ECRI NEWS

Understanding Credit Markets for Europe

EDITORIAL

By Karel Lannoo
Chief Executive Officer at CEPS/ECRI General Manager

The autumn season will be very busy with the confirmation of the new Commissioners and the start of the new College on November 1st. Judging from the speech of Commission President designate Ursula von der Leyen and the priorities of the European Council, financial services will not be very high on the agenda. Apart from the completion of the banking union and capital markets union, nothing specific has been announced so far. However, the newly configured European Parliament, with the addition of representatives of the Liberals as a third group in the top positions and the strength of the Greens, may change the priorities. Von der Leyen has also announced that more right of initiative should be given to the EP, a right that is already part of the Lisbon Treaty but has been seldom used. In the domain of financial services this could lead to more consumer-protection inspired measures.

The CCD review proposal is expected to be adopted by the new Commission before the end of the year. We dedicated an entire day to the subject at ECRI and discussed the various elements in the review in a very well-attended seminar. We will continue to follow this issue closely. In the meantime, our ECRI Statistical Package will offer insights into the latest development of consumer credit markets in the EU and beyond. We will also discuss the results of our study on data sharing in credit markets in the EU during a debate on September 11th.

IN THIS NEWSLETTER

Editorial, Karel Lanoo, pp. 1
Consumer credit in a digital age, Tarik Tawfik, pp. 2
A well-functioning EU consumer credit market, Monique Goyens, pp. 3
Consumer credit: no substitute for income, Martin Schmalzried, pp. 3-4
The role of consumer credit in the economy, Edward Simpson, pp. 5
The role of consumer credit in private consumption and for a sustainable economy, Georg J. Huber, pp. 5-6
Should the scope of application of consumer protection rules be extended?, Lucia Pecchini, pp. 6-7
What should be clearly addressed by a new version of the CCD?, Olivier Jerusalmy, pp. 7
Responsible lending in the EU: do we need additional rules?, Olha Cherednychenko, pp. 8
Responsible lending in consumer credit: do we need additional rules?, Marieke van Berkel and Chiara Dell'Oro, pp. 8-9
How does digitalisation change the consumer credit market?, Mick McAteer, pp. 9-10
Customer-centric AI for the common good, Lu Zurawski, pp. 10

ECRI Publications, pp. 1
ECRI Membership Information, pp. 2
ECRI Statistical Package, pp. 4
Upcoming ECRI Event, pp. 10
ECRI Members, pp. 11

ECRI PUBLICATIONS

Research Report: Price rules in consumer credit: should the EU act?
Authors: Inna Oliinyk, Sylvain Bouyon

Research Report: Data sharing in credit markets (to be published on 11 September)
Authors: Sylvain Bouyon

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CONSUMER CREDIT IN A DIGITAL AGE

By Tarik Tawfik
Regulatory and International Affairs at ING Group

The Consumer Credit Directive (CCD) has helped to develop a sound and harmonised lending framework in Europe by setting standards, focusing on the fundamentals of responsible lending and generally 'keeping honest people honest'. The directive's explicit mandate for transparency, fairness and overall consumer protection has benefitted both customers and lenders. However, further efforts are necessary to harmonise diverging local interpretations and avoid fragmentation in the consumer credit market.

When considering what to include in the revised CCD, it is important to have a consumer-centric approach. The experience of Mr. Tawfik in retail banking showed that customers want the following from their lenders:

- Value: to obtain an adequate loan at a good rate
- Trust: a counterparty that will do what's best for them
- Convenience: a fast and painless application process
- Privacy: the safeguarding of their data
- Partnership: guidance and support for the long term, beyond just banking services.

The current CCD has effectively addressed the customer needs of 'value' and 'trust', but given the fast pace of digitalisation within financial services there are opportunities to further enhance the effectiveness of the CCD around the remaining three needs.

To meet customer expectations of a smooth and convenient onboarding process, much can be done to harmonise electronic identification. Big Techs like Facebook and Google have set the standard for the digital onboarding process and, as we move towards a digital-only (mobile first) experience, lenders need to further digitalise without sacrificing security. To help balance easy and convenient access to banking services with security, electronic identification would be greatly beneficial. We therefore welcome the initiatives of the European Commission to build a pan-European e-ID scheme that would increase trust in the online environment and foster more cross-border activity.

That being said, the greatest challenge for banks in this digital age is the management and safe processing of large amounts of data. Customers demand data privacy, yet they also want convenience and the best offer possible. Market trends indicate that customers also want Value-Added Lending – additional services that can range from helping them pay off a loan faster, to adjusting the rate to a customer's improving risk profile, to offering assistance beyond lending altogether. This trend aligns with the widely held belief that the future of retail is tied to platform-based distribution and effective cooperation with third parties. In order for banks to offer such 'beyond banking' services or be a part of platforms, customer transaction data and alternative data acquisition is necessary.

The starting point of the data discussion should always be the added value for the customer as a trade-off against who can access his/her data and why. While that autonomy is established in the General Data Protection Regulation (GDPR), we still need to make sure that legislation, and in this case the CCD, adapts to the changing digital landscape by embracing and promoting consumer-centric digital developments, instead of slowing them down.

The review of the CCD should accommodate different trends in innovations and digital developments within consumer lending. Here, two elements stand out: i) proper pan-European electronic identification, and ii) secure access to data and data sharing.

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Understanding Credit Markets for Europe

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A WELL-FUNCTIONING EU CONSUMER CREDIT MARKET

By Monique Goyens
Director General of BEUC, The European Consumer Organisation

Since the introduction of the Consumer Credit Directive (CCD) more than 10 years ago, important developments have taken place in Europe. First, a major financial and economic crisis resulted in high unemployment rates and lower household income in many member states. Second, for several years the EU has experienced historically low interest rates, which encourages consumers to borrow for consumption. Third, digitalisation has led to widespread online distribution of credit and the emergence of new business models such as peer-to-peer lending.

BEUC's assessment shows that, while the CCD has delivered benefits to the EU market integration and consumer protection, the directive requires a review to set clear responsible lending obligations for credit providers and to combat over-indebtedness.

First, all consumer credit products should be included in the scope, such as loans below €200, leasing, overdraft, credit granted free of interest and without any charges, and peer-to-peer lending. According to our French member UFC-Que Choisir, since 2008, overdraft and leasing (currently falling outside the CCD scope) have been the two fastest-growing credit segments in France.

Second, CCD II should introduce product design and suitability rules. Creditors should take consumer interests, objectives and characteristics into account and test products with consumers before launching them on the market. Credit distributors should recommend to consumers the option that is best suited to their needs.

Third, CCD II should introduce an EU-level cap on interest rates, regulate abusive fees and charges, and ensure that all expenses linked to the credit are included in the APRC calculation. For example, our Bulgarian member Асоциация Активни потребители (The Association of Active Consumers) reported hidden fees not included in the APRC, such as a guarantor fee – a charge for express-processing the credit application.

Fourth, creditworthiness assessment obligations in CCD II should be aligned with the provisions of the Mortgage Credit Directive. The CCD provisions related to creditworthiness assessment are vague and leave a wide margin for manoeuvre to national authorities as to how to perceive and design the creditworthiness assessment process.

Fifth, unsolicited credit should be banned as it pushes consumers to borrow more and spend beyond their means, instead of incentivising them to save and better manage their finances. According to our UK member Citizens Advice, in 2017, 75% of UK credit-card holders who received a credit limit increase did not request this increase.

Sixth, CCD II should address the risks related to online distribution, such as non-respect of responsible lending obligations by online credit providers, aggressive and unsolicited marketing luring consumers into quickly accessible loans.

Seventh, cross-selling of poor quality payment protection insurance (PPI) causes significant detriment to consumers. PPI should not be sold at the point of sale by credit distributors when arranging a consumer loan. If the consumer considers taking an optional insurance together with the credit, its cost should be included in the APRC to allow for effective comparison.

Eight, misaligned sales incentives and targets can trigger aggressive sales of credit to consumers without proper assessment of their needs and expectations. The remuneration arrangements should be linked to the long-term performance of the credit contract for the borrower, the borrower's satisfaction level and low levels of credit defaults.

Finally, supervision and enforcement need to be strengthened. According to our Slovene member Zveza Potrošnikov Slovenije, certain banks knowingly violate the obligations related to the APRC in credit advertising because penalties are insignificant (up to €25,000). Competent national authorities responsible for oversight and enforcement of the consumer credit legislation should be well-equipped, and sanctions for infringing the provisions of this directive should be harmonised at EU level.

CONSUMER CREDIT: NO SUBSTITUTE FOR INCOME

By Martin Schmalzried
Policy and Advocacy Manager, COFACE

From the consumer perspective, consumer credit has its uses, but unfortunately, nowadays, those uses can be contrary not only to the interests of the consumer, but also to public interest (from the perspective of prudential regulation and the stability of the financial system).

Consumer credit should essentially be used for large/expensive investments, in order to smooth out consumption patterns and income, not to purchase everyday goods such as food or to pay utility bills.

For low-income families, credit is never a solution. If their income cannot cover their expenses and they take out credit, how will they cover both their expenses and service the credit in the following months?

Ideally, consumer credit should be used by families that have a financial buffer (savings of a couple of thousand euro

at least) and take out a loan to spread across time to pay for certain expensive purchases such as a new washing machine or a new car, in order to keep their savings and ensure that they always have a buffer to cater for unforeseen expenses. Unfortunately, in an economy where inequalities are growing, where the wages of low/middle income families are stagnating, where most of the growth benefits the top 1%, and where one in every three families lives from pay cheque to pay cheque, consumer credit is used as a substitute for income, and this is really dangerous.

Normally, as consumers take out more credit and spend it in the economy, this should trigger a virtuous economic cycle whereby their purchases are converted to salaries, which allows them to repay the loan. Consumer credit brings future demand forward and relies on growth to ensure that consumers will not have to compress their expenses in the future thanks to an increase in their salaries and economic growth. But this cycle has been broken since the 1980s as productivity growth and wage growth have decoupled. Our economics have transformed from being trickle-down to trickle-up. In this respect, the debt-to-GDP ratio is key. If it remains stable, coupled with economic growth, it means that extra credit added to the economy has been used for productive means rather than just speculation on existing assets or fuelling consumption that doesn't lead to investment. In the present day, while the debt-to-GDP ratio continues to rise, it does not translate into economic growth, which clearly shows that credit does not help in jump-starting a fragile economy. Companies are now busier cutting costs by firing people (restructuring) or engaging in corporate buy-backs.

The take-away is that it is not possible to solve systemic, societal, and macro-economic shortcomings with consumer credit. Broader policies addressing inequalities, social exclusion and poverty are imperative to create a stable base on top of which consumer credit can be used safely.

In short, consumer confidence and stable consumer demand are key drivers of the economy. If consumers were to compress their expenditure tomorrow and stop taking out credit, the entire economy would collapse within a few months. But even though consumers play such a key role in keeping the economy afloat, they don't even get a 'thank you' for keeping the economy going despite their vulnerable financial situation. Up to now, there is no personal insolvency scheme at European level and all too often existing national schemes are extremely restrictive, even though the 'myth' of the irresponsible borrower is just that – a myth. Most cases of over-indebtedness are linked to life accidents (divorce, health issues, loss of employment, death) which create a financial shock that families cannot absorb (given their vulnerable financial situation, with low levels of savings) rather than irresponsible behaviour.

Consumers therefore deserve better consumer protection within a revised Consumer Credit Directive, closing many loopholes and protecting consumers against predatory lending practices and new credit provision techniques, especially online and via mobile phone. Credit is no substitute for income, nor is it supposed to be used to artificially prop up a failing economic and financial system. Perhaps more stringent regulation will finally force regulators to address the underlying core issues of inequality and trickle-up economics.

ECRI STATISTICAL PACKAGE

Since 2003, the European Credit Research Institute (ECRI) has published a highly authoritative, widely cited and complete set of statistics on consumer credit in Europe. This valuable research tool allows users to make meaningful comparisons between all 28 EU member states as well as with a number of selected non-EU countries, including the US and Canada.

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Two Statistical Packages are on offer. The more compre hensive product "Lending to Households (from 1995)" contains valuable data on consumer credit, housing loans, other loans, total household loans, loans to non-financial corporations as well as total credit to the non-financial business and household sector. The 'standard' "Consumer Credit in Europe (from 1995)" exclusively covers consumer credit data.

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• Tables: present time series data in nominal and real terms, and per capita, as well as breakdowns by lender, type, currency and maturity are also available for selected countries.
• Figures: highlight credit trends in a way that allows user to make meaningful comparisons of the retail credit markets across countries.

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For more information or to purchase the package, visit CEPS website ***www.ceps.eu/ceps-publications/ecri-statistical-package-2018-lending-households-europe/****, contact* ***beatriz.pozo@ceps.eu*** *or call* ***+32 (0) 22293987***

THE ROLE OF CONSUMER CREDIT IN THE ECONOMY

By Edward Simpson
Chair, EBIC Consumer Credit Working Group; Head of Government Affairs, Finance & Leasing Association (FLA)

Consumer credit enables households to buy big-ticket items such as a car or to renovate a house with energy-saving features, but is also used to smooth out the peaks and troughs of household expenditure, such as when unexpected bills come in. Not only does this support the general functioning of the economy, but also the efforts towards increased sustainability. It allows consumers to not only opt for more modern and greener cars, but also to upgrade to more energy efficient equipment, even when faced with the unforeseen and sudden need to replace household equipment, for example.

As they consider the Consumer Credit Directive (CCD) review, the EU institutions must not lose sight of the importance of consumer credit to households and the wider economy.

Market overview

Eurofinas members financed €320bn worth of new consumer loans in 2018, primarily to buy vehicles, but also to purchase electronics, appliances or to carry out renovation work.

Seventy-five per cent of UK consumers hold at least one credit or loan product and 46% of total consumers use credit actively. This compares to around half of Belgian adults with an active credit account and about a quarter of households in France with a credit contract.

Cost and level of credit

In many EU countries, the cost of servicing debt is lower now than it was before the financial crisis, with interest rates near historic lows. This means that loan repayments are generally more affordable for households. Moreover, in the EU28 in 2017, consumer credit represented just 12% of total household credit, a smaller proportion of total credit relative to housing loans than was the case in 2007. However, if interest rates rise this will put pressure on households' disposable income.

Single market

The logic of the single market objective of the CCD is that greater competition should benefit consumers via more choice and lower prices. In reality, it may benefit bigger firms more than smaller players, many of which in the UK are non-banks. Maintaining a diverse market, which reflects varying market characteristics, is important for consumer choice and access to credit.

Pockets of true cross-border activity do exist in border areas such as the Benelux countries, but beyond that, evidence of consumer demand for cross-border loans has not been demonstrated. Even it were to be the case, other challenges remain, notably lenders' ability to recover debt and other important and fundamental variations between the legal frameworks of member states.

Summary

Consumer credit plays a critical role in the modern economy. To illustrate this, FLA research showed that new consumer business written in 2014 boosted UK GDP by 0.42% (taking into account the contribution made by member firms and the consumption and investment activity that their finance supports) and supported nearly 55,000 jobs. Research from Belgium shows that in 2011, consumer credit (0.34%), when combined with mortgage credit, generated a rise in GDP of 0.5%. Without this, a recession would have been likely.

THE ROLE OF CONSUMER CREDIT IN PRIVATE CONSUMPTION AND FOR A SUSTAINABLE ECONOMY

By Georg J. Huber
HEAD of EU Representative Office and Head of EU Policy, DSGV

The growth of consumer credit in all EU member states in recent years has shown its importance in private consumption. However, it remains a 'local' product, since the share of cross-border credit to households in the euro area remains very low, at only 5% of the market. For consumers, the main reasons to stay local are language barriers, convenience and legal differences. This is also shown by the responses to the public consultation on the CCD: 93% of the respondents had obtained credit in the member state in which they lived and 85% had not tried to obtain credit in another member state.

From the point of view of financial institutions, promoting the single market by harmonising regulation may have some advantages and could contribute to them becoming more efficient. The CCD review should therefore strike a fair balance between consumers' interests and creditors' obligations. For convenience sake, information provided to customers should be simplified. Given the importance of consumer credit in private consumption, the directive should be made fit for the digital age and enable customers to benefit from a wider choice of offers.

To prevent over-indebtedness, extending credit to consumers should nevertheless not just be a box-ticking exercise based solely on standardised processes and a uniform set of data

for every customer. It is important that customers have easy access to more individualised advice if they are not sure whether a credit fits their purposes and their financial capacities. Lenders cannot and should not decide for their customers what to use consumer credit for but all parties involved should bear their share of responsibility. Lenders must carefully assess customer creditworthiness and embed it in a wider financial analysis to manage their risks.

In this context, it is also essential to promote financial literacy and financial education, as this allows individuals to gain a better understanding of financial products and how to take informed decisions. To mention one popular example of financial education initiatives, many ESBG members organise events around the World Savings Day to increase awareness of the importance of saving. Many more initiatives are undertaken, for example, some members provide advisory services on how to manage a household budget.

In the same vein, the purchase of more sustainable products could be promoted by lenders. Via favourable lending terms or special marketing initiatives, lenders could set incentives for their customers to acquire sustainable products. The availability of sustainable products and customer awareness of the relevant product features are however preconditions for such initiatives to become effective. And lenders must clearly distinguish between the risk assessment of a credit, capital requirements and the marketing tools that may influence interest rates charged to customers.

It is therefore important to understand that the concept of a sustainable economy is a broad one, impacting all parts of the economy, not just the financial services industry. Product manufactures and regulators must also play their part in this concept and work hand in hand. There need to be true incentives for the real economy, private households and SMEs for sustainable solutions to be attractive at the local, national and global levels.

SHOULD THE SCOPE OF APPLICATION OF CONSUMER PROTECTION RULES BE EXTENDED

By Lucia Pecchini
Policy Advisor Digital & Retail EBF

Many Europeans have had the opportunity to improve their lives or grow their businesses with a personal loan. Whether you are buying a car or investing in education, applying for personal credit is an important economic decision for the long term. Can you think of anything else that is as personal and yet has such far-reaching consequences for financial stability?

This question allows us to reflect on the complexity of consumer credit and its regulation. It is not only about a banking product; it also enters a social and educational dimension, as well as the aspect of financial stability. Any evaluations of the Consumer Credit Directive (CCD) should thus be treated carefully, considering all these aspects at the same time.

The cornerstone of this complex puzzle is obviously the scope and definitions of the CCD: what falls under the directive but also what explains what a credit agreement or who a creditor is.

Questions also arise about new types of credit products or providers and the challenges that come with them. Any evaluation or potential changes to the CCD framework would need to capture the latest innovations and be future-proof. This challenging task can be achieved by taking the following principles into consideration:

- Activity-based approach: it is important to move from an entity-based regulatory paradigm to an activity-based one. The boundaries between different types of business are becoming increasingly blurred as the same service can be provided by many different types of new providers. Taking an activity-based approach ensures that consumers benefit from the same level of transparency, responsible lending, solvency and complaint handling standards, regardless of the business model of the firm offering credit.

- Level playing field: setting a level playing field across the different providers of the same services by avoiding gold-plating practices. By implementing the rules evenly, you guarantee fair market conditions for all. This would not only benefit of financial stability but would also enhance consumer protection and provide more freedom for consumers to shop around while enjoying the same degree of protection.

- Proportionality: rules should be proportionate to the size and duration of the loan and be sufficiently flexible to cope with the market diversity that Europe is hosting. The flexibility embedded in the CCD is a paramount added value to adapt to the different cultures and markets, and to the different types and sizes of loans.

Being able to incorporate these principles is fundamental for the directive to remain relevant and adapt to the dynamic markets and societies that European consumers live in.

Can rules on pre-contractual information be improved?

When looking at pre-contractual information and whether it can be improved, we should always keep in mind from whom such information is collected and to whom it is presented. The information sheet should be first and foremost in the interest of consumers, helping them to make an informed choice, without information overload that would prevent them from focusing on what is relevant for them to take the right decision. Against this background, introducing additional requirements that increase the number of information sheets would not be beneficial as it would confuse customers; the numerous documents would gather the same information under different formats and length.

Rather, we should consider whether the existing rules can be streamlined to avoid tasks or information being duplicated. It is not the quantity of data that makes consumers feel comfortable with a financial product, but rather the quality. CCD provisions and national implementation rules require consumers to document and share large amounts of data.

Ironically, we observe that sometimes additional and detailed requirements imposed by national rules do not fully achieve the goal of informing consumers in a way they fully understand. Also, it is worth questioning how relevant these detailed requirements are in an era of increasing dematerialisation.

Digitalisation definitely plays a role in empowering consumers to access credit and information, also across borders. However, in some member states gold-plating practices created rigidities or increased administrative burdens that do not allow consumers to enjoy the full benefits of digital innovation or reduce the ability of legislation to keep up with developments in the market or in technology.

Pre-contractual information is not a panacea: it can be enhanced by complementary tools such as financial education efforts that can make financial procedures more understandable for a wider audience.

It is a reminder that provision of information should always put the consumer at the centre and is a joint responsibility of all players involved.

WHAT SHOULD BE CLEARLY ADDRESSED BY A NEW VERSION OF THE CCD

By Olivier Jerusalmy
Research and Advocacy Advisor, Finance Watch

EU consumer credit should be free from risky products

The risk of over-indebtedness clearly emerges from market failures rooted in the asymmetry of power between creditors and debtors – especially when the debtor is vulnerable and /or poor – and this allows:

- Exploitative, unscrupulous or irresponsible lending practices:
    - o Terms and conditions that differ significantly from mainstream practices and to which the most vulnerable people have little alternative but to agree.
- High-cost credit:
    - o Costs are significantly higher than for the average offers on the mainstream market.
- Complex credit contract terms and conditions:
    - o Borrowers do not understand where they are liable, or how to avoid penalties and extra costs.
    - o Misleading teaser rates apply for a short period of time.

Responsible lending based on a strict creditworthiness assessment

Adequate personal budget analysis (income and expenditures), ongoing credit and debts that should lead to an offer adjusted (in amount and in duration) to the needs of the borrower or to a refusal when their financial capacity is not sufficient.

Creditworthiness assessment should be reinforced to be effective[1]. This EU Court of Justice of the Union judgment of 18 December 2014 (Consumer Finance) Case 449, states that the obligation to assess the creditworthiness of the consumer can be carried out "from the only information provided by the consumer, provided that such information is sufficient in number and that mere declarations of it are accompanied by supporting documents".

We need to regulate what happens when the result of the creditworthiness assessment is negative. Certain practitioners appear to believe that the acceptance of credit by consumers is the sole responsibility of consumers. This must be challenged in our current reality, where deliberately misleading and exploitative practices exist. The directive should specify that the lender has the duty to refrain from granting credit when the result of the creditworthiness assessment is negative.

The lender should have the obligation to collect and store evidence of the fulfilment of the information and explanation obligations (see Case 449) in accordance with the GDPR.

The purpose (or aims) of the credit should be noted in the contract.

A clear difference should be defined in the CCD between the creditworthiness assessment and the credit risk assessment and the liability of intermediaries to carry out these assessments (at least, the significant ones in the market, whether or not credit is an accessory activity) should be equivalent to that of credit providers.

This should be a precondition for licensing providers and be accompanied by adequate supervision and sanctions.

The remuneration of an intermediary should be designed to ensure that it does not contradict responsible lending principles.

Decisions about whether or not to grant credit should be transparent and allow the consumer to learn what improvements or changes to their budget and budgeting practices could improve their credit access, if the request is denied.

The creditworthiness assessment is, when done properly, the best way to implement responsible lending. The assessment should not only a) identify the remaining amount (incomes from which the unavoidable expenditures have been deducted) of the budget that can be used for credit repayment, but also b) allow the credit provider to adjust its credit offer in amount, duration and cost in order to be affordable for the customer.

[1] http://curia.europa.eu/juris/document/document.jsf?docid=160946&

RESPONSIBLE LENDING IN THE EU: DO WE NEED ADDITIONAL RULES?

By Olha Cherednychenko
Professor of European Private Law and Comparative Law / Director of the Groningen Centre for European Financial Services Law (GCEFSL), University of Groningen, the Netherlands

In the wake of the global financial crisis, it has been widely recognised that consumer credit lending should be responsible. The core concept of responsible lending is that lenders should not act solely in their own interests, but that they should also take into account the consumer borrowers' interests and needs throughout the relationship in order to prevent consumer detriment. Nowadays, more than a decade after the outbreak of the financial crisis, however, lenders still do not always put the consumer borrowers' interests first, as evidenced by the results of the recent studies for the European Parliament ECON Committee and the European Commission DG FISMA, led by Dr Cherednychenko (forthcoming in Journal of Consumer Policy 2019).

The most prevalent irresponsible lending practices across the EU include: i) the provision of high-cost credit, such as payday loans and credit cards; ii) cross-selling, whereby consumer credit products are sold to consumers together with other products, such as payment protection insurance; and iii) peer-to-peer consumer lending (P2PL) which connects consumer lenders to consumer borrowers directly by means of an electronic P2PL platform. The digitalisation of consumer finance further increases the information asymmetry between lenders and consumers, posing new risks to the latter.

The regulatory failure to ensure responsible lending in the consumer credit markets results first and foremost from the lack of adequate consumer protection standards and enforcement failings at member state level. At the same time, close attention should be paid to the role of the EU in ensuring responsible lending, given its harmonisation efforts in this area and the large scale of irresponsible lending across the Union in the post-crisis period. Reflecting the information paradigm of consumer protection and the corresponding image of the 'average consumer' as a reasonably well-informed, observant and circumspect actor, the 2008 Consumer Credit Directive (CCD) fosters increased access to consumer credit and embodies only a limited concept of responsible lending. Despite the efforts of the Court of Justice of the EU to address these limitations through a consumer-friendly interpretation, CCD is likely to remain the 'sleeping beauty' that will never fully awake.

The 2019 review of CCD should be used as an opportunity to reconsider the current approach to EU consumer credit regulation along the lines of the concept of responsible lending. In particular, it should be considered whether it is appropriate to design product governance rules for consumer credit products; to introduce a clear borrower-focused duty of lenders to assess the consumer's creditworthiness, which includes but is not limited to the assessment of credit risk; to adopt the lenders' duty to ensure the basic suitability of financial products offered, together with credit for consumers or even to restrict cross-selling practices involving product tying; to extend the responsible lending obligations to P2PL platforms, with due regard to the principle of proportionality; and to bring CCD into the remit of the European Banking Authority. The time now seems ripe to strike a different balance between access to credit and consumer protection in CCD.

RESPONSIBLE LENDING IN THE CONSUMER CREDIT: DO WE NEED ADDITIONAL RULES?

By Marieke van Berkel and Chiara Dell'Oro
Head of Department Retail Banking, Payments and Financial Markets, EACB
Senior Adviser, Consumer Policy, EACB

From the EACB's perspective, the CCD has been a successful instrument. The directive has put in place a very high standard of consumer protection at EU level. Even if it was an onerous exercise in terms of implementation, updating documentation, practices and training staff, EACB members considered it a positive initiative. The directive has served its purpose. This is also confirmed by the evaluation of the directive[1]. If anything, should the Commission's evaluation process suggest that the directive needs review, adjustments should be limited to the provisions on advertising, pre-contractual and contractual information. These could benefit from an overall simplification, streamlining and adjustment to the digital environment. EACB members would however see no need to add rules on creditworthiness assessment.

Coming back to the topic of this article, EACB members believe that the directive already holds all the elements to put responsible lending practices in place. Besides the article on creditworthiness assessment (Art. 8) there is Recital 26 asking member states to promote responsible lending practices, taking into account the specific features of their credit market. Member states have done so by taking sometimes different approaches towards, among others, the information considered for a creditworthiness assessment. Even if this creates differences across Europe, EACB members consider that such different approaches do not prevent the directive from achieving a high level of consumer protection, from enabling the cross-border provision of credit or from remedying distortions of competition among creditors.

Additionally, EACB members consider that too harmonised or common standards for creditworthiness assessment would not be based on the most flexible or severe risk policy but would set an average that would exclude some people from access to credit – smaller borrowers financed by more specialised institutions or borrowers with atypical profiles for reasons of irregular income, for example. A local lender, such as a cooperative bank that knows its client – and is also a member of the bank – should certainly still be able to grant a loan to consumers experiencing difficulties if the bank has confidence in them. Those with the lowest/ irregular revenues are not necessarily the worst payers.

Finally, the way in which an institution performs a creditworthiness assessment should remain an expression of each credit institution's expertise and risk appetite, taking into account the different circumstantial factors where member states might differ, such as social security/pension/ tax systems and insolvency law, but also savings habits, types of employment contract, etc.

On the topic of creditworthiness assessment versus risk assessment, and the question whether there should be a clearer line between the two, the speaker believe that, on the contrary, they should act in tandem. Even if the risk assessment may be geared towards assessing whether the bank can recuperate its loan and not directly have the customer in mind, the ultimate objective is the same, i.e. to ensure that credits that have been extended can be paid back. It would be counterproductive if the prudential regulator imposed requirements or gave incentives that would be in conflict with the requirements set out in consumer protection law.

[1] The European Commission's summary report is available here: https://ec.europa.eu/info/law/better-regulation/initiative/1844/publication/350280/attachment/090166e5c4195d31_en

HOW DOES DIGITALISATION CHANGE THE CONSUMER CREDIT MARKET?

By Mick McAteer
Co-director, The Financial Inclusion Centre

This article discusses what the emergence of digital finance might mean for consumer credit markets, the risks borrowers will be exposed to, and what can be done to protect them.

The way consumer credit is being sold (including the speed with which decisions are made) is being transformed with decisions increasingly automated and less human interaction. What does this mean for consumers? There will undoubtedly be some benefits for some consumers in the form of cheaper, more convenient consumer credit and supporting technologies to help them manage their finances.

But, although technology is evolving, this doesn't guarantee that markets will become fairer or that ethical standards have improved. Fundamental market dynamics have not changed, and the same conflicts of interest that caused so much consumer detriment in the past remain. Indeed, there is reason to believe that digital finance increases risks.

The idea that digital finance 'democratises' financial markets is naïve. Enhanced data analytics and technology puts more, not less, power in the hands of consumer credit providers and intermediaries. It exacerbates, not reduces, the information asymmetry problem.

The essence of digital finance is speed and convenience, but quick decisions can increase the risk of poor decisions and choices. There is a clear risk that providers and intermediaries will use dynamic data and psychological profiling, high pressure web-based sales and marketing techniques and 'confusion marketing' to exploit behavioural biases and encourage over-consumption of credit, steering consumers into making sub-optimal product and provider choices.

Fintech and big data allow providers and intermediaries to segment and profile with even greater precision those households that are high risk/ low profitability and are psychologically vulnerable. So, unless digital finance can reduce distribution costs and/or alternative credit providers can fill the gaps, financial exclusion and discrimination will increase.

Moreover, we are concerned that there is a culture and knowledge gap between directors and senior managers who run financial firms (often with poor tech-literacy) and developers and designers who may consider consumer protection a hindrance to 'innovation' and getting products to market.

Protecting consumers in the fast-moving, complex digital finance consumer credit market will not be easy. But there are a number of interventions which could be used to constrain the behaviours of providers and intermediaries and help consumers make better decisions and choices.

Regulators need courage and a radical change in philosophy. They cannot rely on creating ground rules and hope the market behaves fairly and efficiently (this rarely works in financial services). Regulators at EU and national level need to adopt the precautionary principle to constrain market behaviours – similar to the approach public health campaigners use when dealing with dangerous foods or food and drink that causes obesity. Overconsumption of consumer credit should be seen as a financial health issue. That means constraining the ability of providers and intermediaries to aggressively sell credit.

It means: putting 'friction' into the process of selling consumer credit; inserting checkpoints to force consumers to slow down and reconsider decisions; banning 'click-through' decisions; preventing credit providers and intermediaries from overstating the benefits of their products; and limiting the use of 'special offers'. We should use digital finance positively by requiring providers and intermediaries to include links to non-profit/publicly run comparative information websites in consumer credit promotions. 'Red-flag' warnings should alert consumers that the credit offer they are considering is expensive or has potentially detrimental terms and conditions. Non-profit comparative websites should make greater use of scenario-based comparisons, thereby allowing consumers to identify

safe offers that most closely meet their needs.

But more is needed. We have analogue governance and regulation for a digital age. Regulators need to ensure that directors and senior managers are held responsible for the negative outcomes created by their company's use of data analytics and digital finance.

Regulators should adapt the product governance approach already used in certain financial sectors to regulate the outcomes created by digital finance techniques. This includes: tough testing and preapproval of digital finance business models during the authorisation process; a requirement for firms to 'stress test' business models and algorithms to determine whether these produce negative outcomes for different groups of consumers, and report the results to regulators; and, where necessary, ban the use of certain digital finance techniques.

Finally, regulators need to ensure this regulatory regime applies consistently across all forms of consumer credit. There is no point introducing tougher more responsible regulation for some forms of consumer credit if all it means is consumers being targeted by less well-regulated firms.

CUESTOMER-CENTRIC AI FOR THE COMMON GOOD

By Lu Zurawski
Solutions Practice Lead, consumer Payments EMEA, ACI

Artificial intelligence has escalated to the highest levels of policymaking; governments are aligning their unique national talents and resources in the hope of winning out in a kind of world league of synthetically created productivity improvements. Among the competing national AI teams, this speaker particularly enjoyed watching the strong French game as plotted by one of his mathematics heroes, Cedric Villani.

But although revolutionary machine-learning techniques and massive data analysis advances have livened up the game, there is a danger that too much effort is being funnelled into the pure, geeky science and management of AI. There could be an accidental shift into thinking that machine analysis is a superior substitute for human decisions, which may be made by consumers explicitly initiating an event decision or by administrators controlling and approving a consequent transaction. Is enough being done to recognise how normal citizens will be empowered to keep some control over the decisions made by agents acting on their behalf?

Villani's approach, called 'AI for Humanity', recognises that AI could become a scary prospect for citizens. The human qualifier is a useful reminder of what AI is for. How can we best harness the technological capabilities of emerging AI? How will societies and individuals benefit? As Nobel laureate in economics, Jean Tirole, might put have it "What does AI do for the common good?"

Self-learning algorithms, automated data insight techniques and robotics embedded with delegated decision-making powers should lead to efficiencies and economic value creation across many vertical sectors of European economies, ranging from manufacturing to transportation, from healthcare to entertainment.

Focusing on the more mundane sector of retail financial services, the application of AI in real-world, real-time transaction scenarios could lead to better outcomes for citizens and consumers, particularly when it comes to minimising the friction associated with authenticating and authorising payments. AI could also make it easier (and more transparent) for account-holders to provide access to – and be rewarded for – their valuable transactional and personal data, as used by third parties. But surely the process by which rules develop and evolve cannot be left entirely within an AI 'black box'. Public trust depends on transparency, even if outcomes are broadly beneficial. Real people will need to be able to interact with and to interrogate AI decision-making.

Already, some prevailing EU policies for digital payments seem to be stacked against automation and analytics. The latest opinions on Strong Customer Authentication within the revised Payments Services Directive create a baseline assumption that all transactions should be subjected explicitly to a human "strong customer authentication" interaction. It seems that physical inherence currently scores higher than artificial intelligence, regardless of a many citizens' desire to have less friction in their daily payment experiences.

AI still has the potential to improve the efficiency of payments at a level of individual consumer experience, and to ramp up the payments industry fight against criminals and fraudsters. But AI should not be viewed as a panacea for patched-up payments operations. AI in payments will still benefit from a human touch. AI will not be a substitute for 'me, myself & I'. To paraphrase Billie Holiday, "all three of us have just one point of view; me, myself and I will all be very satisfied if you'd do the right thing for us".

UPCOMING ECRI EVENT

Wednesday, 11 September, 2019 - 12:30 to 14:30 | ECRI - CEPS Conference- Sponsored by ACCIS

Data sharing in credit markets: Does comprehensiveness matter?

Data sharing between lenders is commonly acknowledged to be one of the core ingredients of successful credit markets. The aim of this CEPS-ECRI lunchtime meeting is to exchange views on the existing rules for data sharing in EU credit markets and to consider how they might be improved. Among other topics of discussion will be whether more comprehensive data is beneficial for credit markets and whether this applies to both traditional credit data and non-traditional data.

To register visit **www.ecri.eu/events/data-sharing-credit-markets-does-comprehensiveness-matter**

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