

Consumer Credit Newsletter

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NEWS

Italian Interest Rates

The European Commission has expressed disagreement with the disproportionate measures taken by the Italian authorities to tackle exorbitant interest rates.

Under the Italian Law on Usury of 24 February 2001, interest rates applied by banks on fixed long-term loans, still ongoing at the end of 2000, cannot exceed the average yield on national bonds (BTP) for the period 1996-2000. As interest rates remain lower than the normal rate on the market, the current definition of usury could be unfavourable for the lending activities of banks of other member states.

Thus, the European Commission decided to oblige Italy to restore an adequate competitive environment in the country within a maximum period of two

months after receiving the European Commission's "reasoned opinion".

FIN-USE Forum (Expert Forum of users of Financial Services)

Internal Market Commissioners decided to strengthen the policy governing the integration of European financial markets. For this purpose users, including retail consumers and small- and medium-sized businesses, will be invited to give their opinion on the subject. The European Commission will designate a forum of 12 experts who will also be given the opportunity to request external targeted research on the issues.

This initiative has been taken within the intention to improve policy-making by taking into account the interests of all parties concerned. Actually, further integration in financial services will contribute to lower costs for suppliers and for customers but will also encourage innovation through stronger competition in the industry.

Wide Disagreement Expressed at EP Hearing on the Proposed Consumer Credit Directive

On April 29th, the JURI Committee (Committee on Legal Affairs and the Internal Market) of the European Parliament convened a hearing organised around the proposal for a directive on credit to consumers. The meeting attracted close to 30 experts from industry, consumer and research organisations, who were asked to express their views on different aspects of the proposal.

The JURI rapporteur (Joachim Wuermeling) confirmed that the complexity and detail of debate around the proposal will make it impossible to maintain the foreseen dates for discussion within the Committees, and therefore the vote on the proposal at the plenary will have to be postponed.

ECRI was invited to participate in the group of experts and addressed questions forwarded by the parliamentarians. The paper submitted by ECRI on the use of consumer credit and its relationship with over-indebtedness in Europe is available on the ECRI website.

The hearing was opened by the Chairman Giuseppe Gargani. Mr. Wuermeling (rapporteur) assured the participants that the goal of the JURI Committee, in concordance with the Commission proposal, was to establish a single EU credit market, "borderless credit", which in turn demands a common standard of consumer protection across the EU. According to Mr. Wuermeling, the Committee is not willing to embark on an ideological debate on consumer protection: it is neither pro-industry nor pro-consumer, but the goal of the Committee is to provide fair rules for all. Such rules should not make credit more expensive to consumers or more difficult to access.

The meeting was divided into five sections covering the most important issues treated in the proposal. Relevant contributions are summarised below.

1. Consumer credit in the internal market

The first set of questions concerning consumer credit in the internal market was addressed by Nicola Jentzsch (Free University of Berlin), who stated that different levels in consumer protection regulation were not the main obstacles to cross-border consumer credit. Other elements, such as language, different credit cultures and legal traditions, information asymmetries, the present reduced mobility of consumers and proximity criteria when borrowing, and competition in national countries, are equally or more relevant factors.

Jim Murray (BEUC) spelled out the fear of consumers that the proposed directive will not maintain the present level of consumer protection in different countries. Despite acknowledging the EP's quest for a good level of protection, Mr. Murray was concerned that the harmonisation character of the directive would endanger the maintenance of existing good practices in certain member states. Examples to look at for instance are early repayment clauses or joint and several liability, which will disappear if a lower common level of protection is agreed in Council discussions.

Industry representatives from new member states stressed that the consumer credit industry in those countries is not as developed as in the current EU members. Therefore, adapting to some of the provisions of the proposed directive, for instance the calculation of different types of interest rates, will require considerable investment on the part of financial institutions that will be ultimately translated into costs to borrowers. Tougher investigation requirements to pursue responsible lending as expressed in the directive will result in credit only

being granted under very restrictive conditions, available thereafter exclusively to wealthy individuals. An economic scenario characterised by restricted credit to consumers and therefore consumption, will certainly lead to slower growth. In anticipation of accession, Central and East European credit industries are currently adapting to the *acquis communautaire*, and the proposed directive will only increase the burden for financial institutions. Simple, clear and transparent provisions would be therefore desirable.

2. Scope of the directive

A large number of speakers addressed the question of the scope of the directive. Martin Hall (Director General of Finance and Leasing Association) and David Rees (Provident Financial) argued on different grounds the inadequacy of the establishment of a lower limit defining consumer credit. For the non-financial industries, the establishment of a lower limit for the application of the directive would affect the financing of lower-priced goods at the point of sale, whereas Mr. Rees argued that the present limit of €200 is too low and would make access to credit more difficult for disfavoured communities. According to him the present lower limit would impose a new burden on lenders, turning them more risk averse and therefore reducing the ability of low-income consumers to borrow. Equally, investigation requirements into borrowers' finances prior to granting credit should not be the same for a €300 loan as for a €6,000 loan since the risk assumed by the lender is certainly not the same. Imposing excessively demanding credit assessment procedures would restrict the granting of loans and would put loan prices up for small-sum borrowers, indeed those for whom borrowing may be more necessary.

Umberto Filotto and Rosa Maria Gelpi (Eurofinas) described as pointless the introduction of a new threshold for the application of the directive. They also argued that upper-level borrowers, who possess sufficient financial resources to request large sums are in general financially knowledgeable and often have access to external advisers, certainly do not require the same protection level as lower-segment borrowers.

Many of the experts demanded that their business or industry be excluded from the scope of the directive. The most significant among these potential exclusions were the insurance sector related to credit, distribution and leasing activities. Leasing associations argued that leasing is a completely different activity from credit, carried out applying

divergent techniques based on the management of the risk of the evolution of the value of the product leased, not only on the risk of repayment. As a consequence, certain provisions such as the right of withdrawal and the provision of certain types of information such as amortisation tables and interest rates should not be part of any leasing regulation.

Xavier Durieux (Eurocommerce) argued that the inclusion of distributors would severely damage the use of point of sale finance and especially small retailers and it would reduce last-minute purchases. He also pointed out that the sale of tailor-made goods is incompatible with the right of withdrawal.

Among the products listed for exemption were mortgage or property-based credit, very short-term loans, overdrafts, secured credit and consumer credit for business purposes.

In his intervention, Mr. Murray (BEUC) observed that the large list of proposed exclusions would reduce significantly the field of application of the directive and would offer poor protection to consumers. In his view, small loans should be covered because they target the most vulnerable segment of the consumers. Mortgages at present are not covered by any directive, only by a code of conduct that is restricted to information provided to the consumer prior to the conclusion of any agreement. In his opinion, therefore, mortgages should be covered by a directive, as also should equity-released mortgages. Mr. Murray also pointed out that distributors often belong to the same group or have close links with lenders, thereby having complementary objectives. At least in these cases joint and several liability should be offered to consumers. Mr. Chalançon also advocated for a directive with not too many exclusions, but generally applicable to all sectors.

3. Conclusion of agreements

One of the most controversial and debated issues prior to the hearing was responsible lending, which was addressed in the context of the discussion on conclusion of agreements.

All the industry experts present argued the case for rebalancing the obligations of lenders and borrowers spelled out in the directive. They agreed that an imbalance towards the lender would bring risk aversion, higher costs and restriction of credit, which would eventually remove some consumers out of the credit market. Higher investigation requirements would deprive consumers of instant availability of credit.

Some speakers, such as the representative of CCRG (Credit Card Research Group), agreed on the notion of responsible lending, but claimed that the drafting of the present text creates uncertainty for lenders. In that sense, he pointed out that consumers should also exercise good management of their own finances, since rationing credit alone would not reduce over-indebtedness. The industry also claimed that certain provisions, again on joint and several liability or the right of withdrawal, would endanger the existence of certain credit products and would have an impact on the price of credit.

The BEUC representative stressed that there were indeed bad practices in the market and that some lenders behaved irresponsibly, though acknowledged that was not the case for the whole industry. To expect lenders and borrowers to exercise equal responsibilities would not be fair, since the level of financial awareness and knowledge is not the same on both sides. In his opinion, the directive was correct in seeking adequate protection for consumers in a framework of increasingly complex credit products, in banning abusive practices and in increasing the transparency in the development of lending activities.

4. Management of agreements

Francis Nze of Barclays Bank opened the next discussion on the issue of managing agreements. He called for provisions aimed at transparency and comparability of products offered, and pointed out that the provisions on early repayment are adequate since they allow the consumer to switch providers and look for better offers, thereby increasing competition. In the case of early repayment, only the recovery of the cost for the lender should be charged, and no other penalties should be levied.

The representative of Eurocommerce expressed disagreement with the provisions on joint and several liability, which he believed should be only applicable in the case of clear links with lenders. Equally, minimum conditions for joint and severable liability must be added.

The expert from the UK-based CCRG stated that the directive would reduce competition and product choice in the market. Certain provisions of the directive will harm the credit card sector, namely, the provision of three different rates, which he asserted would only confuse consumers, and the duty to provide advice, which should not be applicable to credit cards. The directive would also affect the issuing of affinity cards, which will be reduced by imposing higher administrative burdens. The CCRG

would like to see a proper impact assessment carried out.

5. Miscellaneous

The last part of the hearing included questions on databases, legal consistency with other directives, discussion on the adequacy and calculation of three different interest rates to be offered to the consumer and the impact of the directive on existing contracts and in the provision of retail credit.

On the issue of credit databases, the BEUC representative expressed no preference for positive or negative databases, but stressed the importance of discouraging any abusive use of data about consumers. Consumer protection should prohibit the use of data for other purposes than credit and should facilitate the correction of errors in databases.

Conversely, Mr. Bach from ACCIS opposed any limitation on data collection and its use, claiming that restricting the freedom of information would have adverse effects on risk management and assessment.

Equally he claimed that Arts. 7 and 8 of the directive would be counterproductive to the goal of reducing over-indebtedness. On the issue of the creation of a EU-wide central database, he argued that the creation of such a database would contradict internal market principles and would only bring additional costs without any added value.

Industry and consumers demanded meaningful consumer credit rates that represent the real cost of credit for borrowers. The industry in general claimed that information should be limited in volume, and therefore, that one interest rate would be sufficient if calculated correctly, hence, excluding insurance, taxes and external elements that would only cause distortion. BEUC affirmed that the provision of three different interest rates was adequate, and that the calculation of these rates must include all elements that have an impact on the final cost of the credit, whether insurance, taxes or other.

The debate was closed by questions and remarks from MEPs and other experts present. Malcom Harbour (MEP) suggested the possibility of withdrawing the proposal and starting from scratch with closer collaboration between the Commission, industry and experts. Lord Inglewood (MEP) observed that important debate remains on the best approach to regulation in this area, namely, the establishment of the level of harmonisation and the reconsideration of minimal harmonisation together with mutual recognition. Arlene McCarthy (MEP)

also pointed to the need to safeguard the existing level of protection and to arrive at the best approach for establishing core standards.

Belgium Consumer Credit Law

The Directive of the European Council (87/102/CEE of 22 December 1986) for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit has been transposed to the Belgium Consumer Credit Law on 12 June 1991.

In the judgment of the Belgian authorities, however, the new legislation framework didn't adequately meet the objectives, i.e. to offer maximum protection to consumers or to promote competition among suppliers of consumer credit so as to allow comparisons between credit offers and fight against over-indebtedness. Thus, as early as 1997, a modification to the Law of 12 June 1991 was proposed and submitted to the Consumer Council (consultative body of the public authorities including consumer and professional representatives).

The final legislative procedure has resulted in a new Consumer Credit Law of 24 March 2003. The latter was partially put in force on 1 June 2003 and will be completely operational as of 1 January 2004.

Below we review the major modifications introduced by the new law.

1. Strengthened regulation of publicity

The new law strengthens the regulation of consumer credit publicity and in particular the regulation of information concerning the cost of credit.

Moreover, under the objective to fight against over-indebtedness, some types of publicity are forbidden, such as publicity that encourages consumers with debt repayment problems to obtain further credit, that emphasises excessive ease and rapidity to borrow or that encourages the consolidation and centralisation of current consumer debt.

2. Reform of the principle of pre-contractual offer

The principle of pre-contractual offer was one of the major issues of the 1991 Law. In accordance with this principle, lenders had to maintain a pre-contractual offer within a period of 15 days without changing any of the conditions mentioned. In this way, the consumer could compare the offers of different lenders. Nevertheless this mechanism proved to be inefficient and even dangerous, because it gave the consumer the opportunity to accept

several offers simultaneously without informing his/her lenders.

In the future, pre-contractual information has to be given by lenders to consumers through advertising leaflets that have to contain financial information on the credit contracts they offer, i.e. the amount and the duration of credit, the annual percentage rate (APR), different charges and repayment methods.

3. Application of the cooling-off period for all consumer credit contracts

While the 1991 Law instituted a cooling-off period essentially for installment credit and for contracts signed outside the lender's office, the new legislation framework applies the cooling-off period of seven days to all types of consumer credit contracts, including installment credit, repurchase agreements, leasing loans and credit lines (except for certain contracts amounting to less than €1250).

4. Strengthening of credit intermediaries' responsibility

New rules strengthen the responsibility borne by credit intermediaries. For example, credit intermediaries are obliged to examine the financial ability of consumers to repay their debts in order to ensure good future relations. In accordance with the information they have and should have, credit intermediaries cannot respond to a request for credit if they estimate that the consumer will not be able to respect his/her commitments.

5. Reinforcement of the interdiction to impose the signing of an additional contract

Under the 1991 Law it was forbidden to oblige consumers to sign an additional contract at the moment of signing a credit contract. A specific regulatory framework concerning the insurance of the outstanding balance in case of death, illness or job loss has reinforced this interdiction further. If insurance is taken at the time of entering into a credit contract, its costs have to be included in the APR for all credit contracts of a value less than €5000. In this case, the lender, the credit intermediary or the credit-insurer is the beneficiary of the insurance.

6. Strengthening of guarantee protection

Guarantee protection, which constitutes a personal surety, has been strengthened in several aspects.

One feature of the Belgian Consumer Credit Law is the institution of the so-called "responsible lending" principle, which has directly inspired the proposal of the European Consumer Credit Directive. In

accordance with this principle, the lender is obliged to inspect the credit-worthiness of the consumer. This obligation has also been transposed to the guarantee.

Moreover, the amounts eventually owed by the personal guarantee are, at present, strictly limited (they correspond to the capital increased by delayed interest payments, but exclude all other kinds of penalty or charges).

Finally, the duration of personal guarantee contract is limited to five years for indefinite credit contracts (a renewal is possible in the case of formal agreement by the guarantee).

7. Introduction of the obligation to write off the amounts due on credit contracts ("zérotagé") when reimbursement of the capital is not obligatory

Under Belgian legislation, the signing of indefinite credit contracts (bank credit accounts, revolving credit with or without credit card) is allowed without imposing any requirement on the consumer to reimburse systematically or periodically a portion of the deductible capital. Considering this kind of product as very dangerous, the authorities have decided to introduce the obligation for lenders to add an additional clause to credit contracts, called "zérotagé", which forces the consumer to clean his debt after a certain period of time. The law doesn't fix any deadline and lets lenders freely choose the date by which time to repay the debt. It seems however that a deadline of five years should be in accordance with the objectives of the new legislation.

8. Determining the amounts that could be requested in case of consumer default

It is noteworthy that the Consumer Credit Law of 12 June 1991 has already been amended in 2001 (effective 1 January 2002) regarding the amounts that could be requested in case of consumer default. In order to combat over-indebtedness, the authorities decided not to wait for the actual general reform and have passed a specific law determining in a very precise way the method of calculation of the amounts remaining for payment (including capital, delayed interest payments, penalties and charges) in the case of consumer default.

RESEARCH

Court judgments and risk assessment in the UK

Recent research by Peter Welsh concludes that court judgment information is the most important factor in the UK in enabling lenders to lend prudently. The author claims that despite greater availability of other information about borrowers, *county court judgments* continue to play a vital role in the risk assessment process. Even when lenders have open access to information shared through credit reference agencies and accumulate extensive proprietary information, judgments continue to add value to their scoring programmes.

The history of court judgment registries started in 1852 with the creation of the country court judgment registry of England and Wales. At present they are a means by which lenders seek to recover money owed to them and, as a public record, to provide lenders with information about prospective customers who have experienced problems repaying debts in the past.

The report presents evidence on the relationship between the size and structure of the credit market and the demand for judgments. It assesses the substitutability of judgments by other credit information along with the impact of data protection regulation on county court judgment information. Nevertheless, due to the development of sub-prime lending, the existence of a county court judgment does not automatically exclude borrowers from the market.

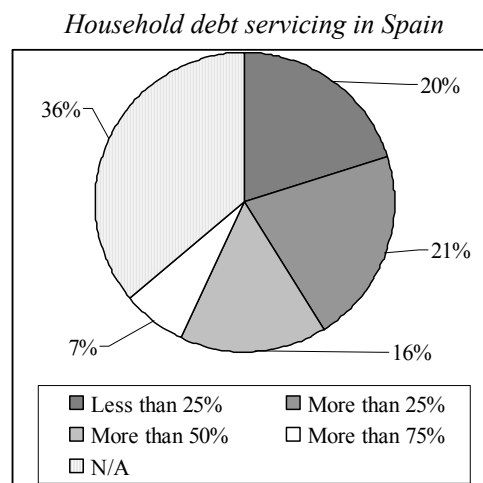
Despite the growth in bank default records accumulated over years of activity, most lenders agree that default records do not provide a direct substitute for judgments. The information on judgments is essential in the sector of low-value and short-term loans, where reference agencies held minimal data. But the author claims that it is difficult to quantify the value of judgments.

For the full report and further information, see rtl@hurlstons.com.

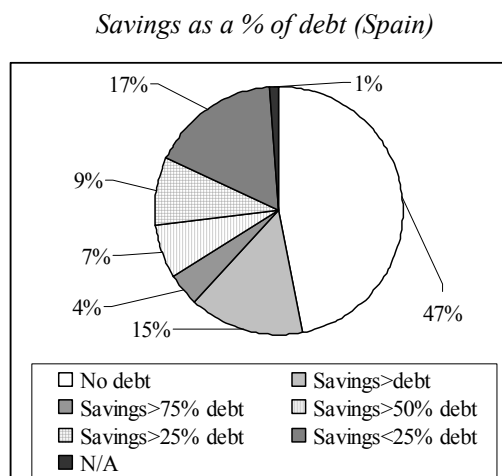
Over-indebtedness in Spain, study by consumer association CEACCU

The study presents interesting results concerning the servicing of debt burden by households. According to the survey, a large group of Spanish households, 23%, dedicate more than 50% of their net income to repay debts (and 7% pay even more than 75%),

whereas only 20% dedicate less than 25% of their income to service debt. Nevertheless the result is affected by the lack of response from 36% of those surveyed. See figure below.

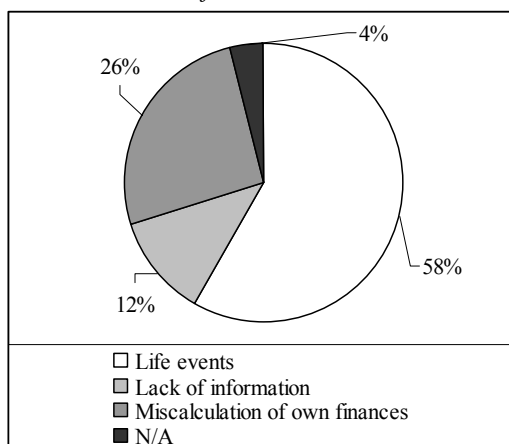


Regarding the ability to save in relation to debt, the study shows that 47% of those surveyed do not have any kind of debts and 15% could fully repay the debt using savings and therefore do not have reasons to worry about their level of indebtedness. Some 26% of those surveyed, however, have savings that are less than 25% of their total outstanding debts (see chart below).



Concerning the incidence of over-indebtedness, the study found that 2% of those surveyed are *de facto* over-indebted (cannot repay the debts). As many as 37% had the impression at some point that they would be forced to default on a loan, but eventually were able to face repayment. The most common reasons for over-indebtedness (insolvency in the study) are graphically illustrated in the figure below.

Causes of over-indebtedness



The study also analyses the use of credit to pay for a house, car, furniture, house repairs and holidays amongst other goods in Spain, as well as details on credit and debit card use, information provided by lenders and the address of complaints to consumers associations.

For the full report and further information, see <http://www.ceaccu.org/docspdf/Cuaderno%201.pdf>.

ANNOUNCEMENT

ECRI New President

At the last meeting of the ECRI Executive Committee, Rosa-Maria Gelpi of Cetelem was elected as new president of ECRI. Rosa-Maria Gelpi replaces Gregorio d'Ottaviano of Findomestic.

CONSUMER CREDIT STATISTICS

Despite the economic slowdown, EU households continued to borrow significantly in 2002. Thus, the increase in total lending to individuals was mainly due to sustained mortgage lending, which grew by 7% over the year. At the same time, consumer lending decelerated sharply in comparison with 2001. While lending to households has not diverged from its usual trend, some member states noted an important increase in housing market prices, which might become a source of concern in future.

Lending to households			
Billion EUROS			
	2000	2001	2002
Austria	57.570	60.653	64.230
Belgium	98.877	96.414	98.990
Germany	905.500	926.700	949.500
Denmark	143.670	157.100	167.950
Spain	288.784	309.033	353.188
Greece	16.016	23.829	31.498
France	476.700	548.897	587.345
Finland	37.511	42.585	46.815
Italy	266.392	278.580	304.310
Ireland	39.231	45.594	52.767
Luxembourg	19.800	20.200	21.700
Netherlands	269.061	295.080	315.759
Portugal	68.813	75.950	83.244
Sweden	105.202	113.709	123.977
UK	1,121.130	1,216.177	1,362.447
Bulgaria	0.291	0.426	0.618
Czech Republic	3.608	4.111	5.324
Croatia	3.029	3.917	5.611
Cyprus	4.950	5.611	5.901
Estonia	0.414	0.554	0.822
Hungary	2.856	4.412	7.808
Latvia	0.091	0.135	0.264
Lithuania	na	0.210	0.255
Malta	0.099	0.178	0.208
Poland	na	na	22.327
Romania	0.213	0.307	0.669
Slovakia	na	1.240	1.477
Slovenia	2.137	2.432	2.533
Turkey	10.993	3.899	6.570

More statistics will be available soon on the ECRI website: <http://www.ecri.be>. Some of them will also be published in the September Newsletter.