more volatile income brackets. This is a very large group, with 68.3 million EU citizens living on less than 60% of the national average income of their member state. The interests of these millions of citizens in having the chance to participate in economic life should not be ignored. However, on this occasion, it seems that they have been.

Consumer credit, debt problems and multiple solutions by Vesa Muttilainen, Researcher at the National Research Institute of Legal Policy, Finland

Consumer credit markets changed rapidly in Europe during the 1980s and 1990s. At the same time debt problems facing households became a serious problem in many countries. Council Directive (87/102/EEC) on consumer credit established the framework for the creation of a common market in credit and introduced minimum common rules on consumer protection.

However, the harmonisation of national legislation on credit agreements is not a general solution to the problem of over-indebtedness. Many European countries reacted to over-indebtedness in the 1990s by creating debt-counselling services and new insolvency legislation for private individuals. Following experiences from Finland enlighten changes in the governance of debt problems and emphasis a complex nature of the current "debt-problem policy".

From static to dynamic policy in Finland

Before the deregulation of financial markets in the 1980s, the core of the regulation of debt problems consisted of a strict control of the use of credits. A stable environment (such as continuous growth, negative real interest rates, a low level of unemployment) favoured debtors, which reduced the risks of getting into debt problems. The regulation of credits acted as an effective deterrent, keeping risk debtors outside the credit markets.

The security of debtors facing problems was *static*. Public authorities did not give any active support to debtors to ease a settlement of their debt problems. Neither did the system provide any structures that would have helped in sorting out debt problems in a credit relationship. People facing debt problems were often dependent on economic support from family or friends or they were at the mercy of the creditor.

With the reform of financial markets during the 1980s credit practices changed, paving the way for an uncontrolled indebtedness. A more insecure environment (such as an end to economic growth, positive real interest rates, increased unemployment) increased the risks of debt problems.

Whereas over-indebtedness had been an underrated and neglected part of public policy during the time of regulated financial markets, it has become an important field for political influence in the credit society of the 1990s. Older attitudes were now substituted by a new *dynamic* approach. The core of this new policy is to help people facing debt

problems so that they either could continue a normal life as a debtor without defaults in their payment, or be discharged of their debts and be able to return to the credit markets.

Multiple solutions to debt problems

In today's credit society, the rules concerning the regulation of debt problems are in many respects different from those of the time of regulated financial markets. The governance of debt problems principally takes the form of negotiated settlements, debt adjustment and counselling services that support these activities. During 1993-2001, a total of some 53,000 private individuals received a debt adjustment through a court.

The debt adjustment legislation acts as an important incentive in today's credit society. It has encouraged debtors to seek a way out of severe debt problems. It has also made creditors change their practices when issuing credits and has made them more inclined to adjust debts. Moreover, this legislation has had an impact on other agents to develop new ways of handling debt problems.

The above-mentioned systems and practices are supplemented by other provisions. These include reform of debt enforcement, specific provisions targeted at different kinds of debts, social credits provided by the Guarantee Foundation, provisions available in social security, credit insurance and other market-based solutions, and different means available in the third sector. All these provisions constitute an extensive totality that offers a good support for debtors facing debt problems.

New institutional design

The vacuum in the governance of debt problems, which ensued from the deregulation of the financial markets, has been filled by now. Thanks to the above-mentioned reforms, a "new institutional design" has emerged for the governance of debt problems. This mosaic of structures, which is embedded in different sectors of society, is difficult to change. So this complex model of governance may favour consumers in the long run.

All in all, the multi-dimensional problem of over-indebtedness needs a multi-instrument policy. In his 1999 article entitled "Consumers in trouble – rights and advice to debtors in default", Reifner concludes that "the triangle of informational, social and collective consumer protection has to provide for what I called inclusive instead of exclusive consumer protection". In the light of Finnish experiences, it is easy to share this opinion.

NEW ECRI PUBLICATION

Credit Bureaus in Today's Credit Markets, Amparo San José Riestra, ECRI Research Report No. 4, September 2002

In all EU countries today, lenders can access information in databases to help them evaluate the creditworthiness of a credit applicant. The establishments that compile these databases are known as credit bureaus, credit registries or credit reporting agencies. Credit bureaus gather information on the payment history of borrowers and issue credit reports prior to the underwriting of a loan, whether for the purpose of buying a house, a car, opening a credit line or simply subscribing to a mobile telephone service.

In the United States, data from credit bureaus on consumer borrowing, payment behaviour and other aspects of household finances have become the cornerstone of underwriting decisions on consumer loans. Credit bureaus in the United States collect and store comprehensive data for over 200 million adult residents. More than 2 million credit reports are sold by credit bureaus every day.

The type and quantity of data available and the mechanisms by which this information is shared vary greatly across EU countries. Lenders often provide information to credit bureaus voluntarily, although in some cases, the authorities impose this disclosure via public registers. The data collected can vary over time and between countries and usually consist of past instances of default or payments having fallen in arrears (known as 'negative' information). The data can also be of a 'positive' nature, however, to include a customer's outstanding liabilities, maturities and other details about his or her credit history.

Credit bureaus are often cited as a valuable instrument in the fight against the growth of over-indebtedness through their extensive collection and sharing of positive data. The industry, social actors and public policy authorities, however, do not agree on the impact of the availability of detailed financial information collected by credit bureaus. Moreover, previous statistical studies have not found evidence correlating the collection of this type of data with lower levels of over-indebtedness in a country. According to recent surveys, in fact, over-indebtedness occurs in most instances as a result of a 'life event', e.g. the loss of a job or the break-up of a family unit due to a divorce or the death of one of the partners – factors that cannot be predicted *ex ante*. European society attaches great importance to the protection of the right of the individual to privacy,

and regards with suspicion the compilation and distribution of files containing personal data. It is necessary, therefore, to negotiate a balance between the rights of the individual and the need of lenders to have access to information on the payment history and practices of loan applicants. Despite recent efforts at harmonisation in this area, EU countries can apply more restrictive provisions, which explains why the regulatory framework of credit bureaus varies widely across the EU.

The debate on the role of credit bureaus in today's credit markets is not restricted to considerations of privacy protection and over-indebtedness. Another important factor is the lack of widespread cross-border credit, which threatens the completion of a truly single retail credit market. Accurate risk assessment of borrowers based in countries other than that of the grantor requires efficient information-sharing agreements between all the credit bureaus in the European Union. The maintenance of transparent records within a secure framework that also respects the rules on privacy should ensure the discreet collection and processing of this information on consumers, and facilitate access to cross-border credit for all consumers. This exchange takes place, at present, however, only on a bilateral basis and is very limited in scope.

In light of the diversity of cultures and practices throughout the European Union and with a view to the forthcoming update of the EU Consumer Credit Directive, it has been argued that harmonisation of laws concerning data protection and the prevention of over-indebtedness represent essential requirements for the completion of a single retail credit market. In the minds of others, however, the existing patchwork picture is simply the temporary result of the functioning of different national markets, and the transformation will come about with the evolution of the market.

Despite their tremendous importance, surprisingly scant attention has been paid in the literature to the role of credit bureaus in the credit markets of Europe today. Additionally, there is very little empirical research being conducted in this field. In this report we attempt to offer a view of the credit reporting industry in Europe, the laws by which it is governed and their impact on over-indebtedness, the availability of credit in the economy and the completion of the single market.

The full report is available for free downloading from the ECRI website.

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