ECRI CONFERENCE

CRISIS, NEVER AGAIN! RESPONSIBLE LENDING AND FINANCIAL EDUCATION ON THE EUROPEAN AGENDA

Minutes

European Credit Research Institute at the Centre for European Policy Studies
14 October 2009, 12:00-16:15, Place du Congrès 1, B-1000 Brussels

Event co-sponsored by intrum justitia

Two years into the discussion of the causes of the financial crisis, irresponsible lending practices on the one hand in combination with a lack of financial education among some consumers on the other are, amongst other issues, often attributed a fair share of the responsibility for stirring up the turmoil.

Dealing with only one but not the other would thus neither be just nor justifiable on the way to fixing what is broken and preventing the crisis from erupting again: both need to be addressed jointly. Even the best lending practices will be ineffective if consumers are not capable to take informed borrowing decisions, in the same way that even the best-informed clients will not get far if lenders apply unfair business practices.

To this end, the European institutions have taken several recent actions to correct the existing deficiencies: amongst others, the Parliament has investigated financial education issues and adopted a report, the Commission has created an Expert Group on the same topic and public hearing on responsible lending took place on 3 September 2009 to evaluate the potential need for further regulatory action.

In the wake of these developments as well as in the context of a new European Parliament and a newly appointed Commission, stakeholders were invited to participate in this ECRI conference to discuss with the speakers the lessons learned, the future challenges faced and possible actions to be taken in the field of responsible lending and borrowing.

One of the main questions discussed was if regulatory action is feasible and necessary. What is the role of the industry in financial education? How effective are educational practices? Just how much and what information do consumers need? These and other questions were addressed on 14 October 2009, in a dynamic and interactive half-day conference, co-sponsored by Intrum Justitia.

More information can be found at: www.ecri.eu.

Karel Lannoo, CEO of the Centre for European Policy Studies (CEPS) and Director of the European Credit Research Institute (ECRI) opened the event and welcomed all participants to the conference. He briefly introduced the structure, work, and history of ECRI, which has provided research on credit markets and regulatory affairs in the area of retail financial services since 1999. Turning towards the subject of the debate, **Mr Lannoo** pointed at the lack of regulation in the area of mortgage credit and the problems of consumer indebtedness arising from the issuance of foreign currency loans as two topics to be addressed in the course of the discussion.

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In his keynote speech, Swedish Secretary of State for Financial Market Affairs **Mr Urban Karlström** affirmed that the financial crisis had made "blame the name of the game", underlining that responsibilities for the turmoil could and should not be attributed to one or the other market side only. He highlighted the lack of transparency in today's financial markets as a "major reason" for the existing problems and blamed excessive bonus payments for creating wrong incentives. According to the Swedish official, the development of increasingly complex financial products had led to risks that "cannot even remotely be assessed anymore".

While emphasising the necessity of supporting schemes of financial education and enhancing their effectiveness, he warned however to not use a "paternalistic approach" and stated that Sweden – currently holding the rotating EU presidency – has no intention to present related actions as a "global crusade to educate people". Nevertheless he depicted financial education to be among the "top three issues" in a financial roundtable chaired by himself and set up in early 2009 to stimulate the financial sector in Sweden.

He briefly sketched further financial education initiatives of his home country, but subsequently shifted the focus to the need of overcoming remaining obstacles in the area of financial supervision, the provision of clear and comparable information on financial products as well as finding effective measures to protect especially financial illiterate consumers from "being cheated", "given reckless financial advice" and "being taken advantage off".

Responding to a question on the lack of a horizontal institution dealing with consumer protection issues at the EU level under the newly proposed financial supervisory structure, **Mr Karlström** indicated that the implementation of the de Larosière proposals is to be seen as a "gradual reform process", at the same time welcoming discussions on the potential inclusion of consumer protection issues. On easy-to-get but high-price SMS loans, popular among young Swedes, **Mr Karlström** hinted to be looking at the issue "from a regulatory point of view in the near future".

OECD Principle Administrator of the Directorate for Financial and Enterprise Affairs **Mr Bruno Lévesque** underlined that the provision of ever more complex financial products in combination with the transfer of associated risks were effective enablers of the crisis. He added that both consumers' overestimation of their own financial knowledge and little interest in financial issues represent additional challenges in raising consumers' awareness of the importance of financial literacy and education.

Introducing the OECD's publication on "Financial Literacy and Consumer Protection: Overlooked Aspect of the Crisis", **Mr Lévesque** elaborated upon the roles of both credit market players and credit bureaus, stating that lenders' responsibilities have to go beyond the mere disclosure of informational documents. In particular, credit market players (financial institutions, intermediaries and other credit providers) should channel funding into training and qualification programmes for own staff, develop uniform 'due diligence' standards to assess consumers' creditworthiness, provide accurate and complete information and ensure consumers' understanding and awareness of the terms and conditions of the credit agreements that they get into.

Credit bureaus, he argued, should allow for consumers' verification of their credit files and, where necessary, for an easy correction of errors. They should, in addition, play a role in raising

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consumers' awareness of the importance of good credit behaviour, and help borrowers adopt the right measures to improve their credit history.

Turning to the issue of financial education, **Mr Lévesque** referred to the results of survey conducted within the framework of the International Network on Financial Education (INFE) in 2009, which revealed that the lack of financial literacy was "one of the contributors to the crisis". The dire consequences, however, have raised awareness on the need for increased financial literacy and capability, now considered as one of the pillars of financial stability and an essential life-skill for households. The crisis prompted, according to the findings, both broad national information campaigns to restore public confidence as well as targeted interventions for specific audiences.

Mr Lévesque called for the development of comparable measures of financial literacy on a global level, better programme assessment indicators and a deepening of knowledge of behavioural and psychological factors affecting financial literacy. Concluding, he highlighted the need to integrate financial education into school curricula and announced the potential inclusion of a financial literacy component in the mathematical section of the Programme for International Student Assessment (PISA) test in 2012.

Mr Mick McAteer from the Financial Inclusion Centre in the UK voiced his conviction that financial education schemes have no effect on consumer behaviour and are supported by financial institutions in order to avoid regulation. With everybody jumping on the bandwagon in the ongoing discussions about the causes, consequences of and remedies for the financial crisis, the question about the actual effectiveness and benefits of educational measures appears to have drowned out.

A study on the efficiency of over 40 active financial education organisation and more than 100 local initiatives, carried out by the Financial Inclusion Centre and to be published beginning of next year, found little evidence showing that savings had been stimulated and consumers' resistance to sales pressures had increased. The researchers also looked at other components such as changing behaviour concerning the 'planning ahead and setting of financial goals' or the day-to-day managing of personal finances. Reasons for the lack of effectiveness can, according to **Mr McAteer**, be found in the general low levels of (financial) literacy among certain parts of the population or consumer inertia leading to scarce interest in financial products and financial education.

The application of classical economic theory, he continued, tracing the causes of the crisis to the existence of information asymmetries between various actors, overly simplifies excessively complex financial markets and products in which "a piece of paper [with clear and accurate information] is no protection" in the presence of "conflicts of interest, absurd remuneration schemes and sales pressure".

Mr McAteer called on the responsible authorities to "clean up and simplify the market and lending behaviours". According to the consumer advocate, financial education can only be effective in a completely transparent market environment and when ensuring the schemes' sustainability by sufficiently funding them over "a long time".

He welcomed the suggestion of introducing 'ISO-loan-standards' and emphasized the importance of making them compulsory at the EU level in order to assure their effectiveness. Asked about the necessity of improving credit bureaus and registers, **Mr McAteer** encouraged

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policy-makers to increase EU level harmonisation, indicating that parts of the high levels of unsecured debt in the UK might have been granted on the basis of insufficiently well-functioning information systems.

He added that attention would also have to shift to the 'after point-of-sale responsibilities' of the lenders in order to ensure fair treatment for those customers that have slipped into arrears. Given the urgency to work on improvements in the European financial markets, **Mr McAteer** postulated to "not waste too many resources on further research when we know we have a problem" and set a priority on getting it "rather roughly right than precisely wrong'.

Bruno Lévesque challenged the statement of the ineffectiveness of financial education schemes, referring to a project in Canada informing consumer about and helping them compare credit card terms and conditions. The undertaking, he stated, led to significant improvements in the proportion of consumers shopping around for the best credit products, translating into higher switching rates between the various providers.

In the ensuing panel discussion, chaired by **David Shirreff from the Economist**, **European Commission Deputy Head of Unit Eric Ducoulombier** assured that the Commission is on the same wave-length with the OECD and underlined the importance to regard consumer protection and financial education as complementary rather than substitutes to each other. He presented the Commission's most recent activities and initiatives in the area of responsible lending, including consultations, public hearings and studies.

Challenged with "taking responsibility for the irresponsibility", **Mr Noel Cramer, Director of consumer lending in Europe, Middle East and Africa for Citi** stated that with current hindsight "perhaps a few things but not everything" could have been avoided. With lending per se not to be considered a problem, **Mr Cramer** explained that both out-of-date risk assessments on the one hand as well as suboptimal choices of and improper use of financial products on the other contributed to the development of the current financial turmoil. He stated that the application of 'responsible lending practices' should not end at point-of-sale but continue along the entire credit life-cycle, including collection.

Being asked whether the Consumer Credit Directive – adopted in 2008 and to be transposed into national law by June 2010 – provided adequate solutions to the issues raised with regard to responsible lending, **Ms Rossella Delfino, Deputy Head of Unit from DG Sanco of the European Commission** stated that in the context of the current financial crisis the Directive could certainly be considered a "first attempt" to provide solutions to these problems. In particular, she specified, the introduction of obligations on lenders to assess the consumer creditworthiness and to provide adequate information and explanations – enabling costumers to assess whether the proposed credit is adapted to their needs and financial situation. **Ms Delfino** emphasized the achievement of having included a standardized consumer credit information sheet – aiming at providing consumers with correct, proportionate and understandable information rather than "overburdening" them. Ms Delfino concluded that the Directive, however, had not yet been implemented and given its adoption before the outbreak of the financial crisis, it had to be seen how the legislative text would work in practice once implemented before evaluating whether more "could and should be done".

Referring to the topic of the conference, **Regional Director of Customer Marketing for Intrum Justitia, Mr Beat Koch,** depicted it as "crucial to couple financial education with

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responsible lending practices". In an environment of estimated losses of €120 bn for Europe's banks between 2008 and 2010 caused by defaulting retail credits, it remains important to promote among consumers an attitude of "sensible spending". According to **Mr Koch**, however, it is equally imperative to prevent lending without proper checks and assessments of the consumer's financial situation. Especially in times of falling property prices, he added, lenders should adopt greater flexibility in order to ease pressure on financially strained consumers and thereby contribute to "help solve the crisis".

On the topic of simplifying and/or standardizing credit products, **Mr Cramer** pointed at the issue of foreign currency loans – especially in some East European countries – as an area in which further self-regulation should be envisaged. Some loan products, according to **Mr Cramer**, "needed to be standardized", suggesting for example loans to be granted only in the currency of the consumers' salary payments.

Decreasing diversity of the financial markets and products may be the price to pay for achieving greater standardization, **Mr Ducoulombier** stated, indicating that "dealing with the product" is the alternative to enhancing levels of consumer financial capability in order to combat increased product complexities. In his opinion, diverging views on the subject matter may be "conflicting but nevertheless valid".

"Some lenders struggle to explain their own products to us", **Mr Koch** from the credit management service company Intrum Justitia said, calling for the development of simpler products that "would bring back the trust" in the financial system.

In the same vein, **Mr McAteer** defied present industry representatives to "justify the existence of over 9.000 loan products" available especially in the UK market, reproaching lenders with disguising new marketing strategies as beneficial innovation and criticising existing imbalances in the market: while in the UK it was possible to receive a 10.000 pound loan within three minutes, so the consumer advocate, the opening of a savings account could take over two hours.

David Rees, Director of Legal Affairs at Provident Financial, an unsecured loan provider in the UK, urged that policy analysis and any resulting legal framework should differentiate between various types of financial services product as risks for consumers as well as level of charges differ. As an example, he stated that secured and unsecured loans warranted different treatment in much the same way that savings and investment products differed from credit products.

This view was supported by **Mr Cramer** by emphasizing the fact that "a consumer loan is not an investment" and alluding to consumers who allegedly financed vehicle purchases via credit cards.

Touching upon the subject of credit intermediaries, **Mr Cramer** illustrated Citi's method to solve potential conflict of interest problems by rejecting to pay their exclusive agents if loans "have gone bad after six months" and by giving more weight to portfolio commission. Conflicts of interest may arise by market practices of granting high up-front commission payments to brokers. He highlighted that it is not "in the bank's interest when a consumer does not pay", referring to the necessity of employing qualified intermediaries and giving them extensive training in order to not only grant credits which are suitable for the consumer but also ensure fair customer treatment during the repayment process.

Mr Ducoulombier elaborated on the Commission's current initiatives in the area of credit intermediaries, arguing that the "unanimity of views on issues such as rules on transparency, competence and remuneration" significantly raised the probability of regulatory action on intermediaries in the upcoming months. He specified, however, that any such decision which could be taken in the context of a broader responsible lending package would have to be made by the next Commission on the basis of a prior and convincing impact assessment.

Mr McAteer voiced his relief that "regulators seem to have understood the conflict of interest problem", however adding that solutions have to be found as regards existing bonus structures, a problematic issue that has become evident also in the retail financial markets. It was, according to **Mr McAteer**, imperative to "align the interests of consumer and intermediaries" and "up-front commission lump-sums just won't do the job".

Coming back on the effectiveness of financial education schemes, **Ms Delfino** presented the European Commission's initiatives such as the online consumer education programme *dolceta* (www.dolceta.eu). The Commission official pointed out that a key challenge after creating educational products is to spread the offer and use of such programmes, ensure their effectiveness and guarantee that "they reach the persons that need them". Quoting the US as an example, **Ms Delfino** explained that in order "to get closer to the people", some educational programmes in financial services were distributed to consumers through public libraries, trade unions or employers.

Mr McAteer emphasized the need to not only rely on webpages, studies, reports or schoolbooks but also sufficiently qualify people to be active "and deliver in the field". Aware of the involved costs, he called on the industry to come forward with "fewer and simpler products that meet the basic needs of consumers in the area of savings, loans and investments". Moreover, means had to be found to reduce aggressive marketing activities such as sending out unsolicited credit cards.

Mr Cramer added that while it was the consumer's responsibility to acquire basic financial knowledge in order to be able to calculate revenues and expenses of his day-to-day life and assess his/her own financial situation, lenders have to assume their responsibility to efficiently explain bank products, informing consumers about the impact of non-payments and carry out appropriate creditworthiness and suitability assessments. The latter, he explained, also requires an ongoing two-way interaction between the lender and the consumer in order to continuously re-assess the borrower's financial situation and, if applicable, adapt lending terms. In addition, the establishment of well-functioning and "fully loaded" credit bureaus systems was essential for lenders to acquire all necessary financial information on a customer.

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In her closing speech **Arlene McCarthy, Member of the European Parliament (MEP) and Vice-Chairwomen of the Committee on Economic and Monetary Affairs (ECON)**, welcomed the Commission's initiatives in the area of financial education and responsible lending. Expressing her concerns over increasing household debt and excessive risk-taking by financial institutions, she explained that her committee would be dealing with unfair and inappropriate business behaviour both on the retail and wholesale level. She approved of the Financial Services Authority's plan to ban so-called 'self-certification' mortgages, requiring verification of borrowers' income for all mortgage applications.

Arguing that consumers might "feel intimidated by the financial language", **Ms McCarthy** said financial education "won't do the trick alone" and has to be regarded as complementary to rules on responsible lending. Many borrowers, the MEP stated, would not be able to exit the credit-debt-cycle without appropriate help and consumer protection in place. Especially given high levels of "functional illiteracy" in some Member States, messages brought about by financial education schemes would have no lasting effect. **Ms McCarthy** also called for the inclusion of financial education in school curricula.

The ECON committee, she presented, would look at a variety of issues in the coming months, including "unacceptable aggressive sales practices", "automated and unsolicited credit card offers", lenders' post-contractual responsibilities, transparency of financial markets and unfair commercial practices in general.

Ms McCarthy pointed at the Consumer Credit Directive and the introduction of the standardized credit information sheets as a step into the right direction and called for further measures to enable consumers take informed borrowing decisions. While consumers would have to take on certain responsibilities when making a "once-in-a-lifetime decision to obtain a mortgage", **Ms McCarthy** nevertheless did not downgrade the necessity for further legislative action in order to provide consumers with "complete, correct, clear, proportionate, understandable, timely and consistent information" in all areas of the financial services market.

Responsible lending, the MEP concluded, would lead to "more trust, healthier markets, more efficient markets and more empowered European consumers" to the "benefit of all".

Asked about future regulation on mortgage lending, **Ms McCarthy** referred to "a world of difference between consumer credit and mortgage lending", indicating to wait for the Commission to become active. Similar hesitation was evident concerning the inclusion of horizontal consumer protection schemes at the EU level.

When challenged as regards a 'better regulation' approach by Europe's legislative body, **Ms McCarthy** stated that the European Parliament did "not just sign off legislation and cross-fingers" but would continue to carry out proper impact assessments in order to assess the advantages and downsides of regulatory action. She also indicated that "more ex-post analyses" of adopted directives and regulations were necessary to come forward with legislative texts beneficial to the whole society.

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