

**Policy Department
Economic and Scientific Policy**

**BROAD ECONOMIC ANALYSIS
OF THE IMPACT OF THE PROPOSED DIRECTIVE
ON CONSUMER CREDIT**

(IP/A/IMCO/FWC/2005-58/LOT 4/SC1)

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Contents

KEY CONCLUSIONS OF THE STUDY	iv
EXECUTIVE SUMMARY.....	vi
1. INTRODUCTION.....	1
2. METHODOLOGY	2
2.1. RESEARCH QUESTIONS.....	2
2.2. METHODOLOGICAL APPROACH.....	3
3. ASSESSMENT OF CHANGES TO THE EU LEGAL FRAMEWORK.....	5
3.1. CONSUMER PROTECTION – MAIN CHANGES THROUGH THE PROPOSED DIRECTIVE	5
3.2. HARMONISATION – ACHIEVEMENTS AND LIMITATIONS.....	11
3.2.1. <i>Substantive law</i>	11
3.2.2. <i>Maximum harmonisation</i>	13
3.2.3. <i>Mutual recognition</i>	22
3.2.4. <i>Private international law</i>	23
4. ECONOMIC ANALYSIS.....	25
4.1. BACKGROUND	25
4.2. OVERVIEW OF THE EU CONSUMER CREDIT MARKET	26
4.3. EXTENT OF CONSUMER CREDIT CROSS-BORDER TRANSACTIONS	28
4.3.1. <i>Consumer credit directly provided cross-border</i>	28
4.3.2. <i>Consumer credit provided through branches / subsidiaries in other EU Member States</i>	29
4.4. OBSTACLES TO SELLING CONSUMER CREDIT ACROSS BORDERS	31
4.4.1. <i>Demand side barriers</i>	32
4.4.2. <i>Supply side barriers</i>	32
4.4.3. <i>Degree to which the CCD addresses barriers identified</i>	34
4.5. BENEFITS OF A SINGLE MARKET IN CONSUMER CREDIT	38
4.6. EFFICIENCY OF CONSUMER PROTECTION RULES (DUTIES OF CREDITORS AND RIGHTS OF CONSUMERS).....	42
4.6.1. <i>The value chain in credit provision</i>	43
4.6.2. <i>Advertising and pre-contractual information obligations</i>	47
4.6.3. <i>Responsible lending and duty to assist</i>	52
4.6.4. <i>Right of withdrawal</i>	55
4.6.5. <i>Right of early repayment</i>	58
4.7. HARMONISATION OF LEGISLATION	61
4.7.1. <i>Full harmonisation with flexibility and mutual recognition</i>	61
4.7.2. <i>Alternative legislative options</i>	62
REFERENCES.....	65

**ANNEX 1: CONSUMER ATTITUDES TOWARDS BUYING CONSUMER CREDIT PRODUCTS
DIRECTLY CROSS-BORDER.....68**

ANNEX 2: COUNTRY STUDIES70

THE UK70

GERMANY90

CZECH REPUBLIC.....108

ANNEX 3: SURVEY QUESTIONNAIRE 118

ANNEX 4: RESPONDENTS TO THE SURVEYS.....134

ANNEX 5: RESULTS OF SURVEYS.....137

Acronyms

APRC : Annual percentage rate of charge

CCD: Consumer Credit Directive

EC: European Commission

ECB: European Central Bank

ECJ: European Court of Justice

EP: European Parliament

EU: European Union

FSAP: Financial Services Action Plan

MFI or non-MFI: Monetary financial institutions or non-monetary financial institutions

MS: Member State(s)

Key conclusions of the study

1. *The main distribution channel for selling of consumer credit products across borders is lenders establishing themselves in other Member States.* Consumer credit is currently rarely extended directly cross-border. There are indications, however, that there might be some increase of demand in this area in the future.
2. *Both demand side and supply side barriers inhibit direct cross-border consumer credit transactions to a significant extent.* These barriers do not prevent creditors establishing themselves in other Member States, but the competitive and efficiency benefits of such establishment are limited as long as supply side barriers prevent creditors from providing consumer credit products from a single platform across national barriers. Fragmentation of consumer protection law in the EU is a barrier, but not perceived as being the most important one. Creditor reluctance to directly sell across borders seems currently to be a significant barrier for an evolving cross-border market in consumer credit.
3. *An integrated EU consumer credit market cannot be expected to be achieved solely with the modified proposal for a Consumer Credit Directive.* A level playing field is a necessary condition for growing markets, but the multitude of barriers seems to require a bundle of measures, both legislative and non-legislative in nature. Because of the significance of differences in culture, language and consumer preferences, and the absence of harmonised credit databases accessible by all European credit institutions, a single market for consumer credit cannot be expected to be created by harmonisation of legislation alone, and this is a long-term rather than a short or medium term perspective. It seems certain that the first steps toward integration will be rather through creditors establishing themselves in other Member States than by the emergence of a large market for cross-border selling of credit products.
4. *A fully integrated internal market for consumer credit can in principle be expected to lead to economic growth, more varied credit products, lower interest rates for consumers and increased market efficiency.* However, the supply side of the market does not expect increased demand and therefore economic growth from the modified proposal for a Consumer Credit Directive. Also, cost reductions and economies of scale from selling consumer credit products in other EU Member States may be limited from a creditors' point of view, reducing the incentives for creditors to cross borders even with reduced legal fragmentation.
5. *While provisions on advertising and pre-contractual information are indispensable for a high level of consumer protection, requirements of the proposed CCD are expected by creditors to have major adverse impact on their operations.* Several efficiency issues are raised regarding (1) definition of product category specific information requirements, (2) flexibility of the legal approach and (3) lack of addressing perception issues. Additional consumer research and/or the evaluation of experiences with existing legislative provision at national level seems to be necessary to identify pre-contractual information that is clearly presented, easily understood and taken up by consumers (such as summary boxes etc.).
6. *Responsible lending and "duty to assist" of the proposed CCD could contribute to a better-informed choice of consumers leading to more efficient markets. However, stakeholders do not expect them in the current form to be effective instruments in reducing the number of defaulted credit contracts.* Both the introduction of responsible lending and "duty to assist" can be expected to increase costs of creditors, e.g. through increased documentation and information efforts. The final definition of these duties has therefore carefully to balance these costs with expected benefits. Efficiency issues are raised regarding (1) a more precise definition of the concepts (2) a clarification of the degree to which automated advice would be acceptable and (3) the role of regulators in enforcing responsible lending.

7. *The right of withdrawal has a significant importance for consumers to correct “hasty decisions”. Depending on the current rules in a specific Member State the introduction of a right of withdrawal might, however, lead to increased direct costs of creditors.* These have to be considered as the costs of having a high level of consumer protection across the EU, because little room for increasing the efficiency of the provision could be identified. Also, harmonisation of the right of withdrawal would reduce a possible distortion of competition caused by the considerable fragmentation of Member States rules.
8. *The right of early repayment is an element of consumer protection as well as an instrument to increase competition by allowing customer mobility.* Efficiency issues are raised regarding the need for guidance for the calculation of a “fair and objective indemnity” that does not raise barriers for switching of credit providers.
9. *The approach of full harmonisation with flexibility and of mutual recognition for issues where there is flexibility could lead to a ‘regulatory’ mix that creates confusion among consumers and affects consumer confidence adversely.* The principle of mutual recognition will add a further level of complexity because of the variety of legal orders that may apply to one contract. Especially problematic from both a creditor’s and a consumer’s perspective are areas where the reach of maximum harmonisation is unclear, as it can be in these cases time consuming to determine which law applies: the law of the creditor, or the law of the consumer.
10. *Regulation of financial markets including the consumer credit market requires a certain degree of flexibility and room for innovation.* Alternative legislative options for a new Consumer Credit Directive include (1) targeted full harmonisation combined with minimum harmonisation and (2) developing the CCD as a framework directive in combination with a comitology procedure. It could also be considered to prioritise institutional barriers to cross-border provision of consumer credit such as the harmonisation of credit databases.

A more detailed description of the study and of the main conclusions is presented in the executive summary (next section).

Executive summary

This report by Civic Consulting presents the results of an economic analysis of the modified proposal for a Directive of the European Parliament and of the Council on credit agreements for consumers amending Council Directive 93/13/EC (COM (2005) 483 final). The study is based on a review of existing reports, stakeholder interviews, surveys of consumer organisation and banking associations in all MS, an analysis of legislative changes at EU level and an economic analysis. It also included case studies in three Member States (the UK, Germany and Czech Republic) consisting of the analysis of changes to the national legal framework, the analysis of the value chain of two selected credit products, the assessment of impacts of the proposed Consumer Credit Directive (CCD) on the value chain, and focus groups with consumers. The structure of the report is as follows: After the introduction (section 1), the following section 2 details the methodology employed for the study. Section 3 provides an overview of the current legal framework and changes introduced by the proposed CCD. In section 4 the economic effects of the proposed CCD are analysed. Finally, the Annex provides an overview of focus group results on consumer attitudes towards buying consumer credit products directly cross-border (Annex 1), detailed case studies on the United Kingdom, Germany and Czech Republic (Annex 2), and the questionnaire, the list of respondents and the results of the surveys of national banking associations and consumer organisations (Annex 3, 4, 5).

Assessment of changes to the EU legal framework

It is generally accepted that the Consumer Credit Directive 87/102/EEC has not introduced a “high level of consumer protection”. As a consequence, virtually all Member States have gone beyond the minimum requirements of Directive 87/102/EEC in their national consumer credit laws. In other words, the Directive does not reflect the law, at least in the “old” Member States. Thus, in order to assess the changes that the modified proposal for a CCD will bring for the protection of consumers, one cannot simply compare the proposed Directive with the provisions of Directive 87/102/EEC. As the proposed Directive aims at fully harmonising the laws of the Member States, it could reduce the level of consumer protection afforded by the Member States even where it increases the level of consumer protection compared to Directive 87/102/EEC. The current national legal framework in Member States must be taken into account. Of the three countries scrutinised in details, both the UK and Germany have drafted rules on consumer credit beyond the level of the minimum harmonization required by the Directive. In the contrary, the Czech Republic has basically only implemented what the Directive requires, i.e. the minimum to formally meet its obligations under EU law. This underlines that the impact of the proposed Directive can be quite different depending on the Member State.

Barriers to an integrated EU consumer credit market

The EU consumer credit market and cross-border transactions

Nearly 20 years after the *Cecchini*-Report highlighted the “Costs of non-Europe”, a recent European Commission inquiry concludes that the retail-banking sector still remains largely fragmented along national lines and integration is far from complete. According to European Commission estimates the retail banking sector generated gross income of between 250 to 275 billion Euro in 2004, equivalent to around 2 percent of EU GDP. Consumer loans generated nearly 18% of gross retail income in the EU 25, the third most important source of income from consumer products after mortgages (30%) and current accounts (28%). The UK, Germany, and France have the largest consumer credit markets in the EU and between Member States there is considerable variation in the degree of lending.

Data on direct cross-border transactions between a creditor and a consumer in two different EU Member States is scarce, although there is a general agreement that currently only a very limited number of direct cross-border transactions regarding financial services take place.

The very low number of direct transactions is also illustrated by the results of the survey of national banking associations conducted for this study. A large majority responded that less than 0.1% of total consumer credit transactions of member banks consisted of direct transactions with consumers resident in another EU Member State. Only one association from Austria reported that figure to be as high as 6% (see Figure 2 in section 4.3 of this report).

Although a large majority of national banking associations do not anticipate the number of direct cross-border transactions with consumers to change in the next 5 years, there is some evidence that the number of direct transactions is growing and that consumers are increasingly considering this option, especially in some countries. For example, in Luxembourg as many as 19% of the respondents confirmed in a 2005 Eurobarometer survey that they opened a bank account in a firm located in another Member State and 8% obtained a credit card from a firm located elsewhere in the EU. In Belgium and Austria, 11% state that they opened a bank account in another Member State. Reasons why demand for cross-border credit could grow in the future include ongoing EU legislative initiatives in the area of financial services, the gradual emergence of a customer segment with international preferences and the significant migration in the EU that also leads to consumers using financial services in both the country of origin and the country of residence.

The most significant distribution channel for creditors to provide credit in other Member States is currently via branches and subsidiaries (including majority holdings in local banks). Although for the majority of associations that provided data the percentage of total consumer credit transactions conducted by member banks across borders through branches/subsidiaries is less than 1%, five banking associations estimated this percentage to be more than 10% (in the case of instalment credits, see Figure 3 in section 4.3 of this report). One of these associations, the Consumer Credit Association of the United Kingdom estimated the percentage of members' business done through this way even as significantly higher than 10% and stated that a very large member of the association has over 1.5 million customers served through subsidiaries in other Member States. Acquiring majority holdings in local banks is a common approach for creditors to enter markets in other Member States. Although some larger mergers involving European retail banks have taken place in past years, compared to other sectors the incidence of cross-border mergers and acquisitions in banking remains, according to the Commission, fairly low and there are very few players in retail banking that have a leading market share in two or more Member States, with foreign banks tending to have much stronger market positions in the new Member States than in the EU 15.

This leads to the following conclusion:

1. ***The main distribution channel for selling of consumer credit products across borders is lenders establishing themselves in other Member States.*** Consumer credit is currently rarely extended directly cross-border. There are indications, however, that there might be some increase of demand in this area in the future.

Obstacles to selling consumer credit across borders

Local establishment of a lender avoids the legal and institutional barriers that handicap or prevent direct cross-border provision. It is therefore unsurprising that the overwhelming proportion of cross-border provision of retail financial services is through local establishment. This situation is a cause for concern because the potential benefits of a single pan-European market in retail financial services cannot be realised through local establishment alone. In many cases of local establishment there is no impact on market structure and little indication of any economies of scale or scope i.e. the competition and efficiency benefits of a single market are absent and any gains of the merger lie entirely in the cost reductions achieved from the introduction of a more effective management. It is argued that local establishment only has a significant impact on economic efficiency if the barriers to direct cross-border provision are removed, allowing a single product to be delivered across national markets.

Local establishment is only one of several distribution channels that can be used for delivery across national markets, and a channel which is likely to diminish in importance over time relative to telephone and the internet. Branches are not needed at all for the provision of some retail financial products and services, and it is in these cases – where competition from free-standing on-line and telephone based providers is effective – that the potential competitive benefits of a single market in retail financial services are greatest. The removal of barriers to direct cross-border provision would then result in a significant increase in the number of potential and actual market entrants and a likely sharp reduction in cost and prices.

Demand side barriers: In spite of the significant increase of e-commerce in recent years, the main barriers that limit consumers from directly purchasing financial services from another Member State have stayed fairly constant, as is illustrated by Eurobarometer surveys and other research. The most serious such obstacles for cross-border financial transactions as perceived by the respondents to a recent Eurobarometer are: *having to use another language* (31% of respondents), *lack of personal contact for distance purchases* (26%), *insufficient information* (25%) and the *risk of fraud* (23%). It is noteworthy that the *lower level of consumer protection in other EU countries* was with 11% of similar relevance for respondents as *excessive/incomprehensible information* and *extra costs related to purchasing financial services in other EU countries*. This general picture has been confirmed by the three focus groups with consumers conducted for this study in the UK, Germany and the Czech Republic. Compared to other forms of cross-border e-commerce, such as purchasing a book or software, taking out a consumer credit raised the greatest concern among participants in all countries in terms of both emotional issues and practical problems.

Supply side barriers are factors, which limit the ability of banks to supply consumer credit outside their own domestic market. The two main barriers to directly selling to consumers cross-border perceived both by banking associations and consumer organisations responding to the survey are *different language and culture* and *consumers' preference for national lenders*. For national banking associations the third most important barrier was *credit risk for lenders - no access to creditworthiness information*. Legislative fragmentation was also seen as a barrier, but not as frequently as other barriers, both regarding differences in national legislation which are in the scope of the modified proposal and regarding differences in legislation outside the scope of the modified proposal (see Figure 4 in section 4.4 of this report).

A weakness of this survey evidence is that, to a large extent, the respondents' views are not based on actual experience of direct cross-border lending. The responses also appear to conflate, to some degree, the demand barriers, that limit consumer uptake of credit from banks from outside their own domestic market and the supply factors that restrict the creditor's ability to compete cross border.

This leads to the following conclusion:

2. ***Both demand side and supply side barriers inhibit direct cross-border consumer credit transactions to a significant extent.*** These barriers do not prevent creditors establishing themselves in other Member States, but the competitive and efficiency benefits of such establishment are limited as long as supply side barriers prevent creditors from providing consumer credit products from a single platform across national barriers. Fragmentation of consumer protection law in the EU is a barrier, but not perceived as being the most important one. Creditor reluctance to directly sell across borders seems currently to be a significant barrier for an evolving cross-border market in consumer credit.

Degree to which the CCD addresses barriers identified

While both the Eurobarometer surveys and the focus groups reveal considerable consumer resistance to direct cross border purchase of consumer credit products, it is still possible that positive experience of cross-border consumer credit could in future erode these demand side barriers, much as experience has eroded the initial consumer resistance to the use of credit cards for internet purchases.

Therefore it is arguable that the more fundamental barriers, at least for the increasing number of EU consumers with a pan-European orientation, are supply side rather than demand side. This is in line with the approach of the proposed CCD to directly address a number of these supply side barriers, associated with lack of regulatory harmonisation. The CCD can, however, do little to directly remove demand side barriers.

The proposed CCD will address existing legal fragmentation in some core areas of consumer credit. For example, elements that are covered by the maximum harmonisation approach include: Standard information in advertisement and pre-contractual information; assessment of the consumer's creditworthiness; right of withdrawal; early repayment; calculation of the annual percentage rate.

Most of these elements have formed part of many national consumer credit laws, however with differences, for example regarding the standard information to be provided, or the duration of the withdrawal period and the formalities to be observed. The proposed CCD therefore clearly addresses one of the barriers for extending consumer credit across borders. However, the proposed CCD also contains provisions that may create new difficulties for providers of cross-border credit:

- The need to consult a relevant database, where appropriate, can lead to compatibility and language issues, as harmonisation of databases is not envisaged by the modified proposal;
- The duty to assist may render cross-border lending due to language issues more difficult than lending at national level, at least regarding non-automated communication.

The legislative analysis has also indicated that important legal issues remain outside the scope of the proposed Directive and are currently not addressed by Community legislation. Independent from this the question remains if a fully integrated market in consumer credit including a direct cross-border market can be achieved solely by introducing new legislation. Financial markets, like the market in consumer credit, develop mainly because of economic opportunities. Therefore, establishing an integrated consumer credit market beyond each national market of a Member State is a result of creditors' expectations that mergers, acquisitions, new ventures or new distribution channels like the internet will lead to economic profits. A level playing field created by a new CCD is an essential economic trigger for cross-border selling of consumer credit products but legal barriers are only one of the barriers on the way to a single market. An important institutional barrier is the lack of harmonisation of credit databases. The proposed CCD requires that all lenders should be given access to existing credit databases, to enable them to carry out their requirement for responsible lending, but this does nothing to ensure that these databases are harmonised or that they provide a complete coverage of European consumers. It seems unlikely that a single market will be established in any consumer credit products – mortgages, credit cards, or consumer credit – without the parallel development and harmonisation of credit databases across the EU or alternatively the creation of a single pan-European credit register.

This leads to the following conclusion:

3. *An integrated EU consumer credit market cannot be expected to be achieved solely with the modified proposal for a Consumer Credit Directive.* A level playing field is a necessary condition for growing markets, but the multitude of barriers seems to require a bundle of measures, both legislative and non-legislative in nature. Because of the significance of differences in culture, language and consumer preferences, and the absence of harmonised credit databases accessible by all European credit institutions, a single market for consumer credit cannot be expected to be created by harmonisation of legislation alone, and this is a long-term rather than a short or medium term perspective. It seems certain that the first steps toward integration will be rather through creditors establishing themselves in other Members States than by the emergence of a large market for cross-border selling of credit products.

Benefits of a single market in consumer credit

Market integration should lead to cheaper and more varied credit products, allowing consumers to manage their short and medium term mis-match of income and expenditures flexibly and at low cost. Increased competition in consumer credit in national markets has dramatically reduced the cost and increased the availability of credit, in turn allowing households to reduce substantially their holdings of precautionary balances and correspondingly enjoy increased lifetime consumption. The possibility to offer consumer credit throughout the Member States should result in improved efficiencies and economies of scale for lenders and, therefore, for customers deliver lower interest rates and greater credit availability of both the volume and variety of credit products. This increased product choice could be especially relevant for consumers in small countries who today are affected most from incomplete retail market integration. Economic modelling of the impacts of an integration of financial markets has consistently indicated significant benefits. Already the 1988 *Cecchini-Report* expected the potential benefit of the liberalisation of financial services as 1.5% of the GDP. A 2002 study on the impact of European financial market integration assesses that EU-wide real GDP is raised by 1.1% in the long run, private consumption up by 0.8% and total employment by 0.5%.

Although from an economic point of view integration of the consumer credit market therefore has considerable potential benefits for both consumers and lenders, stakeholder are rather pessimistic whether these benefits can be expected in practice through the modified proposal for a CCD (see overview over stakeholder assessment of impacts given in Figure 5 and Figure 6 in section 4.5). Banking associations were asked whether in principle they would expect cost reductions and economies of scale from selling consumer credit products in other EU Member States or not. Banking associations that answered are split regarding the question: 43% expected cost reductions and economies of scale, 46% did not (11% don't know). Creditors' comments illustrate that economies of scale can only be expected if pan-European products can be developed and the legal framework allows for a high degree of standardisation of contracts and processes, and even then potentials for cost reductions may be limited from a creditors' point of view.

This leads to the following conclusion:

4. ***A fully integrated internal market for consumer credit can in principle be expected to lead to economic growth, more varied credit products, lower interest rates for consumers and increased market efficiency.*** However, the supply side of the market does not expect increased demand and therefore economic growth from the modified proposal for a Consumer Credit Directive. Also, cost reductions and economies of scale from selling consumer credit products in other EU Member States may be limited from a creditors' point of view, reducing the incentives for creditors to cross borders even with reduced legal fragmentation.

Efficiency of consumer protection rules

The value chain in credit provision

The value chain in the consumer credit business consists of three typical parts:

- The pre-contractual process at the front-office;
- The process during the term of credit agreement at the front and the back-office;
- The bad-debt collection process.

The focus of case studies in three countries (UK, Germany, Czech Republic, see Annex 2) was to analyse the value chain in detail for two specific credit products, namely (1) a personal loan of € 5,000; and (2) an overdraft credit of € 1,000. The study also determined the effects of consumer protection provisions of the CCD on the operational costs of creditors, as identified by the banks providing cost data.

Although the case studies indicated significant differences between individual banks, the overall picture concerning the importance of the different cost elements was remarkably similar and indicated the importance of customer acquisition and information/consultation as cost factors in consumer credit (accounting on average for 66% of operational costs for a personal loan and 56% of operational costs for an overdraft credit, see Figure 7 and Figure 8 in section 4.6.1 of this report). Overdrafts are considered a “lean” product requiring very little marketing and administrative effort. For a similar amount of credit, an overdraft credit therefore involves significantly less operational costs compared to a personal loan. Main conclusions of the case studies are that harmonisation of consumer credit provisions through the proposed CCD will come with some costs to industry. Main factors that are seen as cost-relevant are:

- One-time implementation costs
 - Changing procedures and IT systems (e.g. pre-contractual information)
 - Training (e.g. concerning “duty to assist”)
 - Transitional processes regarding existing open-end contracts (e.g. overdrafts, where applicable)
- Operational costs
 - Introducing processes that are human resource intensive (“duty to assist”)
 - Need to document information (e.g. responsible lending)
 - Increased risk of litigation

Figure 9 and Figure 10 in section 4.6.1 of this report illustrate that the most significant impact is expected by the interviewed banks on front-office and back-office processes. Bad-debt collection processes are in most cases not expected to be affected. The major difference between the two credit products seems to be that the changes affecting operational costs of overdraft credits are assessed as more significant (especially regarding back-office processes), as several processes have to be introduced that are currently not relevant. The operational costs, however, only partly determine the price of the credit for the consumer. Other elements that are relevant include: the costs of capital; the risk premium for the expected loss (standardised risk costs); the profit margin; and the costs of distribution through credit intermediaries.

The relevance of the operational costs compared to the other costs elements listed depends on various factors, including on the credit size, type of product, distribution model, competitive pressure etc. This strongly limits the possibility to assess the overall impact of specific CCD provisions on the price of credit for consumers.

Efficiency of advertising and pre-contractual information obligations

Addressing the question of whether consumer protection rules foreseen in the proposed CCD are efficient responses involves two separate issues. The first is the extent to which they increase creditor costs. An increase in costs, without any offsetting benefit would raise the interest rates charged on credit, and limit competition. The measures can however be efficient if they achieve a given higher standard of consumer protection at minimum cost to creditors. Finally, and separately, there is the question of whether the level of protection represents the best trade-off between effective competition and low pricing, on the one hand, and adequate customer protection on the other.

There are several reasons why specific rules and regulations are needed to protect customers taking out consumer credit contracts. In part this is because, in common with most other retail financial services, consumer credits are *credence goods*. This means that a consumer is unable to evaluate the whole quality and the entire risk of a contract before and even after he or she signs the contract. This leads to a distortion of the “normal” market efficiency, where prices fully reveal information, quality and risk. As a consumer cannot easily derive information about quality and risk of a financial service, a consumer may buy products at a higher price than if he or she had better knowledge.

Reducing information asymmetries is an aim that consumer credit legislation has to address and does so in many national legislative frameworks. The question is therefore mainly to which extent and what information has to be provided to have the envisaged high level of consumer information and protection, without imposing undue obligations on creditors that lead to a high administrative burden, reduce the possibility of fair marketing and create inefficiencies.

Summary of legislative changes: Directive 87/102/EEC is fairly limited concerning advertising and pre-contractual information. The proposed CCD allows in Article 4 credit advertisements that indicate no interest rate or other figures relating to the cost of the credit. If however, an interest rate or such figures are indicated, “standard information” must be supplied. In Article 5 (2) (a) – (m), the proposed Directive goes far beyond the pre-contractual information requirements of Directive 87/102/EEC in setting up an extensive catalogue of information to be supplied. At the same time it prohibits other information obligations to be introduced or maintained by Member States (for more details, see section 3).

Effects on creditors: The advertising and pre-contractual information obligations are clearly seen by creditors as having major adverse impact on their operations. A large majority of 77% of national banking associations estimates that acquiring customers can be expected to be fairly or significantly more difficult because of the requirements for standard information for advertising and pre-contractual information. Even more (93%) of the associations expect for this reason front-office costs to increase fairly or very significantly. Banking associations and banks listed in their statements the expected effects of the proposed CCD on creditors regarding advertising activities, including:

- *Additional administrative burden;*
- *Would hinder banks in advertising; in particular regarding radio and television commercials.*

Statements by banking associations on the effects of pre-contractual information include, for example, that:

- *Some of the information required in Article 5(2) has little to do with practice and would be almost impossible to implement.*

On the other hand, banking associations from both Italy and the Netherlands do not expect dramatic consequences for the banking practice regarding pre-contractual information, as current national legislation was already containing similar provisions. This highlights the significant differences in the legal framework of different Member States that determine the degree to which the proposed CCD would require changes to operators’ practices.

Effects on consumer protection: Member States’ legislation is currently widely diverging both regarding credit advertisements and pre-contractual information requirements. Consumers in Member States that currently have less information requirements in their national legislation therefore have less easy access to information compared to consumers in countries with detailed requirements in this respect. The proposed CCD will address this imbalance and allow consumers to do a better-informed choice. A crucial question in this respect is, however, if the information to be provided in the different pre-contractual phases is understandable for consumers and likely to be taken up. Creditors for their part have significant doubts in this respect. Statements received from banking associations include:

- *Risk of overloading consumers with too much and duplicated information and to make products difficult to understand;*
- *Massive volume of information confuses consumers and requires considerable efforts at clarification on the part of the banks.*

It is no surprise then that three quarters of responding national banking associations were of the opinion that the pre-contractual information to be provided is not in line with consumer needs and perceptions. Consumer organizations had diverging views, with the largest group marking “don’t know” (see Figure 11 in section 4.6.2).

Efficiency issues: The advertisement and pre-contractual information provisions of the modified CCD could raise the following efficiency issues:

- The pre-contractual information to be provided differentiates only to a limited extent between different credit products;
- Prescribing detailed information requirements in a maximum harmonisation directive leaves very little flexibility to adapt legislation to rapidly evolving markets;
- Presentational issues have not been considered sufficiently.

Presentational issues would require extensive consumer research and/or the evaluation of experiences with existing legislative provisions at national level. Based on research, it would also seem possible to define requirements concerning the other elements of easily digestible pre-contractual information. As one consumer organisation put it: “*The comprehensibility of all that data depends significantly on a well thought and ordered and standardized presentation.*” An UK consumer organisation reported that “... *the UK credit card industry has recently introduced summary boxes as a new way of displaying the key terms and conditions of credit card products. We welcomed this development as a useful way of helping consumers to understand relevant information and we are keen to see this extended to other credit products.*” A possible approach could therefore be to require precisely defined summary boxes with key standard information (possibly with differences between the different credit product categories and including standards for presentation). Such a summary box could also be required to form part of the contract. In this case handing out a copy of the contract to the consumer would at the same time reduce the administrative burden of creditors and provide easy access to information for consumers.

This leads to the following conclusion:

5. ***While provisions on advertising and pre-contractual information are indispensable for a high level of consumer protection, requirements of the proposed CCD are expected by creditors to have major adverse impact on their operations.*** Several efficiency issues are raised regarding (1) definition of product category specific information requirements, (2) flexibility of the legal approach and (3) lack of addressing perception issues. Additional consumer research and/or the evaluation of experiences with existing legislative provision at national level seems to be necessary to identify pre-contractual information that is clearly presented, easily understood and taken up by consumers (such as summary boxes etc.).

Responsible lending and duty to assist

Summary of legislative changes: Article 5 (1) of the proposed CCD requires the creditor and, where applicable, the credit intermediary to adhere to the principle of responsible lending. As part of this obligation the creditor has to assess the consumer’s creditworthiness on the basis of accurate information provided by the latter, and, where appropriate, on the basis of a consultation of the relevant database. This assessment of creditworthiness is new to the Consumer Credit Directive and to many national legal systems. Also Article 5 (5), the duty to assist, is new to the Consumer Credit Directive and to many national legal systems. An exception is, for example, Belgian law.

Effects on creditors: Creditors have a significant interest to assess the ability of a customer to repay a credit. This has led to information exchange among lenders and the creation of private credit bureaux and public credit registers. Nearly all national banking associations state that pre-contractual analysis of creditworthiness is already established good banking practice in their country, a view that is shared by most of the consumer organisations that had an opinion on the issue. A legal obligation in this respect is, however, not welcomed by creditors. They stated, for example, that asking lenders to keep track of this activity in order to be able to give legal evidence to this practice would be expensive and complicated and a civil law requirement would result in liability risks.

Similarly, responsible lending rules of the modified proposal, including a duty to assist, are seen by nearly all banking associations as reason for a fairly or very significant increase in costs. Reasons include:

- *Nearly all banking associations expect a higher effort to explain to customers the new information required and the credit decision in line with the proposed CCD;*
- *Credit institutions stated that they would have to document the type, content and extent of the information and advice supplied to every borrower before concluding a contract to have evidence in case the borrower subsequently claims damages on the grounds that he or she was not adequately advised;*
- *On the other hand, two thirds of banking associations do not expect the risk premium for the expected loss (standardised risk cost) to change through the more differentiated and individualised analysis, i.e. better assistance would according to their view not lead to less risk of default and related savings.*

A major concern for creditors is the obligation introduced in the new CCD to explain the advantages and disadvantages of a specific product proposed. The main line of argument is that only the consumer can have an overall perception of the own financial situation and can assess what is advantageous or disadvantageous for him or her. One of the associations expressed: “... *it is important to stress that a clear line has to be drawn between the provision of information (including explanations in face-to-face situations) and the provision of any other service, be it consultation, assistance or advice. Whereas providing information includes giving the facts necessary to describe a product (something which can be fulfilled in online transactions), giving advice, for example, does imply some form of recommendation (something which cannot be easily fulfilled in online transactions) and increased liability.*”

Effects on consumer protection: Responsible lending and the “duty to assist” could potentially lead creditors to provide consumers with more personalised information on a specific credit product. This is especially significant as financial products are often complicated and the pre-contractual information provided on paper may not be adequately understood. These provisions could therefore allow consumers to do a better-informed choice. Additionally, overindebtedness of consumers has become a major social problem. It is estimated that close to every tenth household in Germany is overindebted, more than 3 million households. Figures from the UK suggest that over one million adults are falling behind with payments for bills and credit commitments and a further two million are constantly struggling. Overindebtedness is a highly complex issue. From the creditor perspective, reasons for loan defaults lie outside the loan relationship and are not foreseeable (e.g. divorce, unemployment). One of the banks interviewed stated that defaults on average occurred 15 to 18 months after the signature of the contract, and it is therefore difficult to assess relevant problems early on. Also, refusing potential customers may lead to exclusion of some consumers from the possibility to take on credit. An individual bank responding to the questionnaire stated that “*in order to cut in half the number of defaulted contracts would require to refuse one third of the credits actually granted: the consequences would [be] to increase the costs of credit and exclude one third of the consumers*”. From the creditor perspective, reasons for loan defaults lie outside the loan relationship and are not foreseeable (e.g. divorce, unemployment). Also from the perspective of organisations that provide consumer advice, assessing creditworthiness is only part of the solution. For example, one organisation stated, “*we are seeing [...] numerous cases of heavy overindebtedness. Indeed the incidence of such cases has perhaps grown as the system of credit scoring has grown and become more extensive. This evidence includes cases where lenders appear to have granted credit that was unaffordable or unsuitable for the needs of the borrower from the outset. In many of these cases we believe that the creditor would have had sufficient information to realise that this was the case but sold the credit product despite this.*” Consumer organisations therefore generally support a responsible lending principle, although the responsible lending provisions in the modified proposal for a CCD are considered to be vague, a view also shared by creditors.

Efficiency issues: Efficiency of the provisions on responsible lending and the “duty to assist” could be raised by:

- Defining the concepts more precisely in legislation or accompanying guidance;
- Clarifying the degree to which automated advice would be acceptable; and
- Considering the role of regulators in enforcing responsible lending.

With the modified proposal of a CCD as it stands stakeholders are not optimistic regarding the possibility to reduce the number of defaulted contracts. A large majority of creditors and more than half of consumer organisations expected the number of defaulted contracts to remain similar if the proposed CCD was implemented (see Figure 12 in section 4.6.3). This rather pessimistic assessment illustrates the need to clarify what precisely is the aim of the principle of responsible lending and the “duty to assist” to be introduced (a better choice for consumers or reduction in defaulted contracts?), provide guidance accordingly and address the issue of enforcement.

This leads to the following conclusion:

6. ***Responsible lending and “duty to assist” of the proposed CCD could contribute to a better-informed choice of consumers leading to more efficient markets. However, stakeholders do not expect them in the current form to be effective instruments in reducing the number of defaulted credit contracts.*** Both the introduction of responsible lending and “duty to assist” can be expected to increase costs of creditors, e.g. through increased documentation and information efforts. The final definition of these duties has therefore carefully to balance these costs with expected benefits. Efficiency issues are raised regarding (1) a more precise definition of the concepts (2) a clarification of the degree to which automated advice would be acceptable and (3) the role of regulators in enforcing responsible lending.

Right of withdrawal

Summary of legislative changes: The right of withdrawal, Article 13, is new to the Consumer Credit Directive compared to Directive 87/102/EEC. The right of withdrawal already forms part of most national consumer credit laws, with variations as to the withdrawal period and the formalities to be observed. The proposed CCD also foresees that in case of linked transactions, when the consumer has a right to withdraw from the purchase agreement, the consumer also has a right to withdraw from the linked credit agreement. However, the right to withdraw from the credit does not give a right to withdraw from the purchase agreement.

Effects on creditors: A large majority of more than 80% of the national banking associations expect a fairly or very significant increase in costs through a right of withdrawal. Reasons given include: *increased administrative and liquidity management costs* and *abuse of the right of withdrawal by some customers*. A significant additional concern is related to credit at the point of sale. In these cases the retailer is directly paid by the creditor, according to the terms of their mutual agreement. Creditors could decide to not release funds before the end of the withdrawal period. Consequently a retailer might in turn not deliver the goods as long as the consumer can withdraw from the credit agreement. This is because although cancelling the credit would not give the consumer a right to also withdraw from the purchase agreement, a retailer might need to recover the amount due from the consumer instead of receiving it from a bank as envisaged, or would have to take back the product leading to an increase in cost for depreciated products.

Effects on consumer protection: The right of withdrawal is beneficial to the consumer in giving the chance to have a second thought on the contract and also to have a last look at other offers. It is therefore a complementary provision to the pre-contractual information provisions that have the aim to reduce information asymmetries and to allow consumers a better-informed choice.

It is also conceivable that the right of withdrawal may provide a “last exit”-option for consumers that otherwise would be at risk of defaulting on the contract. The current differences regarding the withdrawal period in Member States’ legislation are a very tangible sign of fragmentation that probably will not increase confidence of consumers in a high level of consumer protection across the EU in case these differences are known to them. The duration of the withdrawal period of 14 calendar days would bring the proposed CCD in line with the provisions of Directive 2002/65/EC concerning the distance marketing of consumer financial services. This alignment of the duration of the withdrawal period has also to be seen in the context of the ongoing review of the Consumer Acquis. A uniform duration of the withdrawal period across all relevant directives including the CCD would lead to a considerable simplification for consumers, who cannot be expected to differentiate easily between specific vertical rules.

Efficiency issues: Although the right of withdrawal could bring increased costs for banks in some countries, and structural effects concerning point of sale credit cannot be excluded, it will also reduce a possible distortion of competition between banks located in different Member States. Also, clear benefits for consumers can be expected from this “*legal instrument to protect the consumer against hasty decisions*”, as one banking association put it. This is especially relevant, as the proposed CCD will also abolish the written form requirement, thereby potentially speeding up the timeframe for entering into a valid contract.

An option that would reduce the costs of the right of withdrawal would be to reduce the duration of the withdrawal period, as this might reduce the number of customers making use of it. However, seen the very sensible efforts to harmonise the withdrawal period across the consumer protection directives this depends on the outcome of the consultation on the Green Paper on the Review of the Consumer Acquis. A significantly shorter period of withdrawal would also reduce the practical value for consumers, who would have to be aware of this limitation and often need a certain period of time before acting. Another option could be to provide the possibility to waive the right of withdrawal. The probable outcome would, however, likely be to abolish the right of withdrawal, as one could expect creditors, especially in case of point of sales credit, to require such a waiver from all consumers.

This leads to the following conclusion:

7. *The right of withdrawal has a significant importance for consumers to correct “hasty decisions”. Depending on the current rules in a specific Member State the introduction of a right of withdrawal might, however, lead to increased direct costs of creditors.* These have to be considered as the costs of having a high level of consumer protection across the EU, because little room for increasing the efficiency of the provision could be identified. Also, harmonisation of the right of withdrawal would reduce a possible distortion of competition caused by the considerable fragmentation of Member States rules.

Right of early repayment

Summary of legislative changes: The consumer already has a right of early repayment under Directive 87/102/EEC, and this Directive also entitles the consumer to an equitable reduction in the total cost of the credit. The additional rules provided by the proposed Directive in Article 15 relate to the creditor’s claim of an indemnity. The creditor shall be entitled to claim a fair and objective indemnity for early repayment according to the amount or the calculation method set out in the credit agreement; which means that the creditor is only entitled to such a claim if this is set out in the credit agreement.

Effects on creditors: In the explanatory memorandum of the proposed CCD it is argued that this provision would only entail “*marginal costs for creditors*”, because “*creditors may charge fair and objective fees to compensate the loss*”. Some banks and 25 % of national banking associations agree and indicate that they do not expect significantly increased costs due to the right of early repayment of the proposed CCD because of similar rights in current national legislation in place. However, a majority of 60% of national associations see this differently and expect an increase in costs.

The remaining associations have no opinion on the issue. The banking associations that expected increasing costs provided the following reasons:

- *It would no longer be possible to make a legally binding contractual agreement to waive termination rights for fixed-interest loans;*
- *Early repayment at any time would constitute interference in generally accepted prudential liquidity and interest rate mechanisms. It would also be for larger creditors a manual interference in an otherwise automated process and increase the overall cost of providing the loan;*
- *The compensation for early repayment would not cover forgone profits and therefore loan interests would increase. There was also no justification to exclude the banks entitlement to an indemnity for early repayment under certain circumstances mentioned in Article 15(2).*

Effects on consumer protection: A right of early repayment has considerable advantages for consumers, as it increases flexibility and allows changes in the pre-agreed payment schedule. It is possible to switch credit providers in case the market offers better conditions, in case that the indemnity paid for early repayment is not prohibitive. It also allows the consumer to reduce the total costs of a credit in case the credit is no longer necessary, e.g. because of an improvement in income, etc. Some consumer organisations, however, criticise that the proposed Directive does not go far enough in that it “*does not solve some of the most important aspects of the limited competition in retail banking such as [...] high fees for early repayment*”.

Efficiency issues: The current fragmentation of national provisions already might distort competition, as the results of the survey of national banking associations illustrate. Additionally, the recent Commission sector inquiry identifies customer mobility and related switching costs as important issues. It is clear that the possibility to switch the credit provider would increase the competitive pressure, if the related fees are not prohibitively high. Therefore, the competition effects of the right of early repayment will depend to a considerable degree on what a “fair and objective indemnity” will mean in practice. Consequently, efficiency of the provisions on right of early repayment could be raised by providing guidance for the calculation of a “fair and objective indemnity” in a way that does not unduly inhibit customer mobility.

Several banking associations expected a negative effect of the right of early repayment on the availability or price of long-term fixed-interest loans. This cannot be excluded, if the calculation of the indemnity would lead to a higher rate of consumers that switch the credit providers. On the other hand, a more competitive market could be expected to lead to more and better offers for consumers, therefore also limit the possibility for price increases in the retail banking sector, a sector that has according to the Commission inquiry seen an increase of profitability over the last decades.

This leads to the following conclusion:

8. ***The right of early repayment is an element of consumer protection as well as an instrument to increase competition by allowing customer mobility.*** Efficiency issues are raised regarding the need for guidance for the calculation of a “fair and objective indemnity” that does not raise barriers for switching of credit providers.

Harmonisation of legislation

Full harmonisation of legislation with mutual recognition for some issues

To prevent new and additional barriers to the internal market, mutual recognition for some issues is foreseen to be introduced by the proposed CCD. A creditor would only have to comply, for an activity in another Member State than the one he is established in, with legal requirements of its Member State of origin and not with those of the host Member State.

The legal analysis indicates that creditors and consumers would have to deal with four sets of rules, if the modified proposal for a CCD were to be adopted:

- (1) Those rules that are fully harmonised;
- (2) Those rules that are not harmonised but where the trader, under the principle of mutual recognition, can rely on the own Member State's law if this is more generous than the law of the Member State where the consumer is domiciled;
- (3) Those issues that remain in the competence of the Member States; and
- (4) Last but not least, issues where the reach of maximum harmonisation is unclear.

The last category is problematic from both a creditor's and a consumer's perspective, as it can be in these cases time consuming to determine which law applies: the law of the creditor, or the law of the consumer. The relationship between the principle of mutual recognition and private international law is not clarified in the proposed Directive, raising the question whether the home country control principle can be overruled by choice of law rules. Because of the related problems, neither consumer organisations nor most of the banking associations are favouring mutual recognition.

This leads to the following conclusion:

9. ***The approach of full harmonisation with flexibility and of mutual recognition for issues where there is flexibility could lead to a 'regulatory' mix that creates confusion among consumers and affects consumer confidence adversely.*** The principle of mutual recognition will add a further level of complexity because of the variety of legal orders that may apply to one contract. Especially problematic from both a creditor's and a consumer's perspective are areas where the reach of maximum harmonisation is unclear, as it can be in these cases time consuming to determine which law applies: the law of the creditor, or the law of the consumer.

Alternative legislative options

Stakeholders offer a variety of views concerning the question what elements should be left to national legislation or self-regulation in Member States. Several banking associations stated that maximum harmonisations should go as far as possible, as even relatively minor complications would make the extension of cross border credit unprofitable. There were, however also statements requiring that there should be as much flexibility on the national level as possible. This illustrates the dilemma of maximum harmonisation, namely that is perceived as levelling the playing field across the EU, but at the same time as being a rather inflexible instrument that does not allow to accommodate flexibility at the national level. Consumer organisations, on the other hand, tend to favour maximum harmonisation in selected core areas with minimum harmonisation in others.

The challenges any legal approach for a new CCD has to face include the following:

- There are very significant differences between national consumer credit markets, in terms of market size, products offered and consumer demand.
- The environment for consumer credit products is rapidly changing. New distribution channels, product innovations and consumer demands create a need for a pro-active and innovative regulatory approach.
- Financial retail markets are largely fragmented along national lines. If this is to change, legislative action at EU level is required.

What are the legislative options at hand that could possibly lead to a more efficient and integrated internal market while avoiding some of the problems with the proposed Directive?

Option 1 - Targeted full harmonisation combined with minimum harmonisation: The current divergence between the consumer credit laws of the Member States is to a large extent owed to the low level of consumer protection afforded by Directive 87/102/EEC. If the level of consumer protection would increase significantly with a new CCD, the incentive to maintain or adopt more stringent national legislation will decrease accordingly. Some of the concepts of the proposed Directive, in particular improved information, clarified consultation and responsible lending rules, but also the right of withdrawal and a more clearly shaped right of early repayment, could well serve this purpose. In addition to this, important issues outside the scope of the Directive would have to be addressed by Community legislation, including e.g. the harmonisation of credit-databases. If one follows this line of thinking, it would be sufficient to harmonise some crucial elements of the Directive fully, such as the Annual Percentage Rate. In other areas the principle of minimum harmonisation would prevail and would allow continuing development of innovative concepts at national level. Such a concept is indeed promoted by some Member States and stakeholders.

Option 2 – Developing the CCD as a framework directive in combination with a comitology procedure: This could be modelled according to other directives employing the comitology procedure, or by using the Lamfalussy process for a new Consumer Credit Directive. The recent evaluation of the Financial Services Action Plan concludes that “*the new approach to the preparation of legislation introduced under the Lamfalussy process brought significant improvements in terms of consultation, institutional co-operation, and (potentially) greater flexibility to respond to market events and there is a general appreciation of the quality of the measures finally introduced*”.

This leads to the following conclusion:

10. Regulation of financial markets including the consumer credit market requires a certain degree of flexibility and room for innovation. Alternative legislative options for a new Consumer Credit Directive include (1) targeted full harmonisation combined with minimum harmonisation and (2) developing the CCD as a framework directive in combination with a comitology procedure. It could also be considered to prioritise institutional barriers to cross-border provision of consumer credit such as the harmonisation of credit databases.

1. Introduction

Aim of the study

This report presents the results of an economic analysis of the modified proposal for a Directive of the European Parliament and of the Council on credit agreements for consumers amending Council Directive 93/13/EC. The original proposal¹ for a new Consumer Credit Directive (CCD) was adopted by the Commission in 2002. The European Parliament adopted amendments in the first reading in 2004, and a consolidated version was adopted by the Commission on October 7, 2005.²

The study has been commissioned by the European Parliament to Civic Consulting to serve as supportive material during the second reading of the co-decision procedure.

Structure of the study

The structure of the report is as follows: Section 2 details the methodology employed for the study. Section 3 provides an overview of the current legal framework and changes introduced by the proposed Directive. In section 4 the economic effects of the proposed CCD are analysed. The analysis is structured according to the research questions into the following parts:

- Overview of the EU consumer credit market;
- Extent of consumer credit cross-border transactions;
- Obstacles to selling consumer credit across borders;
- Benefits of a single market in consumer credit;
- Efficiency of consumer protection rules (duties of creditors and rights of consumers);
- Harmonisation of legislation.

Finally, the Annex provides an overview of focus group results on consumer attitudes towards buying consumer credit products directly cross-border (Annex 1), detailed case studies on the United Kingdom, Germany and Czech Republic (Annex 2), and the questionnaire, the list of respondents and the results of the surveys of national banking associations and consumer organisations (Annex 3, 4, 5).

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¹ COM (2002) 443 final

² See COM (2005) 483 final/2, Corrigendum published on November 23, 2005

2. Methodology

The analysis of this study has been based on the following resources:

- Review of existing studies and reports;
- Expert and stakeholder interviews;
- Survey of consumer organisations and banking associations in all MS;
- Analysis of legislative changes at EU level;
- In-depth case studies in three Member States (the UK, Germany and Czech Republic), including the analysis of changes to the national legal framework for consumer credit, the analysis of the value chain of credit products, the assessment of impacts of the CCD on the value chain, and focus groups with consumers;
- Economic analysis.

2.1. Research questions

Relevant questions that addressed specifically *cross-border transactions* are:

- To what extent is consumer credit extended across borders?
- What are the barriers to establishment of a single market (including both cross border trade and lenders establishing themselves in other MS)?
- To what extent would the proposed Consumer Credit Directive overcome these barriers?
- What other measures might be needed to overcome them?
- To what extent would consumers benefit from the creation of a single market (increased competition) in consumer credit?

Relevant questions addressing elements of the Commission's modified proposal that concern *duties of creditors and rights of consumers* are:

- To what extent would the duties of creditors (information, consultation, responsible lending) and the rights of the consumer (right of withdrawal, right of early repayment), which are more broadly defined than in the existing directive, lead to more efficient consumer protection?
- Would it increase the cost of the credit at the consumer's expense and would it make consumer's access to cost-effective credit more difficult?
- Are there other micro-economic effects which can be anticipated?
- Can we expect that greater access to information will be perceived by the consumer as helpful or as unnecessary information overflow?
- Will consumers feel more secure when taking out credit?

Relevant questions that addressed specifically *harmonisation of legislation* are:

- Which economic effects on behaviour of economic players might be expected from the approach of full harmonisation with flexibility and of mutual recognition for issues where there is flexibility?
- To what extent will full harmonisation of essential elements increase in the short term the volume of cross-border consumer credit?

- Is it likely to create momentum in the medium/long-term?
- What elements should be left to national legislation or self-regulation in Member States?

2.2. Methodological approach

The economic analysis is based on the qualitative and quantitative data collected during the following research phases:

Interviews/meetings with key partners and stakeholders

Key partners and stakeholders have been involved throughout the whole process of the economic analysis by means of interviews and surveys. Depending on the availability, interviews were carried out face-to-face or by phone. The number of interviewed stakeholders can be found in the following table.

Table 1: Total number of interviewed stakeholders

Organisation	Number of interviews
European banking associations	group meeting
National banking associations	3
Individual banks	6
European consumer organisations	1
National consumer/citizen advice organisations	3

Surveys

Two surveys were developed and circulated targeting the key stakeholders: banking associations at both the EU level and in all MS and consumer organisations at both the EU level and in all MS. The questionnaires were sent out by email, after comments from the European stakeholder groups on the draft questionnaires had been integrated, to the relevant organisations. The response rate was very satisfactory for both banking associations and consumer organisations. Table 2 describes the profile of the respondents.

Table 2: Number of respondents to the survey

Respondents	Questionnaires received
Consumer organisations	9
Individual banks	>15
National banking associations	35
European banking associations	2
Other banking associations	4
TOTAL	>65

Graphs in the main report and in Annex 5 present in numerical form the survey data obtained from 32 national banking associations and the 9 consumer organisations.

Three of the national banking associations were not active in the field of consumer credit and were therefore not included in the numerical evaluation, as were “other banking associations”, individual banks and European level associations to not distort the overall picture, which was intended to reflect the stakeholder perspective at Member State level. However, the detailed comments of all stakeholders that returned a questionnaire have been taken into account for the analysis.

Focus groups

Focus groups were conducted with consumers in three different EU countries that have been selected for the case studies (see below), namely the UK, Germany and Czech Republic. The focus groups were conducted for Civic Consulting by Opinion Leader Research, a market research company. The focus groups consisted of 8-9 consumers of mixed age and gender, who are experienced on-line shoppers, but have not yet done this cross-border. This is an especially relevant target group, as cross-border consumer credit agreements are likely to be concluded online and any growth in this area is likely to be linked to an increase in cross-border shopping. During the 2-hour focus group, participants were asked a set of pre-determined questions related to their experience, followed by wider questions and discussion. The protocol for the focus groups was developed by Civic Consulting.

Case studies

Expected impacts of the Commission's modified proposal were scrutinised through case-studies in three Member States (UK, Germany, Czech Republic). The methodology for the case studies consists of two steps:³

In a first step, major legal changes are analysed that the transposition of the Commission's modified proposal would bring compared to the current national legislative framework. In a second step the value chain for two specific credit products is analysed:

- A credit agreement for a total amount of credit of 5,000 EUR with a fixed interest rate and repayable in equal monthly instalments.
- An open-end credit line in the form of an overdraft advance on a current account. Total amount of credit 1,000 EUR.

Both transactions are examined for different costs elements in the status quo and how they are likely to change under the Commission's modified proposal in the three selected Member States. For this aim, the analysis differentiates between the different elements of the credit value chain, namely between front-office, back-office and bad-debt collection processes.

³ The questionnaire for the case studies and for the stakeholder survey was prepared with support from Prof. Dr. Andreas Oehler, who also provided some input into the interpretation of the survey results.

3. Assessment of changes to the EU legal framework

3.1. Consumer protection – main changes through the proposed Directive

It is generally accepted that Directive 87/102/EEC has not introduced a “high level of consumer protection”.⁴ As a consequence, virtually all Member States have gone beyond the minimum requirements of Directive 87/102/EEC in their national consumer credit laws. In other words, the Directive does not reflect the law, at least in the “old” Member States. Thus, in order to assess the changes that the proposed Directive will bring for the protection of consumers, one cannot simply compare the proposed Directive with the provisions of Directive 87/102/EEC. As the proposed Directive aims at fully harmonising the laws of the Member States, it could reduce the level of consumer protection afforded by the Member States even where it increases the level of consumer protection compared to Directive 87/102/EEC. The current national legal framework in Member States must be taken into account. Therefore this study presents three case studies on the United Kingdom, Germany, and the Czech Republic (see Annex 2), that are used to illustrate existing differences between Member States. Of the three countries, both the UK and Germany have drafted their own rules on consumer credit beyond the level of the minimum harmonization required by the Directive. In the contrary, the Czech Republic has basically only implemented what the Directive requires, i.e. the minimum to formally meet its obligations under EU law.

Advertising

Directive 87/102/EEC clarified that if a rate of interest or any figures relating to the cost of the credit are indicated, advertisement also has to include a statement of the annual percentage rate. Only where no other means is practicable, a representative example has to be given.

As Directive 87/102/EEC, the proposed Directive allows in Article 4 credit advertisements that indicate no interest rate or other figures relating to the cost of the credit. If however, an interest rate or such figures are indicated, “standard information” must be supplied. This relates to (a) the total amount of credit, (b) the annual percentage rate, (c) the duration of the agreement, (d) the amount, number and frequency of payments to be made and (e) any kind of fees in connection with the credit agreement in conformity with the terms thereof and which are known to the creditor. The representative example will be mandatory.

Other types of advertisement that could be regarded as misleading anyway are dealt with by Article 4 (3) and (4). According to Article 4 (3), the annual percentage rate of charge shall be stated by means of at least two representative examples, where credit terms are not available to the general public.

Under Article 4 (4), it is not allowed to advertise a lower interest rate that only applies for a limited duration at the beginning of the credit agreement, thereby disguising the real costs of the credit over the total duration of the credit contract. Thus, the annual percentage rate must be calculated on the total duration of the credit contract.

Finally, compulsory ancillary service, in particular insurance, must be mentioned in advertisements even if their costs cannot be determined in advance. Here a significant problem of the proposed Directive could be concealed. When is insurance compulsory? It seems possible that creditors argue that insurance is never compulsory.

⁴ The reasons are, amongst others, explained in the Commission’s report on the application of the Directive of 1995, and also in an article by Patrick Latham, the official who has negotiated the Directive for the Commission, see P. Latham, Dispositions communautaires relatives au crédit à la consommation: la directive 87/102/CEE du 22 décembre 1986, *Revue du Marché Commun (RMC)* 1988, 219, at 224

Whether or not insurance is required always depends on the individual case, in particular on the creditworthiness of the consumer – and many consumers will only obtain credit if they take insurance.

If this line of argument is followed, Article 4 (5) does not apply, and the same goes for information obligations under Article 5 (2) lit. h).

Whilst German law does not provide for specific rules on credit advertising, the UK has only recently modernised the respective Regulations. In parts, they appear to be more stringent or at least more specific than the ones envisaged by the Directive, and this with regard to their content but also with a view to design specifications. Czech law reflects the state of the EC law as laid down in the Directive 87/102/EEC.

The proposed Article 4 also appears to be contradictory to Directive 2005/29/EC on Unfair Commercial Practices.⁵ The proposed Directive provides in Article 4 (6) that ‘this article shall be without prejudice to Directive 2005/29/EC’. Article 3 (9) of the said Directive states ‘that in relation to financial services – and consumer credits must be regarded as financial services in this sense – Member States may impose requirements which are more restrictive or prescriptive than this Directive in the field which it approximates’. So which rules shall prevail? As the proposed directive provides for full harmonisation, Member States would be bound to the standards under Article 4, without taking into account the concept of fairness under the Directive 2005/29/EC and in particular the distinction between the average and the vulnerable consumer. On the other hand, Article 3 (9) of the Unfair Commercial Practices Directive grants them regulatory leeway.

Information obligations

Directive 87/102/EEC is fairly limited concerning information obligations. The only compulsory information to be given is a statement of the annual percentage rate where possible, and the other “essential terms” of the agreement. A list in the Annex illustrates what terms may be regarded as essential.

In Article 5 (2) (a) – (m), the proposed Directive goes far beyond these requirements in setting up an extensive catalogue of information to be supplied. At the same time it prohibits other information obligations to be introduced or maintained by Member States. This catalogue must be analysed in two respects: firstly in comparison to the information obligations established in the Member States that exceed the provisions of Directive 87/102/EEC by far and secondly with a view to its effectiveness in protecting the consumer and to potential gaps that Member States would not be allowed to fill. This is illustrated by the results of the case studies:

- A comparison between the proposed Directive and UK law shows a lot of overlap but also differences. There are information obligations enshrined in the proposed Directive that UK law has not introduced yet, but also information obligations of UK law that find no equivalent in the proposed Directive. In its Consultation Paper, the DTI regards these additional obligation requirements as “critical to properly describing the nature of the credit product being provided”.⁶ Moreover, UK law specifies formalities and design requirements on information to be provided.
- German law does not contain particular rules on the disclosure of contractual information. Indirectly, however, the consumer is protected. The consumer may examine the mandatory minimum content of the contract within 14 days, as he or she has a right to withdraw from the

⁵ J. Stuyck & T. van Dyck, Consumer Credit Directive, Briefing Note, requested by the European Parliament’s Committee on Internal Market and Consumer Protection, IP/A/IMCO/NT/2006-16, PE 373.567.

⁶ DTI, Consumer Credit Law, A Consultation on a proposed European Consumer Credit Directive, February 2005, available at <http://www.dti.gov.uk/files/file14388.pdf>, p.23

contract.⁷ Outside and beyond legislation, German courts have developed a limited set of contractual disclosure obligations.

- These however are only triggered off if very special circumstances require the creditor to intervene.⁸ Therefore the proposed Article 5 reaches far beyond existing German law.
- Czech law implements Directive 87/102/EEC. However, the Act does not contain any particular provisions regarding an obligation to disclose information.

Assessment of creditworthiness

The assessment of creditworthiness in Article 5 (1) is new to the Consumer Credit Directive and to many national legal systems. German courts, for example, have held that banks were not obliged to assess the consumer's creditworthiness.⁹ UK and Czech law do not have this element of responsible lending either.

Duty to assist

The duty to assist, Article 5 (5) is new to the Consumer Credit Directive and to many national legal systems, including Germany, the Czech Republic and the UK. An exception is, for example, Belgian law.

Right of withdrawal

The right of withdrawal, Article 13, is new to the Consumer Credit Directive. It is beneficial to the consumer in giving the chance of a second thought on the contract. The right of withdrawal is therefore an instrument that could reduce the negative effect of the abolition of the written form requirement.

However, the right of withdrawal already forms part of most national consumer credit laws, with variations as to the withdrawal period and the formalities to be observed.¹⁰ This is true for the UK and Germany, but not for the Czech Republic. The proposal intends to harmonise these rules.¹¹ The true benchmark is therefore the national legal systems. In this context, it is not only the right of withdrawal as such but also the rules concerning the costs that the consumer has to bear when exercising this right which are of relevance.

- a) The right of withdrawal itself, the relevant period of time and the manner in which it may be exercised is in line with the rights of withdrawal enshrined in other EC Directives. The period of withdrawal of 14 calendar days is not exceeded by any national consumer credit law.
- b) This may be different with the consequences of the withdrawal. Under Article 13 (4), the consumer has to pay the agreed interest rate for the period during which credit was drawn down. This is even where the consumer withdraws from the contract because he or she finds out that the interest rate was above average.

⁷ U. Reifner, § 11 Verbraucherdarlehensvertrag, in: P, Derleder, K.-O. Knops & H. G. Bamberger (eds), Handbuch zum deutschen und europäischen Bankrecht (Springer, Berlin, 2004), at no. 95

⁸ U. Reifner, § 11 Verbraucherdarlehensvertrag, in: P, Derleder, K.-O. Knops & H. G. Bamberger (eds), Handbuch zum deutschen und europäischen Bankrecht (Springer, Berlin, 2004), at no. 95, with references to established case-law

⁹ Bundesgerichtshof, Neue Juristische Wochenschrift 1989, 1665

¹⁰ For example, the analysis by C. Ritz, Harmonisierungsprobleme bei der Umsetzung der EG-Richtlinie 87/102 über den Verbraucherkredit (Lang, Frankfurt, 1996). See also U. Blaurock, Verbraucherkredit und Verbraucherleitbild in der Europäischen Union, Juristen-Zeitung 1999, 801 at 804 f

¹¹ Bundesgerichtshof, Neue Juristische Wochenschrift 1989, 1665, at 2.2

- c) Whilst Article 13 (4) of the proposed Directive deals with interests on the credit for the time until the right of withdrawal is exercised and also prohibits indemnities in connection with the withdrawal, it does not address, for example, the question who has to pay for the costs of concluding the contract (see section 3.2.2.6 below).

Right of early repayment

The consumer already has this right under Directive 87/102/EEC, and this Directive also entitles the consumer to an equitable reduction in the total cost of the credit. The position of the consumer with a view to the right of early repayment is not improved by the proposed Directive.

The additional rules provided by the proposed Directive in Article 15 relate to the creditor's claim of an indemnity. The creditor shall be entitled to claim a fair and objective indemnity for early repayment according to the amount or the calculation method set out in the credit agreement; which means that the creditor is only entitled to such a claim if this is set out in the credit agreement. No indemnity shall be claimed in two specific situations. The new rules work both ways: They limit the creditor's right to claim an indemnity but they also prohibit more generous national rules. Thus, their effect can only be judged against current national laws and current banking practice. Results of the case studies indicate that impacts on the national legal framework can be quite different:

- a) UK law is fairly specific on the right of early repayment. Reg. 4 of the Consumer Credit (Early Settlement) Regulations 2004 specifies the indemnity to be claimed by the creditor to be calculated on the basis of actuarial principles. The UK has also introduced an applicable notice or deferment period, which is not reflected in the Directive. Under the UK regime, if a lender receives an early settlement request in writing, the settlement date becomes the date 28 days after receipt of the request.¹² If the term of the credit agreement is more than one year, the settlement date for calculation of the rebate can be deferred for a further one month or 30 days.¹³ These rules would be barred by the proposed Directive.
- b) German law grants the consumer the right to early repayment of instalment credits. The overall idea is that the consumer is credited the amount of those costs which have not been used and are no longer used due to the abbreviated duration of the contract.¹⁴ However, the creditor may at least claim the costs for the first nine months. This is largely in line with the proposed Article 15 of the Directive, although the true difficulty results from the way in which the credited amount is calculated.¹⁵
- c) Czech law gives the consumer in line with Directive 87/102/EEC the right of early repayment. The purpose of the Directive (equitable reduction of the costs), however, can hardly be reached due to a very vague clause of the Act ("prevention of disproportional profit").

Reduced formal requirements

Directive 87/102/EEC requires the credit agreement to be made in writing. This will be replaced by the credit agreement to be provided on paper or on another durable medium, Article 5 (2); which is in line with other recent EC Directives but has nevertheless been heavily criticised.

¹² Consumer Credit (Early Settlement) Regulations 2004, Reg. 5.

¹³ Consumer Credit (Early Settlement) Regulations 2004, Reg. 6.

¹⁴ P. Ulmer, § 504 BGB, in: Münchener Kommentar zum Bürgerlichen Gesetzbuch, 4th ed. (Beck, Munich, 2004), no. 1

¹⁵ With regard to German law, P. Ulmer, § 504 Rn. 9 and 10, but see on the uncertainties BMJ, Zweiter geänderter Vorschlag für eine neue Verbraucherkreditrichtlinie, Deutsche Stellungnahme, March 2006, p. 28

In fact, many Member States, among them Germany, have retained the written form for few types of contracts that they deem to be particularly relevant for consumers, and amongst them are usually consumer credit contracts and suretyship contracts. The Czech Republic and the UK, in contrast, have already allowed electronic consumer credit contracts.

However, the Consumer Credit Act 1974 (Electronic Communications) Order 2004 requires a special agreement between the creditor and the consumer to use electronic means for contracting, and exceptions have been made for default, enforcement and termination notices. In contrast, it has been held that the alternative channel of electronic contracting may be of benefit for the consumer in allowing creditors to offer discounts for consumers that consent to electronic contracting; a development that has already become apparent in the insurance market.¹⁶

Linked credit agreements

Article 11 (2) of Directive 87/102/EEC will be transformed unchanged into Article 14 (2) of the proposed Directive, however, it will in the future come under the maximum harmonisation clause. This is noteworthy because Article 11 (2) of Directive 87/102/EEC has been recognised, even by the Commission, to have established a low level of consumer protection. The member of staff of the Commission responsible for Directive 87/102/EEC, Patrick Latham, had expressed his disappointment with Art. 11 as early as 1988 and he had hoped that the Member States would introduce more protective rules voluntarily.¹⁷ In 2002, the Commission has given an implicit evaluation of Art. 11 (2) of Directive 87/102/EEC, by stating in its first proposal for a new Consumer Credit Directive that a "number of Member States simply transposed Article 11 and created legislation that was ineffective", whereas other Member States have gone (far) beyond the requirements of that Directive.¹⁸

The most important restrictions are Art. 11 (2) lit. b) and e) of Directive 87/102/EEC. According to lit. b), the provision only relates to cases in which the creditor and the supplier of the goods or services have a pre-existing agreement under which credit is made available *exclusively* by that creditor to customers of that supplier for the acquisition of goods or services from that supplier. Thus, the consumer may not be protected in cases where a trader co-operates with several creditors.¹⁹ Obviously, this opens the door for circumvention strategies that cannot be countered by making use of Article 14 (2) of the Directive. Moreover, this criterion does not reflect the consumer's interest: From the point of view of the consumer, it is merely important that the trader and the creditor form an economic unit.²⁰ And finally, the criterion of exclusivity is difficult to prove for the consumer.

Under Article 11 (2) lit. e) of Directive 87/102/EEC, the consumer must first pursue remedies against the supplier and fail to obtain the satisfaction to which the consumer is entitled before he or she can exercise his/her rights against the creditor. What this exactly means is subject to some controversies. Whilst some

¹⁶ DTI, The Consumer Credit Act 1974 (Electronic Agreements) Order 2004, Regulatory Impact Assessment, available at <http://www.dti.gov.uk/files/file23061.pdf> at 5.4

¹⁷ P. Latham, Dispositions communautaires relatives au crédit à la consommation: la directive 87/102/CEE du 22 décembre 1986, *Revue du Marché Commun (RMC)* 1988, 219, at 224

¹⁸ COM(2002) 443 final, at 22. See also C. Ritz, *Harmonisierungsprobleme bei der Umsetzung der EG-Richtlinie 87/102 über den Verbraucherkredit* (Lang, Frankfurt, 1996); S. Herrmann, *Der Verbraucherkreditvertrag* (VVF, München, 1996), and U. Blaurock, *Verbraucherkredit und Verbraucherleitbild in der Europäischen Union*, *Juristenzeitung (JZ)* 1999, 801 ff., all on Germany, France and UK; D. Henrich, *Die Umsetzung der Richtlinie 87/102/EWG zur Harmonisierung des Verbraucherkredits in Deutschland und Italien*, in: C.-W. Canaris & A. Zaccaria (eds), *Die Umsetzung zivilrechtlicher Richtlinien der Europäischen Gemeinschaft in Italien und Deutschland* (Duncker & Humblot, Berlin, 2002), at 25 ff., on Germany and Italy.

¹⁹ N. Reich & H.-W. Micklitz, *Europäisches Verbraucherrecht*, 4th ed. (Nomos, Baden-Baden, 2003), at 748

²⁰ S. Grundmann, *Europäisches Schuldvertragsrecht* (de Gruyter, Berlin, 1999), at 676

authors argue that the consumer must initiate insolvency proceedings against the trader,²¹ others suggest that “simple” court proceedings or even extra-judicial measures suffice.²²

Others argue that Article 11 (2) s. 2 of Directive 87/102/EEC leaves it to the Member States to regulate on details, this being a consequence of disagreement between the Member States at the time when the Directive was adopted;²³ an interpretation that would be difficult to uphold under the principle of maximum harmonisation. The ECJ has not had the opportunity yet to clarify the law.²⁴ The situation in the three Member States scrutinised in depth is therefore again quite different:

- a) UK law goes far beyond Article 14 (2) of the proposed Directive in providing for a system of joint and several liability of the seller and the creditor. Under Article 14 (3) of the proposed Directive, the UK will be allowed to maintain this system. However, British consumers who contract with foreign creditors might be deprived of this benefit, due to the proposed principle of mutual recognition (see Annex 2).
- b) German law contains fairly detailed rules on linked credit agreements. Linked agreements are those which form a commercial unit. In the German legal point of view, the credit agreement has to ‘serve’ partly or in full the financing of a sales or service contract.²⁵ This is suggested to be the case if the supplier finances the contract himself or herself, or in case of financing by a third party, if the creditor involves the supplier into the preparation or the conclusion of the credit agreement. According to the German courts, the consumer perspective is crucial: If the trader and the creditor present themselves as a unit, the two contracts are linked. The courts do not require a pre-existing agreement between the trader and the creditor, factual co-operation suffices.²⁶ A long-standing relationship between the trader and the creditor is not necessary either.²⁷ Furthermore, German law does not require the consumer to take action against the trader first. Instead, he or she can raise objections from the relationship with the trader immediately against the creditor. German law therefore represents a system that is not outside the scope of the Directive but that is far more stringent than Article 14 (2) of the proposed Directive and that does not comply fully with Article 14 (3).
- c) Czech law, however, is largely in line with the provisions of Directive 87/102/EEC. The law regulates entitlements of the consumer entering into a credit agreement in connection to an agreement on purchase of goods or provision of services.

²¹ For example, F. J. Scholz, *Schwerpunkte der EG-Verbraucherkreditrichtlinie – unter Berücksichtigung des geltenden deutschen Rechts* -, *Monatsschrift des Deutschen Rechts (MDR)* 1988, 730, at 734; A. Hüttebräuker, *Die Entstehung der EG-Richtlinien über den Verbraucherkredit* (Diss., Bonn, 2000) at 147

²² N. Reich & H.-W. Micklitz, *Europäisches Verbraucherrecht*, 4th ed. (Nomos, Baden-Baden, 2003), at 749

²³ S. Grundmann, *Europäisches Schuldvertragsrecht* (de Gruyter, Berlin, 1999), at 676

²⁴ The question of the *Juzgado de Primera Instancia n. 10 de Seville* that was answered by ECJ, judgment of 7/3/1996, Case C-192/94 *El Corte Inglés SA v. Cristina Blázquez Rivero*, [1996] ECR I-1281, merely related to the horizontal direct effect of this provision although the case also raised important questions on the prerequisites of Art. 11 (2)

²⁵ U. Reifner, § 11 *Verbraucherdarlehensvertrag*, in: P. Derleder, K.-O. Knops & H. G. Bamberger (eds), *Handbuch zum deutschen und europäischen Bankrecht* (Springer, Berlin, 2004), at no. 155

²⁶ BGH, *Neue Juristische Wochenschrift* 2003, 2821

²⁷ BGH, *Neue Juristische Wochenschrift* 1971, 2303

3.2. Harmonisation – achievements and limitations

The Commission has recognised that an internal consumer credit market has failed to develop after Directive 87/102/EEC was adopted. The Commission has identified impediments in the substantive law of Directive 87/102/EEC itself, in particular the written form requirement of Article 4 (1) of the Directive. However, the Commission is also convinced that it is the lack of harmonised rules on consumer credit contracts throughout the EC that has prevented a cross-border consumer credit market to develop. This belief is also shared by many Member States.²⁸ The main reason given is that transaction costs on the trader's side can be reduced when the trader has to follow only one set of rules for all cross-border transactions within the EU. The proposed Directive provides for two mechanisms that are meant to deal with this issue, one being maximum harmonisation, the other mutual recognition. Whilst maximum harmonisation aims at creating one single law for all Member States, mutual recognition does allow for differences in the legal systems. However, creditors are only bound by the law of the Member State of their own place of business and therefore do not need to care about the corresponding rules of the Member State where the consumer is domiciled.

From the consumer's perspective, maximum harmonisation is thought to increase consumer confidence because there will be one set of rules to rely upon, irrespective of whether one acts in a national context or cross-border.²⁹ This point of view, is, however, not shared universally.³⁰ Also, the impact of the principle of mutual recognition on consumer confidence has to be taken into account.

The facilitation of cross-border credit contracts is the benchmark the new legislative provisions are tested against in this study. The following sections therefore scrutinise the degree to which specific provisions of the modified proposal are likely to facilitate the conclusion of cross-border credit contracts or, in contrary, may result in additional barriers. Of relevance are both the substantive law and the degree of harmonisation envisaged by the modified proposal. Moreover, the principle of mutual recognition in Article 21 (2) of the modified proposal must be taken into consideration. Finally, private international law of consumer credit contracts is of major importance for the prospects of an increase in cross-border consumer credit.

3.2.1. Substantive law

This study focuses on the more important substantive provisions. Issues such as the assignment of rights are not sufficiently significant to make any impact on cross-border consumer credit likely.

Advertisement and information obligations

The new requirements on advertisement and on information obligations do not seem as such to be an impediment for the internal market, because the information the creditor has to provide to consumers is in principle available to him. However, because of the current diverging rules of the Member States creditors will have to adapt to the new rules, e.g. by redrafting and printing agreements, adapting IT systems etc. The issue is dealt with in more detail below.

²⁸ Council document COD/2002/0222 of 29/5/2006

²⁹ COM(2005) 483 final, at 4, Harmonisation of certain key elements of the consumer credit agreement will improve consumer confidence and encourage consumers to buy credit across borders in the EU.

³⁰ Critics have blamed this particular way of arguing as abuse of the 'confident consumer' as a justification for EC Consumer Law. T. Wilhelmsson, The Abuse of the 'Confident Consumer' as a Justification for EC Consumer Law, (27) Journal of Consumer Policy 2004, 317 ff

Responsible lending, consultation of databases

The duty to responsible lending of Article 5 of the proposed Directive is not part of Directive 87/102/EEC. Responsible lending includes providing accurate pre-contractual information and the consultation of databases where appropriate. The duty to consult the relevant database may as such not pose technical problems to cross-border crediting, because access will obviously be by electronic means and has to be guaranteed without discrimination, according to Article 8 (1) of the proposed Directive.³¹ Access to databases is crucial for creditors that are willing to conclude cross-border credit contracts, and therefore this provision could in principle facilitate the conclusion of such contracts (in as much as this is a major impediment currently, see below). However, databases may differ in design and content and therefore creditors may have to adapt relevant processes and IT systems. A language problem may also remain.³² Harmonisation of the databases is not envisaged by the modified proposal. The proposal clarifies that Member States do not need to set up new databases,³³ and it may be assumed that they would not have to modify existing databases either. The new Article 5 (1) could therefore introduce at the same time a new impediment to cross-border credit contracts, as consultation of un-harmonised databases would be required.

Duty to assist

According to Article 5 (5) of the proposed Directive, Member States shall ensure that creditors and, where applicable, credit intermediaries provide adequate explanations to the consumer, in order to put the consumer in a position to assess whether the proposed credit agreement is adapted to his and her needs and financial situation, where appropriate by explaining the pre-contractual information to be provided in accordance with paragraph 2 as well as the advantages and the disadvantages associated with the products proposed. Member States may adapt the manner by and extent to which this assistance is given, as well as by whom it is given, to the particular circumstances of the situation in which the credit agreement is offered.

This duty to assist is new as well. The relevant question here would be how individualised the advice envisaged by Article 5 (5) has to be. The consumer's needs and financial situation are individual so that individual advice will be necessary. From the whole context of the Directive, one may safely assume that no face-to-face conversation is required but the communication in writing or by electronic means should suffice. However, this may well have to happen in the language of the consumer if the consumer is not sufficiently capable to understand and speak the trader's language. Therefore, the duty to assist may render cross-border lending more difficult than lending at national level.

Formal requirements

As already mentioned, the written form of Article 4 (1) of Directive 87/102/EEC shall be replaced. The new Article 9 (1) will allow credit contracts to be drawn up "on paper or on another durable medium". The same applies to the supply of pre-contractual information, under Article 5 (2) of the proposed Directive and to the supply of information on the change of the borrowing rate, Articles 10 and 11. The notion of "durable medium" is known from the Distance Selling Directives 97/7/EC and 2002/65/EC. It covers, in particular, CD-ROMs and e-mails, although it will still not suffice to provide relevant information only on the internet.

³¹ It has to be noted, however, that Article 8 (1) provides very little detail and the practicality of database access for creditors from other MS could depend on implementation rules.

³² See COM(95) 117, no. 70, on the diversity of databases

³³ See COM(2005) 483 final, at 6

Linked transactions

Linked transactions have already been subject to minimum harmonisation under Article 11 of Directive 87/102/EEC. As said before, Article 14 (2) of the proposed Directive is identical to Article 11 (2) of Directive 87/102/EEC. Article 14 (1) of the proposed Directive is new. It relates to situations in which the consumer has exercised a right of withdrawal concerning a contract for the supply of goods or services by a trader. In such a case, he shall no longer be bound by a linked credit agreement. Impediments to cross-border trade may stem from the linked contract since no full harmonisation has taken place as to contracts for the supply of goods or services where the consumer has a right to withdrawal.³⁴ Here, the parallel Review of the Consumer Acquis³⁵ that aims, inter alia, at harmonising the different rights of withdrawal in EC consumer law, may solve the issue.

Other issues

Provisions of the modified proposal concerning the following issues are unlikely to be impediments to the internal market as such but only due to the currently diverging laws of the Member States:

- Termination and renewal of open-end and long-term agreements
- Right of withdrawal
- Early repayment
- Calculation of the annual percentage rate

These issues are therefore dealt with in more detail in the next section on maximum harmonisation.

3.2.2. Maximum harmonisation

Article 1 of the proposed Directive expresses the aim of the Directive, which is to harmonise “certain aspects” of the laws, regulations and administrative procedures of the Member States concerning agreements covering credit contracts. Article 21 (1) prohibits other provisions than those laid down by the Directive “insofar as this Directive contains harmonised provisions”. And in its explanations of the amended proposal, the Commission stated: “The proposal now clarifies that only those elements explicitly dealt with in the text are fully harmonised.”³⁶

Thus, the scope of application of the principle of maximum harmonisation is restricted in two ways: First, not all the Articles of the Directive contain harmonised provisions, and second, issues that are not addressed by the Directive at all remain in the competence of the Member States.³⁷ More than this, the term “insofar” also suggests, or leaves the possibility open that provisions are partly harmonised. This will be discussed in more detail below.

³⁴ For example, such a right to withdrawal exists in the Netherlands for contracts on the sale of a house; a right of withdrawal that is certainly unknown to most Member States. However, this would not fall into the scope of application of the proposed Directive.

³⁵ See COM(2006) 744 final

³⁶ COM(2005) 483 final, p.7

³⁷ See also COM(2005) 483 final, p.7

3.2.2.1. Issues that are covered by the maximum harmonisation approach

Advertisement and information

Standard information in advertisement is dealt with by Article 4 of the modified proposal. This provision lays down the content and the order of standard information in advertisement and that information has to be provided in a clear, concise and prominent way. No deviation is allowed. This is a clear change to Directive 87/102/EEC under which Member States were free to decide what information to require. However, this might be different insofar as the design of the standard information is concerned (see sections 3.2.2.2 and 3.2.2.4 below), and certainly Article 4 does not harmonise specific issues such as credit advertisement towards minors (see section 3.2.2.6 below).

The same applies to pre-contractual information that now forms a subcategory of responsible lending and is detailed out in Article 5 (2). Although the notion “include” is used, the list is clearly meant to be exclusive. This can be concluded from a comparison with Article 4 (2) of Directive 2002/65/EC on the distance marketing of financial services. Under this provision, Member States are explicitly allowed to maintain or introduce more stringent provisions on prior information requirements. The proposed Consumer Credit Directive does not contain a corresponding provision. Again, however, this might be different with regard to the design of pre-contractual information (see sections 3.2.2.2 and 3.2.2.4 below). The same applies *mutatis mutandis* to pre-contractual information obligations in case of overdraft facilities as dealt with in Article 6 of the proposed Directive, to contractual information under Articles 9 (2) and (3) and 11 and to information obligations in the case of overrunning, Article 17.

This is not quite so obvious with the second part of Article 5 (2) on voice telephony communications, according to which the pre-contractual information must include “at least” the items referred to in points (b), (c) and (e) of Article 5 (2), first sentence etc. Still, this cannot be understood as allowing the Member States to add compulsory elements to pre-contractual information in voice telephony communications. Rather, one must assume that creditors can, of course, provide more information than the minimum required by Article 5 (2).

Responsible lending, consultation of databases

The duty to responsible lending of Article 5 of the proposed Directive is not part of Directive 87/102/EEC. It includes providing accurate pre-contractual information and the consultation of databases where appropriate. Member States have adopted different approaches to this issue, ranging from full self-responsibility of the consumer in Germany to a duty of responsible lending, for example, in Belgium.³⁸ The issue will be fully harmonised through the proposed Directive.

According to Article 5 (1), the creditor shall assess the consumer’s creditworthiness on the basis of accurate information provided by the latter and, where appropriate, on the basis of a consultation of the relevant database. This implies, firstly, that the creditor is not obliged to gather any information that is not provided by the consumer and not available from the relevant database, and Member States cannot oblige the creditor to do so. Secondly, the creditor does not have to consult the relevant database in all cases but only where this is appropriate. National laws requiring compulsory consultation of the database in all cases will not be allowed any longer.

³⁸ COM(95) 117, n. 177 ff

Duty to assist

The duty to assist of Article 5 (5) as such is subject to maximum harmonisation, and it carries some limitations with it. In particular, explanations as to the pre-contractual information to be provided and the advantages and disadvantages associated with the products proposed is only required “where appropriate”. Thus, national consumer credit laws requiring compulsory explanations in any case will not be allowed any longer. Apart from this, Member States have significant leeway as to the modalities (see below).

Termination and renewal of open-end and long-term agreements

Article 12 on termination and renewal of open-end and long-term agreements does not appear to give any leeway to the Member States. This provision follows the maximum harmonisation approach of Article 21 (1).

Right of withdrawal

The right to withdrawal is new to the Directive, although it has formed part of many national consumer credit laws for a long time. These different rights that all follow different rules are largely harmonised by the proposed Directive. The harmonisation relates to:

- The period of withdrawal of 14 calendar days;
- The begin of the period of withdrawal;
- The rule that the dispatching of the notice is relevant for notification in due time;
- The consumer’s payment obligations for having used the credit before exercising the right of withdrawal;
- the creditor’s duty to notify the consumer of his or her payment obligations;
- the calculation of interests due;
- the prohibition to claim any other indemnity in connection with exercising the right of withdrawal.

The only explicit exception appears to relate to the notification of the withdrawal (see below). For further uncertainties see above (section 3.1).

Linked transactions

The harmonising effect of the proposed Directive in the field of linked transactions is difficult to assess.³⁹

As for Article 14 (1), the consequences of the withdrawal of the linked contract for the credit agreement is regulated in a precise manner. It therefore qualifies for maximum harmonisation. At the same time, Article 21 (2) on mutual recognition mentions Article 14 (1), which implies that the Commission sees some leeway of the Member States in implementing Article 14 (1) of the proposed Directive.

³⁹ For details, see P. Rott, *Maximum Harmonisation and Mutual Recognition versus Consumer Protection: The Example of Linked Credit Agreements in EC Consumer Credit Law*, *The European Legal Forum* 2006, I-61, at I-66 f

The rules laid down in Article 14 (2) s. 1 concerning the preconditions under which two contracts are linked for the purposes of Article 14 (2) seem to qualify for maximum harmonisation as well. In contrast, the available remedies and formalities remain in the national competence (see below, section 3.2.2.2).

Early repayment

Article 15 on early repayment appears to leave no leeway to the Member States. However, Article 21 (2) on mutual recognition mentions Article 15, which implies that the Commission sees some leeway of the Member States in implementing Article 15 of the proposed Directive (see below, section 3.2.2.2).

Calculation of the annual percentage rate

The Commission has set out to improve the calculation of the annual percentage rate. This rate is crucial for the consumer's ability to compare different offers. It therefore comes under the principle of maximum harmonisation, no national deviations are allowed.

3.2.2.2. *Explicit leeway within the Directive*

In some cases, it proved difficult to find agreement on provisions, mainly due to existing heterogeneity as regards national markets or national legislation. Some Articles of the modified proposal give a certain amount of leeway to the Member States. These provisions are:

- Article 5 (5) on the duty to assist, with a view to the manner by and extent to which this assistance is given, as well as by whom it is given, to the particular circumstances of the situation in which the credit agreement is offered;
- Article 13 (3) on the notification of the withdrawal, with a view to the means in which the notification can be proven;
- Article 14 (2) on remedies in linked transactions. Member States shall determine to what extent and under what conditions these remedies shall be exercisable. Under Article 14 (3), Member States may also introduce or maintain a system of joint and several liability, although this merely seems to relate to the question of remedies and also allows not to introduce the subsidiarity envisaged by Article 14 (2) s. 1 lit. e). In contrast, it does not seem to allow altering the preconditions for linked transactions in the terms of Article 14 (2), as set out in the first sentence of this paragraph.

Furthermore, the proposed Article 21 (2) on mutual recognition mentions Article 5 (1) and (2), implying that Member States have some leeway in implementing these provisions. Since the Commission clearly intends to harmonise the content and order of standard information in advertisement and also the content of pre-contractual information, the leeway can only relate to the modalities or design, such as model forms, colours or font sizes. The same applies to the information obligations under Article 17 that is mentioned in Article 21 (2) as well.

Equally unclear is the kind of leeway left by Article 14 (1), which Article 21 (2) refers to. It may relate to the rights of withdrawal that can be exercised and that appear to be subject to national law (unless, of course, they result from the implementation of another EC Directive, such as Directives 85/577/EEC, 94/47/EC, 97/7/EC or 2002/65/EC). However, Article 21 (2) on consumer credit law is highly unlikely to be meant to impact on the private international law of rights of withdrawal in other fields of law.

The mentioning of Article 15 in Article 21 (2) might relate to the notions of “equitable” and “fair”. The Directive appears to give some leeway to the Member States to specify how the indemnity for the trader shall be calculated in the case of early repayment,⁴⁰ although this leeway is of course limited by the notions of “equitable” and “fair” themselves. Until now, the laws of the Member States have differed drastically with regard to the compensation the consumer had to pay for early repayment.⁴¹

To conclude, non-harmonised national rules will prevail to a certain extent after the adoption of the new Directive. These shall, however, come under the principle of mutual recognition of Article 21 (2) that is discussed below (section 3.2.3).

3.2.2.3. Sanctions

Sanctions for the breach of obligations set out by the proposed Directive have to be adequate, dissuasive and proportionate (Article 22). In so far the proposed Directive reiterates the formula introduced by the ECJ which has since then made its way into EC law making. It leaves much leeway to the Member States which have developed a variety of sanctions in private law, criminal law and/or administrative law. These will not be harmonised by the proposed Directive. In contrast to the issues discussed above, the principle of mutual recognition does not apply to sanctions.

3.2.2.4. Modalities of totally harmonised issues

As mentioned above, information obligations are fully harmonised by the proposed Directive as to their content. However, the proposed Directive does not contain rules as to how information is to be provided. Article 21 (2) suggests that Member States are still allowed to set up rules as to the design of information, such as model forms, colours or font sizes, at least in the cases mentioned above. Does this extend to similar cases, for example, to the information obligations of Article 6,⁴² which is not mentioned in Article 21 (2) on mutual recognition? If so, the only limit would be the freedom of services, i.e. such national provisions would have to be necessary to protect the consumer. The proposed Directive does not give a clear answer to this, although a systematic approach suggests that specific national rules on modalities are only allowed where the proposed Directive explicitly or implicitly allows them.

3.2.2.5. General clauses

Even if one assumes that Member States are not allowed, under Article 21 (1) of the proposed Directive, to specify the modalities of, for example, designing standard information of Article 4, the general terms used, such as “in a clear, concise and prominent way”, will be subject to national court practice. This issue is of course well-known from other pieces of EC legislation, such as the Unfair Contract Terms Directive 93/13/EEC or the Misleading Advertisement Directive 84/450/EEC. However, it gains much more importance where maximum harmonisation is involved.⁴³ In principle, such general terms have to be interpreted in an autonomous way, i.e. in a way that is dissolved from previous national case-law.

⁴⁰ See also House of Lords, European Union Committee, Consumer Credit in the European Union: Harmonisation and Consumer Protection, July 2006, available at <http://www.parliament.the-stationery-office.com/pa/ld200506/ldselect/ldecom/210/210i.pdf>, at 10

⁴¹ COM(95) 117, n. 190 f

⁴² UK Consumer Credit (Disclosure of Information) Regulations 2004

⁴³ The debate is also present in the law of unfair commercial practices. G. Howells, H.-W. Micklitz & T. Wilhelmsson, European Fair Trading (Ashgate, Aldershot, 2006), Chapter 4 (e), at 83

Nevertheless, differences in national court practice can be predicted that may create, or maintain, uncertainty on the part of the traders. This could be solved, in the way of preliminary proceedings under Article 234 EC, by the European Court of Justice. However, in the field of unfair contract terms the ECJ has already proved unwilling to “solve” national cases, i.e. to apply EC consumer law to national cases and to decide whether a particular contract term is unfair or not.⁴⁴ Thus, uniform rules may only develop over a long period of time. However, Member States would be free to seek advice in what ‘clear; concise and prominent’ could mean. In so far the ECJ remains competent to give shape to such general clauses.

Other examples are the notion of “significant increase” in the total amount of credit of Article 5 (1)⁴⁵ or the notion “appropriate” that is used in a number of provisions.

3.2.2.6. Issues that lie outside the Directive

An important question is also which issues are not covered at all by the Directive and therefore remain in the competence of the Member States. The question is difficult because one has to distinguish such national provisions that are “more stringent” than those of the Directive from those national provisions that deal with “different issues”. Those national rules concerning “different issues” can then only be tested against the EC Treaty.

Personal scope of application

First of all, the Directive only applies to consumer contracts, and the ECJ has in the past applied a fairly limited notion of consumer. Already at the EU level, the problem shows up that the ECJ developed its case-law mostly under the jurisdiction provisions of the Brussels Convention. It is far from being clear whether the case-law can be transferred as it stands to the consumer contract law directives’, which are mostly based on minimum harmonisation.⁴⁶ or the so-called non-professional, i.e. a professional who during business buys consumer goods that are not related to his or her professional activities,⁴⁷ or Member States have extended the protection of national consumer credit law to non-consumers, in particular to persons that wish to use the credit for setting up a business. One example for the latter is German law.⁴⁸

With a view to harmonisation, several alternative conclusions could be drawn:

- 1) The Member States retain their national competence to regulate credit contracts with non-consumers (under EC law terminology) to their liking; or
- 2) The Member States are prevented from affording any protection to non-consumers; or
- 3) The Member States are at least prevented from affording a higher level of protection to non-consumers than the maximum protection foreseen by the proposed Directive.

ECJ case-law in the case of *di Pinto* suggests that alternative 2) is not correct. In *di Pinto*, the French *Cour de Cassation* had referred the question to the ECJ as to whether French law could protect a trader

⁴⁴ ECJ, judgment of 1/4/2004, Case C-237/02 *Freiburger Kommunalbauten GmbH Baugesellschaft & Co. KG v. Ludger Hofstetter and Ulrike Hofstetter*, [2004] ECR I-3403; ECJ, judgment of 26/10/2006, Case C-168/05 *Elisa María Mostaza Claro v. Centro Móvil Milenium SL*, not yet reported, para. 22

⁴⁵ COM(95) 117, n. 62

⁴⁶ COM(95) 117, n. 106

⁴⁷ J. Calais-Auloy & F. Steinmetz, *Droit de la Consommation*, 6th ed. (Daloz, Paris, 2003), at 178

⁴⁸ See § 507 BGB

who was canvassed for the purpose of concluding an advertising contract concerning the sale of his business.

The ECJ held that such a businessman was not to be considered a consumer even though this particular contract was not his usual business. Therefore, Directive 85/577/EEC did not protect him. Nevertheless, the ECJ held that the Directive did not prevent Member States from protecting traders from doorstep selling if they wished to do so. This, however, was not a question of the minimum harmonisation clause of Article 8 of Directive 85/577/EEC. Rather, the Directive did not apply at all to the instant case since the French scenario fell outside the scope of application of the Directive.⁴⁹

This would point at alternative 1),⁵⁰ although one could argue that the proposed Directive will define what can possibly be “necessary” to protect persons that fall outside the scope of the Directive in the field of credit agreements. In contrast, it would not disallow to simply extend the rules of the proposed Directive to persons who fall outside the narrow notion of consumer of the Directive.⁵¹

Excluded consumer credit contracts

The same question arises with regard to consumer credit contracts that are excluded from the Directive. These are listed in Article 2 (2) of the amended proposal and include secured credit contracts, credit contracts exceeding 50,000 Euros and many more. Again, alternative 2) is not imaginable so that Member States can afford protection to consumers (and non-consumers) where the Directive does not apply, according to Article 2 (2).⁵²

Whether or not the provisions of the proposed Directive may be regarded as a kind of ceiling for consumer protection depends on the grounds for the exception. Some exceptions have their reason in a reduced need for consumer protection. This applies, for example, to consumer credit agreements with employers that are exempted under Article 2 (2) lit. f) or credit agreements where the creditor is fulfilling a statutory duty, Article 2 (2) lit. k). In these cases, consumer protection that exceeds the level of the proposed Directive may not seem to be necessary.

In other cases, the relevant credit agreements are deemed to be too different to come under the same set of rules, the prime example being credit agreements which are secured by a mortgage on immovable property or by another comparable surety commonly used in the Member States. In this case, the Directive cannot serve as a benchmark at all.

⁴⁹ Case C-361/89, Criminal proceedings against Patrice di Pinto, [1991] ECR I-1189, para. 15 et seq. For a more detailed analysis, see P. Rott, Minimum harmonisation for the completion of the internal market? – The example of Directive 1999/44/EC, *Common Market Law Review* 40 (2003), 1107, at 1115 f.; id., *Consumer Guarantees in the Future Consumer Credit Directive: Mandatory Ban on Consumer Protection?*, *European Review of Private Law* 2005, 383, at 399 ff.

⁵⁰ House of Lords, European Union Committee, *Consumer Credit in the European Union: Harmonisation and Consumer Protection*, July 2006, available at <http://www.parliament.the-stationery-office.com/pa/ld200506/ldselect/ldcom/210/210i.pdf>, at 18

⁵¹ See also M. Wolf, *Störungen des Binnenmarkts durch das Verbraucherkreditgesetz*, in: F. Kübler et al. (eds), *Festschrift für Theodor Heinsius (de Gruyter, Berlin & New York, 1991)*, 967, at 972 f

⁵² See also M. Wolf, *Störungen des Binnenmarkts durch das Verbraucherkreditgesetz*, in: F. Kübler et al. (eds), *Festschrift für Theodor Heinsius (de Gruyter, Berlin & New York, 1991)*, at 972 f.; and House of Lords, European Union Committee, *Consumer Credit in the European Union: Harmonisation and Consumer Protection*, July 2006, available at <http://www.parliament.the-stationery-office.com/pa/ld200506/ldselect/ldcom/210/210i.pdf>, at 18

Consumer credit contracts to which only some parts of the proposed Directive apply

In contrast to consumer credit contracts that are completely excluded from the scope of application of the Directive, some types of consumer credit contracts fall inside the scope of application but not all the provisions of the Directive apply to them, according to Article 2 (3) and (4).

Examples are overdraft facilities and credit agreements of below 300 Euros, where the Directive enumerates the provisions of the Directive that shall apply. With regard to the envisaged maximum harmonisation, this would seem to prevent Member States from applying the other instruments provided by the Directive to those consumer credit contracts.

Equally, Member States are certainly prohibited from deviating from Article 7 that excludes suppliers of goods or services acting as credit intermediaries in an ancillary capacity from the duties under Articles 5 and 6.

Moreover, Member States are prohibited from extending the right to withdrawal to those credit contracts mentioned in Article 13 (5) of the proposed Directive.

Non-regulated issues in consumer credit law

As mentioned above, the proposed Directive merely aims at harmonising “certain aspects” of consumer credit law, not at harmonising this field of law in its entirety. It has however never been specified what issues are not regulated by the Directive. The distinction is not always easy. Some provisions of the Directive may imply that alternative regulatory instruments are prohibited although this is not spelt out expressly.⁵³ Other issues are clearly outside the scope of the proposed Directive. This issue is of course not new: It has come up in other fields of EC law where maximum harmonisation instruments have been used, such as chemicals law. For example, Directive 67/548/EEC,⁵⁴ as amended, covers a very clearly defined field, namely the notification, classification, packaging and labelling of dangerous substances. As regards the use of such substances, the classification Directive merely requires that their packaging bear safety recommendations designed to inform the general public of the particular care that should be taken when handling the substance in question. However, it does not harmonise the conditions under which dangerous substances may be marketed or used.⁵⁵

A few examples shall illustrate relevant issues related to consumer credit law. Most of them are borrowed from the Commission’s Report on the Application of Directive 87/102/EEC of 11 May 1995.⁵⁶

(1) The most important example is probably usury (charging unreasonable or excessive interest) where the policies of the Member States differ greatly.⁵⁷ Clearly, the proposed Directive does not deal with usury. One may therefore conclude that this issue will remain in the competence of the Member States. In contrast, one could also argue that the information requirements enshrined in the proposed Directive guarantee transparency and therefore prevent abusive interest rates – so that the issue would be implicitly covered by information requirements. This would however be an extremely intransparent way of abolishing existing Member States usury laws, and it would go

⁵³ For a more detailed analysis of the distinction between issues within and without the scope of application of a Directive, see P. Rott, Minimum harmonisation for the completion of the internal market? – The example of Directive 1999/44/EC, Common Market Law Review 40 (2003), 1107, at 1115 f.; id., Consumer Guarantees in the Future Consumer Credit Directive: Mandatory Ban on Consumer Protection?, European Review of Private Law 2005, 383, at 399 ff

⁵⁴ Directive 67/548/EEC on the approximation of laws, regulations and administrative provisions relating to the classification, packaging and labelling of dangerous substances, O.J. 1967 196/1.

⁵⁵ ECJ, Case C-473/98 *Kemikalieinspektionen v. Toolex Alpha AB*, [2000] ECR I-5681, para. 29

⁵⁶ COM(95) 117 final

⁵⁷ COM(95) 117, no. 273 ff

against the Commission's statement that "only those elements explicitly dealt with in the text are fully harmonised".⁵⁸ Exclusion of usury legislation can therefore not be assumed to be intended by the Commission.

(2) The Directive does not regulate the consequences of late payment or failure to pay back the credit by the consumer, although this is a legally and economically important issue.⁵⁹ Member States have introduced instruments to prevent immediate termination of the contract or heavy increase of the credit amount.⁶⁰ For example, under German law the interest rate for compensation in the case of delayed repayment is limited to 5 %. The law also includes a rule that prevents that incoming payment by the consumer is primarily used to satisfy the creditor's claims for compensation for delayed repayment, and the right to termination in case of delay is also restricted.⁶¹ And finally, the laws of several Member States restrict the creditor's right to recover goods delivered under linked agreements in cases where the consumer is in delay.⁶² Under recent UK legislation, the court may reopen agreements on the basis of how the creditor has exercised or enforced his rights under the agreement if the behaviour gives rise to an "unfair relationship", a rule that has caused some uncertainty.⁶³ The proposed Directive does not affect this type of rules.

(3) Of course, the Directive does not regulate the procedural side of enforcing the repayment of credit either. In this respect, the new instruments of international civil procedural law⁶⁴ have certainly facilitated cross-border enforcement. Nevertheless, differences between the systems of the Member States have remained,⁶⁵ for example with a view to fast-track procedures.

(4) Consumer credit plays a significant role in consumer overindebtedness. The Member States have introduced various types of debt relief procedures that may impact on the position of the creditor who, in the worst case, may lose the claims against the consumer.⁶⁶ The relevant regimes that frequently form part of insolvency law are not affected by the Directive.

There are some other cases where the interpretation of the proposed Directive as to its scope is unclear because the issues concerned are at least partly dealt with. These include:

- Article 4 deals with the content of advertisements but not with other aspects such as advertisements directed at minors for which Member States have introduced specific rules.⁶⁷ These may come under Directive 2005/29/EC on unfair commercial practices. Article 5 of the said Directive allows for a distinction between the average and the vulnerable consumer (see above section 3.1). However, the subject is discussed controversially in literature.⁶⁸
- Specific marketing practices such as doorstep selling of consumer credit explicitly remain unregulated and therefore the Member States remain competent to prohibit such practices. By explicitly shifting the issue to a later amendment of the Doorstep Selling Directive

⁵⁸ COM(2005) 483 final, at 7

⁵⁹ COM(95) 117, no. 267. For criticism, see House of Lords, n 33 above, at 11

⁶⁰ COM(95) 117, no. 72

⁶¹ COM(95) 117, no. 244

⁶² For Belgian law, see already COM(95) 117, no. 242

⁶³ E. Lomnicka, Consumer Credit Bill, Yearbook of Consumer Law 2007, 395, at 398

⁶⁴ Brussels Convention of 27. September 1968, OJ C, 26.1.1998 (consolidated version), 1, and Brussels Regulation 44/2001 of 22 December 2000 on jurisdiction and the enforcement of judgments in civil and commercial matters, OJ L 12, 16.1.2002, 1

⁶⁵ COM(95) 117, no. 73

⁶⁶ COM(95) 117, no. 364 ff

⁶⁷ COM(95) 117, no. 166 ff

⁶⁸ G. Howells, H.-W. Micklitz & T. Wilhelmsson, European Fair Trading (Ashgate, Aldershot, 2006), Chapter 4 (e), at 83

85/577/EEC,⁶⁹ the EC legislators refrain from interfering with this latter Directive which allows such bans as stated in recital 7 of Directive 85/577/EEC.

- Another issue is the consequences of the withdrawal. Whilst Article 13 (4) of the proposed Directive deals with interests on the credit for the time until the right of withdrawal is exercised and also prohibits indemnities in connection with the withdrawal, it is silent on, for example, the question who has to pay for the costs of concluding the contract in the first place. The issue can best be illustrated by referring to German law on the consequences of the withdrawal of a distance selling contract. Article 6 (2) of the Distance Selling Directive 97/7/EC provides for a similar rule. According to this provision, the only charge that may be made to the consumer because of the exercise of his or her right of withdrawal is the direct cost of returning the goods. The German legislator has nevertheless introduced the consumer's liability for the loss or deterioration of the goods during the time the consumer is in possession of the goods, and also liability of their deterioration in value once they have been used and thereby turned into second-hand goods. The German legislator has argued that these types of liability were not "because of the exercise of his right to withdrawal", and therefore, they had not been regulated by Directive 97/7/EC. The same view could be taken with regard to Article 13 (4) of the proposed Consumer Credit Directive.
- It is also unclear whether a Member State could, for example, prohibit the creditor to ask for compulsory credit insurance. Under Article 5 (2) of the proposed Directive, the creditor has to inform the consumer about "the obligation to take out an ancillary service relating to the credit agreement, in particular an insurance, where the conclusion of a contract regarding this service is compulsory for obtaining the credit (...)". Does this imply that the proposed Directive implies that such practice has to be allowed?

3.2.3. Mutual recognition

The concept of mutual recognition is laid down in Article 21 (2) of the modified proposal: "When implementing and applying Article 5(1), (2) and (5), Article 13, Article 14(1) and (2), Articles 15, 17, 19 and 20, and without prejudice to necessary and proportionate measures which Member States may take on grounds of public policy, Member States shall not restrict the activities of creditors established in another Member State and operating within their territory in accordance with this Directive either through freedom of establishment or free provision of services."

The concept of mutual recognition reflects that the proposal gives leeway to national implementation, as discussed above. It is the Commission's aim to ensure that the degree of flexibility provided for national implementation within the limits of the Directive does not contribute to raise additional barriers to the single market in consumer credit.⁷⁰ The proposed Directive therefore shifts compliance security of the consumer to the creditor. If the creditor respects the rule of the own country, the creditor obtains some sort of a European passport for credit products.⁷¹

For the present study, two perspectives must be distinguished: the trader's perspective and the consumer's perspective. From the trader's perspective, the principle of mutual recognition is the optimum since it allows the trader only to take into account its own Member State's law. One caveat must be made: In the case of a conflict, it will be the courts of the Member State in which the consumer is domiciled that will apply the law of the trader's place of business. Thus, there remains a certain risk that these courts will apply the trader's law in a way that differs from the attitude of the courts in the trader's Member State.

⁶⁹ COM(2005) 483 final, no. 4.3.6

⁷⁰ COM(2005) 483 final, at 7 f

⁷¹ J. Stuyck & T. van Dyck, Consumer Credit Directive, Briefing Note, requested by the European Parliament's Committee on Internal Market and Consumer Protection, IP/A/IMCO/NT/2006-16, PE 373.567

From the consumer's perspective, the principle of mutual recognition means that the diligent consumer who is aware of this principle will have to research the different implementations of the proposed Directive in order to find out the differences.

Thus, the consumer will be burdened with the related transaction costs, which will be an impediment to creating consumer confidence. Advice will only be available from specialised lawyers. The consumer who is unaware of this principle will only find out about it once it is too late. This means that he or she may conclude a credit contract on the basis of false assumptions.⁷²

The European Commission has commissioned a comprehensive study of EU consumer law (called consumer compendium)⁷³ which is meant to inform on the implementation and application of consumer law directives in the Member States. However, the compendium, which in theory could serve as a guide at least for lawyers to get acquainted to other national laws, does not cover the Consumer Credit Directive.

3.2.4. Private international law

The analysis shows that the creditors and consumers have to deal with four sets of rules:

- (1) Those rules that are fully harmonised (with potential pitfalls as to their interpretation by national courts);
- (2) Those rules that are not harmonised but where the trader, under the principle of mutual recognition, can rely on the own Member State's law if this is more generous than the law of the Member State where the consumer is domiciled;
- (3) Those issues that remain in the competence of the Member States; and
- (4) Last but not least, those issues where the reach of maximum harmonisation is unclear.

The last category is problematic from both a creditor's and a consumer's perspective. With a view to the fully harmonised rules, it should not matter which of the (harmonised) laws of the Member States apply. This can be very different regarding issues that remain in the competence of the Member States. Therefore, it must be determined which law applies: the law of the creditor, or the law of the consumer. However, the relationship between the principle of mutual recognition and private international law is not clarified in the proposed Directive. The question remains – and has already been raised⁷⁴ – whether the home country control principle can be overruled by choice of law rules. Compliance control of the creditor taken seriously would imply that the law of the home country applies, independent of whether the parties have chosen the law of the host country or not. Such a far-reaching consequence of the principle of mutual recognition would have to be explicitly laid down in the proposed Directive. In so far choice of law rules remain applicable.

3.2.4.1. Current regime

Under the current regime of Article 5 of the Rome Convention on the Law Applicable to Contractual Obligations,⁷⁵ the choice of a law by the parties to the contract may not deprive a consumer of the

⁷² See also House of Lords, European Union Committee, Consumer Credit in the European Union: Harmonisation and Consumer Protection, July 2006, available at <http://www.parliament.the-stationery-office.com/pa/ld200506/ldselect/ldselect/210/210i.pdf>, at 48

⁷³ Available on the EC website, http://ec.europa.eu/consumers/cons_int/safe_shop/acquis/comp_analysis_en.pdf

⁷⁴ J. Stuyck & T. van Dyck, Consumer Credit Directive, Briefing Note, requested by the European Parliament's Committee on Internal Market and Consumer Protection, IP/A/IMCO/NT/2006-16, PE 373.567

⁷⁵ Consolidated version in O.J. 1998, C 27/34

protection of the mandatory provisions of the law of the country of the consumer's habitual residence, and in the absence of a choice of law, a consumer contract is governed by the law of the country of the consumer's habitual residence.

This clearly applies to linked transactions where the supply of goods or services is financed by the trader or by a third party. Thus, the so-called "passive" consumer who was in some way approached by the creditor in his or her home country may not lose the protection afforded by the mandatory consumer protection laws of his or her home country, and the consumer credit laws of the Member States are usually mandatory.

In contrast, isolated consumer credit contracts⁷⁶ do not come under Article 5 of the Rome Convention. In these cases, the creditor can introduce a choice of law clause. Thus, under the current regime of private international law, the creditor can rely exclusively on the law of the Member State of his place of business as far as isolated consumer credit is concerned.

3.2.4.2. The proposed Rome I Regulation

The Commission has also tabled a proposal for a Regulation on the law applicable to contractual obligations (Rome I)⁷⁷ and its modernisation that is meant to modernise the Rome Convention of 1980 and to harmonise and consolidate the rules on private international law within the EC. In its Article 5, the proposed Regulation opts for a strict application of the consumer home country principle in consumer contracts. The scope of application of Article 5 will be extended to isolated consumer credit contracts. Thus, as far as the "passive" consumer is concerned, the situation will change: The consumer will be protected by the consumer credit law of his own Member State. Only where the principle of mutual recognition of Article 21 (2) of the proposed Consumer Credit Directive applies, the trader may rely on his own law. Thus, the laws of the two Member States will both be applicable, each restricted to specific issues of consumer credit law.

⁷⁶ Isolated consumer credit contracts are consumer credit contracts that are not linked to the sale of a good or a service.

⁷⁷ COM(2005) 650 final of 15/12/2005

4. Economic analysis

4.1. Background

Nearly 20 years after the *Cecchini*-Report highlighted the “Costs of non-Europe”, a recent European Commission inquiry concludes that the retail-banking sector still remains largely fragmented along national lines and integration is far from complete. It is this background that makes the “harmonisation of consumer protection provisions in the area of retail financial services ... a key aspect of the Commission strategy for developing the retail financial services market”, as the exploratory memorandum of the modified proposal for a new Consumer Credit Directive (CCD) from 2005 states.⁷⁸ The analysis is structured according to the research questions and focuses on four main areas:

- Overview of the EU consumer credit market;
- Extent of and obstacles to consumer credit cross-border transactions;
- Effects of broader defined duties of creditors and rights of consumers;
- Effects of harmonisation and mutual recognition.

The analysis is based on methodological tools that are described in detail in section 2 of this report. It takes into account objectives of the modified proposal for a CCD, that are either explicitly listed in the exploratory memorandum or can be deduced from it:

- ⇒ Removal of barriers to competition, establishing the conditions for a genuine internal market;
- ⇒ Ensuring a high level of information and protection for consumers;
- ⇒ Improving consumer confidence and encouraging consumers to buy credit across borders in the EU through harmonisation of certain key elements of the credit agreement;
- ⇒ Improving the clarity of EC regulation.

The explanatory memorandum also refers to the Lisbon strategy that aims at increasing EU competitiveness by completing the internal market and intends at the same time to reduce the administrative burden for business. It is these stated objectives that are referred to during the analysis.

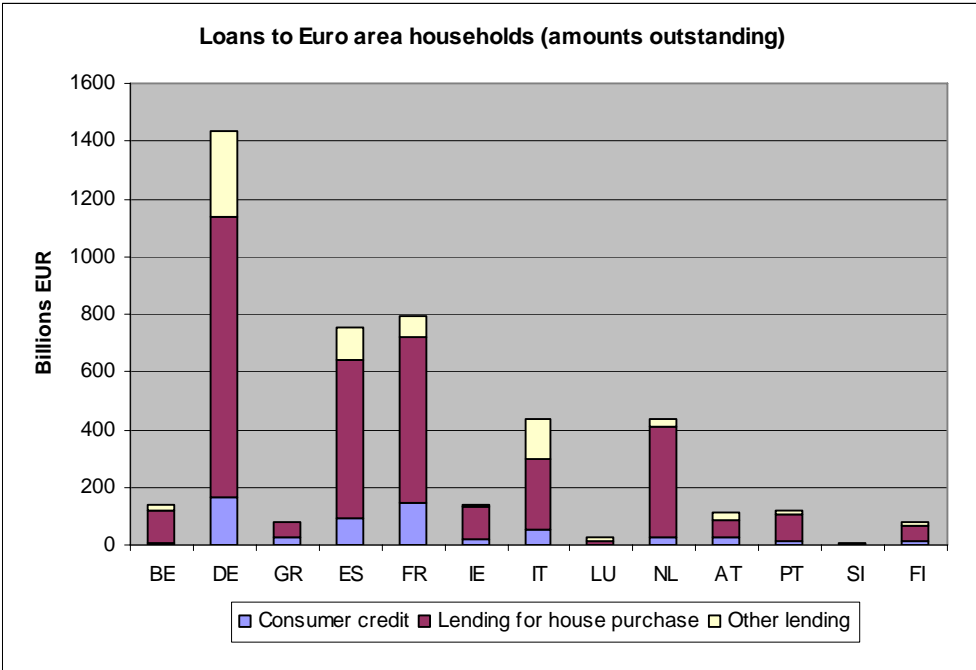
⁷⁸ COM(2005)483 final/2, p.2

4.2. Overview of the EU consumer credit market

According to European Commission estimates the retail banking sector generated gross income of between 250 to 275 billion Euro in 2004, equivalent to around 2 percent of EU GDP. Consumer loans generated nearly 18% of gross retail income in the EU 25, the third most important source of income from consumer products after mortgages (30%) and current accounts (28%).⁷⁹

The UK, Germany, and France have the largest consumer credit markets in the EU and within the Euro area there is considerable variation in the degree of lending (see Figure 1). Total outstanding loans to Euro area households was 4,553 billion Euro in January 2007; of which 588 billion Euro (13%) was specifically for consumer credit⁸⁰; Outstanding amounts for consumer credit in the UK in January 2007, which is not included in the Euro area figures, was 321 billion Euro⁸¹.

Figure 1: Loans to Euro area households (January 2007)



Source: Deutsche Bundesbank Statistics.

Most lending to households in the EU continues to take place within domestic markets due to a number of factors on both the supply and the demand side. Several countries with more highly integrated markets (e.g., the Benelux and Nordic countries) display significantly more cross-border activity (see Table 3).⁸²

⁷⁹ SEC(2007)106, European Commission, Report on the retail banking sector inquiry, January 2007, p. 13, 18, 21

⁸⁰ Deutsche Bundesbank. MFI balance sheets: outstanding amounts. Retrieved March 2, 2007 from: http://www.bundesbank.de/statistik/statistik_eszb_neuesfenster_tabelle.php?stat=outstanding_amounts&lang=en

⁸¹ Bank of England. Monetary & Financial Statistics. Volume 11, February 2007. Page 35. Converted to Euro at 1 GBP= 1.51 EUR (January 30, 2007). Seasonally adjusted

⁸² SEC (2007)106. p.13

Table 3: Total loans to non-monetary financial institutions (outstanding amounts) (2006 4.Q)

	Euro area	BE	DE	GR	ES	FR	IE	IT	LU	NL	AT	PT	FI
Total loans to non-MFIs (EUR billions)	10,823.9	388.5	3,053.2	167.3	1,602.1	1,894.6	404.3	1,423.6	159.5	1,019.1	349.5	230.8	131.4
Domestic transactions (%)	88.2	68.4	86.2	97.2	96.7	88.8	76.1	97.2	23.5	87.5	80.1	96.7	97.3
Business with other EU Member States (%)	6.7	22.1	7.1	0.8	2.4	4.8	15.8	2.2	52.1	6.3	11.0	2.2	2.1
Transactions with rest of world (%)	5.1	9.5	6.7	2.0	0.9	6.4	8.1	0.6	24.4	6.2	8.9	1.2	0.5

Source: Deutsche Bundesbank Statistics, Domestic and cross-border positions of MFIs (Monetary Financial Institutions) - outstanding amounts.

http://www.bundesbank.de/statistik/statistik_eszb_neuesfenster_tabelle.php?stat=domestic_cross_border&lang=.en

The table above indicates that the extent of cross-border lending to non-monetary financial institutions (non-MFIs) in other EU Member States differs significantly by country, varying in the Euro area from 0.8% of lending in Greece to 52.1% of lending in Luxembourg. In the Euro area at the end of 2006, monetary financial institutions conducted 6.7% of their lending activities to non-MFIs in other EU Member States, including lending to the commercial sector. This figure is up from 4.8% in 2000 indicating that there has been an increase of cross-border lending in the past 6 years (in both absolute and relative terms).⁸³

⁸³ However, due to the accession of the 10 new Member States in 2004 the composition of countries categorised under “rest of EU Member States” and “rest of world” changed.

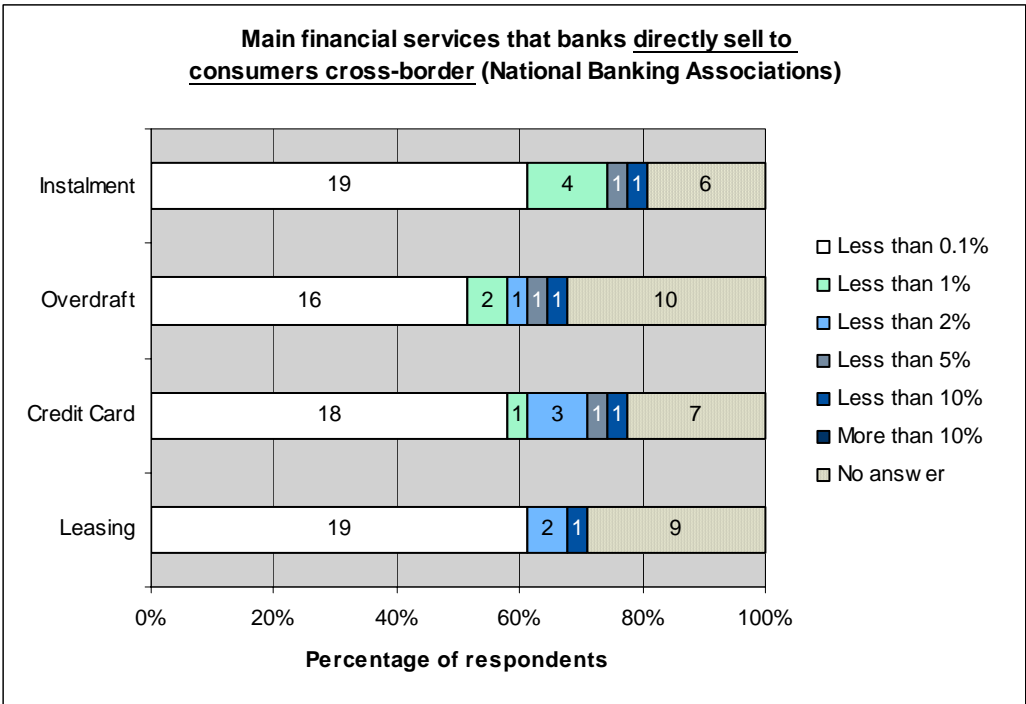
4.3. Extent of consumer credit cross-border transactions

To what extent is consumer credit extended across borders?

4.3.1. Consumer credit directly provided cross-border

Data on direct cross-border transactions⁸⁴ is scarce, although there is a general agreement that currently only a very limited number of direct cross-border transactions regarding financial services take place. The very low number of direct transactions is also illustrated by the results of the survey of national banking associations conducted for this study. A large majority responded that less than 0.1% of total consumer credit transactions of member banks consisted of direct transactions with consumers resident in another EU Member State (see graph below). Only one association from Austria reported that figure to be as high as 6%.⁸⁵

Figure 2: Consumer credit transactions conducted directly cross-border



Source: Survey of national banking associations

Nearly 70% of national banking associations do not anticipate the number of direct cross-border transactions with consumers to change in the next 5 years if no major legislative change were to happen.

⁸⁴ In this analysis the following terminology is used: “Direct cross-border transaction” refers to a transaction between a creditor and a consumer in two different EU Member States (i.e., the product is not sold through branches, subsidiaries, or majority holdings of a creditor in the country where the consumer is resident). “Creditors established in other MS” refers to creditors that sell consumer credit products across borders through branches, subsidiaries, or majority holdings in the Member State where the consumer is resident. The term “Selling of consumer credit products across borders” refers to both direct cross-border transactions and selling to consumers resident in other EU countries through local branches, subsidiaries, and majority holdings of creditors.

⁸⁵ Austrian Federation of Co-operatives response to questionnaire. The figure relates to consumer credit transactions with customers from abroad (6.1% in 2005 and 6.4% in 2006), mostly German customers. The Federation assumes that this is to be seen in the context of customers having a holiday home in Austria, but no further information on this was available.

However, there is some evidence that the number of direct transactions is growing and that consumers are increasingly considering this option, especially in some countries. For example, in Luxembourg as many as 19% of the respondents confirmed in a 2005 Eurobarometer survey that they opened a bank account in a firm located in another Member State and 8% obtained a credit card from a firm located elsewhere in the EU. In Belgium and Austria, 11% state that they opened a bank account in another Member State.⁸⁶

Reasons why demand for cross-border credit could grow in the future include ongoing EU legislative initiatives in the area of financial services, including the Consumer Credit Directive (CCD), the gradual emergence of a “customer segment with increasingly international preferences”⁸⁷ and the significant migration in the EU that also leads to consumers using financial services in both the country of origin and the country of residence. Also, a bank interviewed for this study reported that traders distributing point-of-sale credit in a handful of cases provided credit products of the bank to customers from a neighbouring EU country. For this a special permission of the bank management was required, as otherwise general policy was to not serve cross-border clients. This underlines that an increasing demand of consumers will only lead to a higher number of credit agreements directly concluded across borders if also the willingness of at least some creditors increases to sell credits in this way.

4.3.2. Consumer credit provided through branches / subsidiaries in other EU Member States

The most significant distribution channel for creditors to provide credit in other Member States is via branches and subsidiaries (including majority holdings in local banks). Although for the majority of associations that provided data the percentage of total consumer credit transactions conducted by member banks across borders through branches / subsidiaries is less than 1%, five banking associations⁸⁸ estimated this percentage to be more than 10% (in the case of instalment credits). One of these associations, the Consumer Credit Association of the United Kingdom estimated the percentage of members' business done through this way even as significantly higher than 10% and stated that a very large member of the association has over 1.5 million customers served through subsidiaries in other Member States.⁸⁹

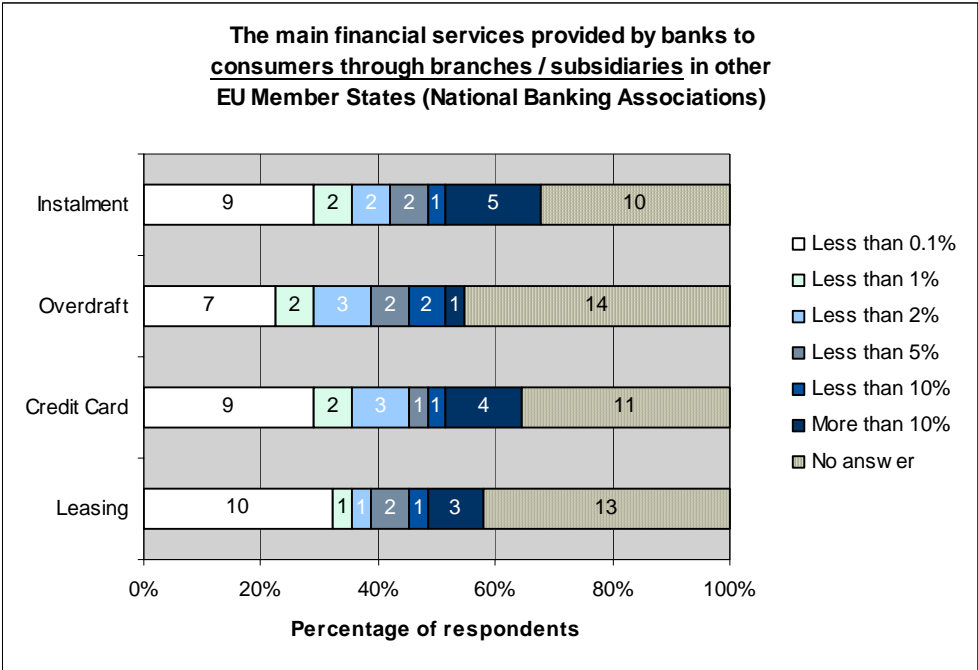
⁸⁶ Special Eurobarometer 230, 2005

⁸⁷ Deutsche Bank Research, EU retail banking – Drivers for the emergence of cross-border business, EU monitor 34, April 7, 2006

⁸⁸ From France (2 associations), Ireland, the UK and Spain

⁸⁹ Questionnaire Consumer Credit Association of the United Kingdom

Figure 3: Consumer credit transactions conducted cross-border through branches/subsidiaries



Source: Survey of national banking associations

Acquiring majority holdings in local banks is a common approach for creditors to enter markets in other Member States. Although some larger mergers involving European retail banks have taken place in past years, compared to other sectors the incidence of cross-border mergers and acquisitions in banking remains, according to the Commission, fairly low and there are very few players in retail banking that have a leading market share in two or more Member States, with foreign banks tending to have much stronger market positions in the new Member States than in the EU 15.⁹⁰ The extent of EU fragmentation within the retail banking sector is highlighted by the fact that the average share of foreign branches and subsidiaries accounts for only about 15% of the Euro area banking market⁹¹, though there are several banks which have been successful in establishing themselves in consumer credit markets in several MS.⁹² This indicates the existence of significant barriers for further integration of the financial retail market in large parts of the EU.

This leads to the following conclusion:

1. **The main distribution channel for selling of consumer credit products across borders is lenders establishing themselves in other Member States.** Consumer credit is currently rarely extended directly cross-border. There are indications, however, that there might be some increase of demand in this area in the future.

⁹⁰ SEC (2007)106, p. 17, 19

⁹¹ ECB, Speech by Lucas Papademos, Monetary stability and financial integration in Europe. May 9, 2005. Referenced from: <http://www.ecb.int/press/key/date/2005/html/sp050509.en.html>.

⁹² Including: GE Consumer Finance, Cetelem, Citigroup, Santander Consumer Finance, and Sofinco. Source: Mercer Oliver Wyman and European Credit Research Institute. Consumer Credit in Europe: riding the wave. November 2005. p. 7

4.4. Obstacles to selling consumer credit across borders

What are the barriers to establishment of a single market (including both cross border trade and lenders establishing themselves in other MS)?

To address this question it is necessary to first disentangle the economic impacts on retail financial markets of removing barriers to local establishment from those of removing the (much more extensive) barriers to direct cross-border provision. Local establishment, whether through acquisition of an existing market participant or through a *de novo* enterprise avoids the legal and institutional barriers that handicap or prevent direct cross-border provision. It is therefore unsurprising that the overwhelming proportion of cross-border provision of retail financial services is through local establishment (an observation documented by several previous research studies and confirmed by the surveys of national banking associations and individual banks reported above).

This situation is a cause for concern because the potential benefits of a single pan-European market in retail financial services cannot be realised through local establishment alone. In many cases of local establishment (for example the acquisition by Santander bank of the UK bank Abbey National) there is no impact on market structure and little indication of any economies of scale or scope i.e. the competition and efficiency benefits of a single market are absent and any gains of the merger lie entirely in the cost reductions achieved from the introduction of a more effective management.

As argued by Deutsche Bank Research⁹³: “Unlike domestic consolidation, where synergies can be reaped on the distribution side (closure of overlapping branch networks), the investment case for cross-border retail deals must be made on the production side: selling the same products to a broader market using a single platform for product development, transaction services, and product administration so as to achieve economies of scale.” In other words they argue that local establishment only has a significant impact on economic efficiency if the barriers to direct cross-border provision are removed, allowing a single product to be delivered across national markets.

Local establishment is only one of several distribution channels that can be used for delivery across national markets, and a channel which is likely to diminish in importance over time relative to telephone and the internet. Branches are not needed at all for the provision of some retail financial products and services, and it is in these cases – where competition from free-standing on-line and telephone based providers is effective – that the potential competitive benefits of a single market in retail financial services are greatest. The removal of barriers to direct cross-border provision would then result in a significant increase in the number of potential and actual market entrants and a likely sharp reduction in cost and prices.

This is not to say that local establishment, without direct cross border provision, does not have a role to play in the evolution towards a single market in retail financial services. The quoted Deutsche Bank Research report understates the benefits of improved management practice and consequent beneficial impact on local markets from cross border acquisition. As a result local establishment, even without removing the barriers to direct cross border provision, can still in many cases achieve some of the economic and efficiency benefits of a single market.⁹⁴ A period of local presence may also be necessary in order to acquire the cultural and institutional understanding for the development of the eventual successful delivery of a single product across different national markets.

⁹³ Deutsche Bank Research, EU retail banking – Drivers for the emergence of cross-border business, EU monitor 34, April 7, 2006, p. 5

⁹⁴ Evidence for such beneficial impacts from local establishment comes mostly from emerging markets, see for example the study of Powell et. al. (2005) of inward investment in local banking markets across Latin America.

It should also be recognised that in the case of consumer credit the current differences in legal and institutional arrangements between different Member States are particularly large, and there are also major cultural and linguistic barriers that inhibit customer acceptance of their direct cross-border provision, making it difficult to believe that an attempt at full harmonization can result in rapid growth of direct cross-border provision.⁹⁵

4.4.1. Demand side barriers

In spite of the significant increase of e-commerce in recent years, the main barriers that limit consumers from directly purchasing financial services from another Member State have stayed fairly constant, as is illustrated by Eurobarometer surveys and other research.⁹⁶

Demand side barriers are factors, which limit the willingness of consumers to take credit from banks based outside their own domestic market. The most serious such obstacles for cross-border financial transactions as perceived by the respondents to a recent Eurobarometer⁹⁷ are: *having to use another language* (31% of respondents), *lack of personal contact for distance purchases* (26%), *insufficient information* (25%) and the *risk of fraud* (23%). It is noteworthy that the *lower level of consumer protection in other EU countries* was with 11% of similar relevance for respondents as *excessive/incomprehensible information* and *extra costs related to purchasing financial services in other EU countries*. Another obstacle frequently referred to in relevant research, namely the insufficient knowledge of consumers about cross-border redress mechanisms/support, was also highlighted by the Eurobarometer survey. Only 2% of respondents have heard of FIN-NET, 11% of the European Consumer Centres. This general picture has been confirmed by the three focus groups with consumers conducted for this study in the UK, Germany and the Czech Republic. Compared to other forms of cross-border e-commerce, such as purchasing a book or software, taking out a consumer credit raised the greatest concern among participants in all countries in terms of both emotional issues and practical problems. The results of the focus groups are presented in more detail in Annex 1 and in the case studies in Annex 2.

4.4.2. Supply side barriers

Supply side barriers are factors, which limit the ability of banks to supply consumer credit outside their own domestic market. These barriers include the differences in consumer protection legislation addressed by the new CCD. But there are other important institutional barriers which lie outside the scope of the new CCD, including lack of integration of payments systems for collection of credit repayments; lack of harmonisation of credit databases; and the additional costs of marketing and documenting products to consumers with varying languages and cultures.

The importance of these different supply side barriers to financial service providers, considering the sale of consumer credit products across borders, are much less consistently documented, than the corresponding demand side barriers. One source of information is survey evidence such as that which has been conducted for this report.

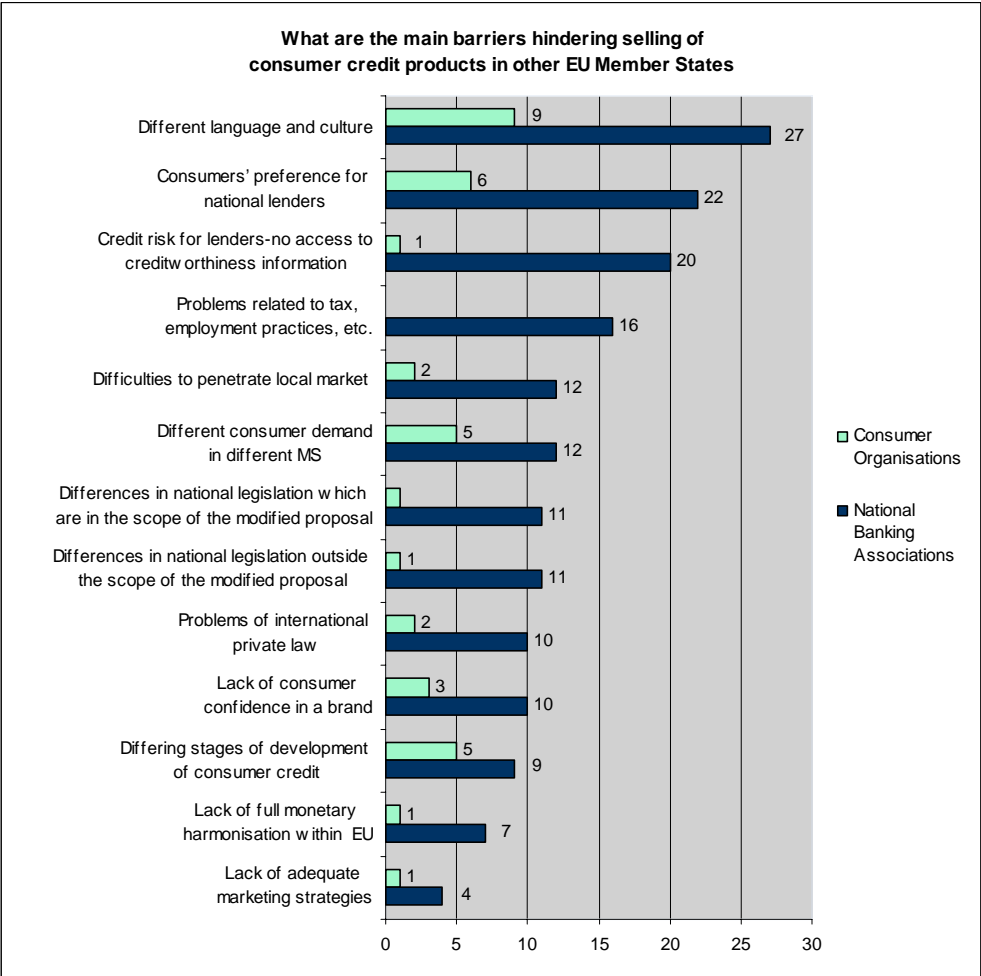
⁹⁵ For this reason a recent House of Lords report argues that full harmonization and mutual recognition should not be attempted for a period of some years, until such time as there has been an evolution towards broadly similar products and institutions for consumer credit across the various Member States. See House of Lords, European Union Committee, Consumer Credit in the European Union: Harmonisation and Consumer Protection, July 2006, available at <http://www.parliament.the-stationery-office.com/pa/ld200506/ldselect/ldecom/210/210i.pdf>, pp.34

⁹⁶ This is also true for cross-border e-commerce in general, see Civic Consulting, Consumer Confidence in the Digital Environment, Briefing note prepared for the European Parliament's Committee on Internal Market and Consumer Protection, IPOL/A/IMCO/2006-21, PE 382.173, p.13

⁹⁷ EB Special Report 252, Consumer protection in the internal market.

The two main barriers to directly selling to consumers cross-border perceived both by banking associations and consumer organisations responding to the survey are *different language and culture* and *consumers' preference for national lenders*. For national banking associations the third most important barrier was *credit risk for lenders - no access to creditworthiness information*. Legislative fragmentation was also seen as a barrier, but not as frequently as other barriers, both regarding differences in national legislation which are in the scope of the modified proposal and regarding differences in legislation outside the scope of the modified proposal (see graph below).

Figure 4: Main barriers for direct cross-border transactions related to consumer credit



Source: Survey of national banking associations and consumer organisations. Please note that the questionnaire for banking associations referred to *Barriers for member banks to directly sell to consumers cross-border*, whereas the questionnaire for consumer organizations referred to *Barriers hindering consumers from engaging in direct cross-border transactions related to consumer credit products with lenders in other EU Member States*.

Barriers perceived by banking associations to be relevant regarding establishing branches or subsidiaries in other Member States included *difficulties to penetrate local market* and *problems related to tax, employment practices, etc.* (see Annex 5). The significantly higher barriers perceived by creditors regarding direct cross-border transactions were also clearly expressed in written statements received from the associations.⁹⁸

⁹⁸ For example, one banking association emphasised that “from a commercial perspective, the most significant operational issues for any lender are a) recovering the sums due from the customer (this depends on the local debt recovery processes) and

A weakness of this survey evidence is that, to a large extent, the respondents' views are not based on actual experience of direct cross-border lending. The responses also appear to conflate, to some degree, the demand barriers, that limit consumer uptake of credit from banks from outside their own domestic market and the supply factors that restrict the creditor's ability to compete cross border. It is noteworthy however that, aside from cultural and linguistic factors, clearly the next most important factor is institutional (access to databases) rather than legislative fragmentation.

Whether these barriers can be addressed by appropriate supply side strategies, seems to be a matter of debate. Deutsche Bank Research states, for example, that “‘artificial’ hindrances [for designing pan-European retail products] are more important than so-called ‘natural’ barriers such as language, cultural preferences and the desire for (geographical) proximity, all of which opponents of retail market integration present as the natural reason for retail financial services being intrinsically domestic in nature. The shift towards alternative distribution channels clearly indicates that the importance of personal geographical proximity is steadily decreasing and that, hence, these factors are not ‘insurmountable natural obstacles’, but rather management challenges.”⁹⁹ However, none of the banks interviewed for this study expressed intentions for engaging in direct marketing of consumer credit products cross-border.

This leads to the following conclusion:

2. Both demand side and supply side barriers inhibit direct cross-border consumer credit transactions to a significant extent. These barriers do not prevent creditors establishing themselves in other Member States, but the competitive and efficiency benefits of such establishment are limited as long as supply side barriers prevent creditors from providing consumer credit products from a single platform across national barriers. Fragmentation of consumer protection law in the EU is a barrier, but not perceived as being the most important one. Creditor reluctance to directly sell across borders seems currently to be a significant barrier for an evolving cross-border market in consumer credit.

4.4.3. Degree to which the CCD addresses barriers identified

To what extent would the proposed Consumer Credit Directive overcome these barriers? What other measures might be needed to overcome them?

While both the Eurobarometer surveys and the focus groups reveal considerable consumer resistance to direct cross border purchase of consumer credit products, it is still possible that positive experience of cross-border consumer credit could in future erode these demand side barriers, much as experience has eroded the initial consumer resistance to the use of credit cards for internet purchases. Therefore it is arguable that the more fundamental barriers, at least for the increasing number of EU consumers with a pan-European orientation, are supply side rather than demand side. This is in line with the approach of the proposed CCD to directly address a number of these supply side barriers, associated with lack of regulatory harmonisation. The CCD can, however, do little to directly remove demand side barriers.

The proposed CCD will address existing legal fragmentation in some core areas of consumer credit. For example, elements that are covered by the maximum harmonisation approach include:

- Standard information in advertisement and pre-contractual information;

b) assessing customer risk. These two factors in turn translate into lender confidence. It is possible to achieve that confidence when ‘scale entry’ is involved [establishing oneself in another MS], since lenders can spend the sums needed to discover how local recovery processes work and how best to integrate with them. [...] Lenders can also build up a customer base of sufficient size to enable them properly to assess risk. In case of ‘cross-border’ credit, it is not possible to build up lender confidence in any economic way on either of these two key aspects.” (Consumer Credit Association of the UK)

⁹⁹ Deutsche Bank Research, EU retail banking, p.5

- Assessment of the consumer's creditworthiness, where appropriate, on the basis of a consultation of the relevant database;
- Right of withdrawal;
- Early repayment;
- Calculation of the annual percentage rate.

Most of these elements have formed part of many national consumer credit laws, however with differences, for example regarding the standard information to be provided, or the duration of the withdrawal period and the formalities to be observed. The proposed CCD therefore clearly addresses one of the barriers for extending consumer credit across borders. However, the proposed CCD also contains provisions that may create new difficulties for providers of cross-border credit (see section 3 above):

- The need to consult a relevant database, where appropriate, can lead to compatibility and language issues, as harmonisation of databases is not envisaged by the modified proposal. While the proposed CCD provides a legal basis for non-discriminatory database access, which is a crucial condition for an internal consumer credit market, Article 5 (1) of the proposed CCD could introduce at the same time a new impediment to cross-border credit contracts, as consultation of un-harmonised databases would be required;
- According to Article 5 (5) of the proposed Directive, Member States shall ensure that creditors and, where applicable, credit intermediaries provide adequate explanations to the consumer, in order to put the consumer in a position to assess whether the proposed credit agreement is adapted to his/her needs and financial situation. This may well have to happen in the language of the consumer if the consumer is not sufficiently capable to understand and speak the creditor's language. Therefore, the duty to assist may render cross-border lending more difficult than lending at national level, at least regarding non-automated communication.

The legislative analysis in section 3 has also indicated that important legal issues remain outside the scope of the proposed Directive and are currently not addressed by Community legislation. Independent from this the question remains if a fully integrated market in consumer credit including a direct cross-border market can be achieved solely by introducing new legislation. Financial markets, like the market in consumer credit, develop mainly because of economic opportunities. Therefore, establishing an integrated consumer credit market beyond each national market of a Member State is a result of creditors' expectations that mergers, acquisitions, new ventures or new distribution channels like the internet will lead to economic profits. A level playing field created by a new CCD is an essential economic trigger for cross-border selling of consumer credit products but, as indicated in the previous section, *legal barriers* are only one of the barriers on the way to a single market.

Other measures brought forward by banking associations and banks to address policy-induced barriers that are outside of the scope of the modified proposal include:

- Reducing legislative fragmentation in other areas relevant for consumer credit, including regarding relevant contract law provisions, debt recovery, debt relief procedures for consumers etc;
- Improving the legislative basis for cross-border electronic banking and integrating the market for retail payment services (the issue of cross border payment systems is addressed by the European banking industry with the SEPA project, the Single Euro Payments Area);
- Safeguarding cross-border access to credit registers to permit fraud, identity and credit risk checks or introducing a pan-European Credit Agency;
- Greater co-operation from anti-fraud agencies;
- Creating more favourable conditions for cross-border mergers and acquisitions in the retail banking sector;

Options for additional measures brought forward by consumer organisations include:

- Extending the scope of the modified proposal to include unfair terms in credit contracts, including usury, protection of consumers as guarantors (provisions that were partly already included in previous drafts, but deleted at a later stage);
- Improving data protection rules to ensure accuracy of data and rights of consumers if data is transferred cross-border;
- Ensuring that the language of the consumers is used - including the time after the signature of the contract.

Both consumer organisations and banking associations agree on significant deficits in consumers' financial literacy and financial competences, and therefore, stress the need of more consumer education regarding financial services.

The responses of both national banking and consumer associations suggest that there are significant institutional barriers to direct cross-border supply of consumer credit that remain unaddressed by the CCD. A good deal of further analysis, beyond what it has been possible to undertake for the present report, is required in order to determine how important these different institutional barriers are in restricting direct cross-border supply. But it is likely that two others – absence of fully integrated payments arrangements including in particular for direct debits and credit transfers *and* the lack of harmonisation of credit databases – make it especially costly to supply credit directly cross-border.

The fragmentation of retail payment systems is well known and already being addressed. In contrast, less public policy attention has been paid to the credit databases (public credit registers or private credit referencing agencies) that play a crucial supporting role in all consumer lending markets.¹⁰⁰ They are important for two distinct reasons. First they are an essential tool for risk reduction, protecting creditors from fraud and allowing them to better assess the default risk of individual borrowers (outstanding credit and past history of payment difficulties are both statistically significant risk factors). In addition these registers also discourage loan default because the threat of loss of credit standing is a key incentive for timely repayment. Second (as recognised in the new CCD) they are also an important tool for making sure that a lender is not overburdening a debtor, and is therefore conducting lending responsibly, again because they provide information on total credit exposure that would not be accessible without a shared or public register.

The payment barriers are already being addressed by the introduction of SEPA – the Single Euro Payments Area. Although pan-European direct-debit is now being delayed beyond the original SEPA deadline, it should still be in place by the end of the decade, and credit transfers even earlier. Thus payments difficulties should no longer inhibit cross-border provision of retail credit products. But progress has not yet begun on harmonisation of credit databases, or the alternative of creating a pan-European credit register. The new CCD requires that all lenders should be given access to existing credit databases, to enable them to carry out their requirement for responsible lending, but this does nothing to ensure that these databases are harmonised or that they provide a complete coverage of European consumers.

This is an issue, which goes well beyond the establishment of a single market in consumer credit alone. It seems unlikely that a single market will be established in any consumer credit products – mortgages, credit cards, or consumer credit – without the parallel development and harmonisation of credit databases across the EU or alternatively the creation of a single pan-European credit register. On the more positive side it may be noted that this also implies that the requirement in the proposed CCD, obliging creditors to access such databases in order to fulfil their obligation for responsible lending, is unnecessary.

¹⁰⁰ The wide range of different credit database arrangements in Europe, and their impact on consumer lending markets, is reviewed in Pagano and Japelli (1995), CEPR discussion paper

For reasons of risk-reduction, it can be expected that all creditors will voluntarily access such databases before approving a cross-border credit. Therefore this element of compulsion is unnecessary. The recent Commission inquiry on the retail-banking sector has also highlighted the importance of a non-discriminatory access to credit registers and concluded, “a future examination of credit registers may be warranted to assess their compatibility with an open and competitive European credit market”.¹⁰¹

Given the importance of these remaining institutional barriers, as well as the long list of further regulatory options favoured by the banking and consumer associations, it is clear that no single measure can be expected to overcome the current fragmentation of the EU consumer credit market. Instead measures in several areas will be required to create a truly integrated EU consumer credit market. Several of the measures suggested would create better opportunities for both types of selling consumer credit products across borders. However, judged on basis of the results of this study, it seems certain that the first step towards integration of the market will be driven by creditors establishing themselves in other Member States, rather than by the emergence of a large market for cross-border selling of credit products. This is also the view of national banking associations. 60% of banking associations that had an opinion on this issue expect the number of transactions with consumers through branches in other EU Member States to increase fairly or very significantly in the next 5 years, even if no major legislative change at EU level were to happen. In contrast, only 25% of national banking associations that had an opinion on this issue expect the number of direct cross-border transactions related to consumer credit products to increase fairly significantly in the next 5 years. Interestingly, this assessment was given for both a situation where no major legislative change at EU level would occur and for a situation where the modified proposal was adopted. In both cases the large majority of associations did not expect any change. Also a majority of consumer associations that expressed an opinion did not expect an increase in the number of direct cross-border transactions. Of course, crucial factors for the development of a direct EU cross-border market in the coming years will be to which degree the willingness of a significant number of consumers increases to engage in cross-border credit, and to which degree creditors will seriously test a direct cross-border marketing strategy. As has happened in other markets, even a few players can change the rules of the game once a critical threshold of demand is reached or created.

This leads to the following conclusion:

3. ***An integrated EU consumer credit market cannot be expected to be achieved solely with the modified proposal for a Consumer Credit Directive.*** A level playing field is a necessary condition for growing markets, but the multitude of barriers seems to require a bundle of measures, both legislative and non-legislative in nature. Because of the significance of differences in culture, language and consumer preferences, and the absence of harmonised credit databases accessible by all European credit institutions, a single market for consumer credit cannot be expected to be created by harmonisation of legislation alone, and this is a long-term rather than a short or medium term perspective. It seems certain that the first steps toward integration will be rather through creditors establishing themselves in other Members States than by the emergence of a large market for cross-border selling of credit products.

¹⁰¹ SEC(2007)106, European Commission, Report on the retail banking sector inquiry, January 2007, p. 38

4.5. Benefits of a single market in consumer credit

To what extent would consumers benefit from the creation of a single market in consumer credit?

The relationship between consumer credit markets and consumer welfare is complex. Unlike, for example, markets for manufactured goods there is the possibility that liberalisation and competition that prevails in a single market for consumer credit could have significant costs for consumers, costs stemming from either lack of consumer understanding or from irrational decision making and resulting problems of overindebtedness. This is not to say that market liberalisation will necessarily lead to such costs, but that ensuring consumers' benefit requires vigorous measures for consumer protection.

The efficiency of such consumer protection, under the proposed CCD, is addressed in the following section 4.6. The discussion provided here in section 4.5 will assume that effective consumer protection is in place, and considers then the benefits to consumers of a single market in consumer credit. Effective consumer protection, at a pan-European level, can itself also be expected to help overcome problems of customer trust in direct cross-border provision and hence directly enhance competition.

Financial intermediaries such as banks fulfil a range of economic functions, including the provision of payment services, the bridging of informational gaps through the processes of loan screening and subsequent monitoring of borrowers, and the diversification of credit market and other risks. In addition, and this is the most important economic function for consumer credit products such as overdraft and personal loans, they extend liquidity to allow both firms and households to cope with unanticipated shocks to income and cash flows.

Directly relevant from a consumer perspective is therefore that market integration should lead to cheaper and more varied credit products, allowing consumers to manage their short and medium term mis-match of income and expenditures flexibly and at low cost. Increased competition in consumer credit in national markets has dramatically reduced the cost and increased the availability of credit, in turn allowing households to reduce substantially their holdings of precautionary balances and correspondingly enjoy increased lifetime consumption.

The possibility to offer consumer credit throughout the Member States should result in improved efficiencies and economies of scale for lenders and, therefore, for customers deliver lower interest rates and greater credit availability of both the volume and variety of credit products. This increased product choice could be especially relevant for consumers in small countries who today are affected most from incomplete retail market integration.

Potentially, new demand for consumer credit could be satisfied from retail delivery via online facilities and the internet, where domestic institutions fail to satisfy demand at competitive prices. This stimulation of competition will be particularly large in those national markets where only a few players dominate and lead to lower interest rates for credit products. One piece of evidence suggesting that these markets are not yet fully competitive is empirical research indicating that banks tend to adjust credit rates faster in times of increasing market rates than in times of falling rates. Further progress in retail market integration would benefit private borrowers in periods of falling market rates through a faster fall in retail credit rates. If private households had access to credit everywhere in the EU, banks adjusting rates more slowly would immediately be punished by a loss in market share as consumers could take credits from banks adjusting rates more quickly in other EU countries.¹⁰²

¹⁰² ZEW/IEP, The Benefits of a Working European Retail Market for Financial Services - Report to the European Financial Services Round Table, 2002, p. 12, 35

Economic modelling of the impacts of an integration of financial markets has consistently indicated significant benefits. Already the 1988 *Cecchini-Report* expected the potential benefit of the liberalisation of financial services as 1.5% of the GDP.¹⁰³

A 2002 study on the impact of European financial market integration assesses that EU-wide real GDP is raised by 1.1% in the long run, private consumption up by 0.8% and total employment by 0.5%.¹⁰⁴ Also the integration of the retail sector for financial services is expected to be associated with higher economic growth and a growing international role of the Euro because the efficiency of a currency's financial markets is among the determinants of its global acceptance.¹⁰⁵

Although from an economic point of view integration of the consumer credit market therefore has considerable potential benefits for both consumers and lenders, stakeholders are rather pessimistic whether these benefits can be expected in practice through the modified proposal for a CCD. This is indicated by the following results of the survey:

- A large majority of national banking associations does not expect an increase of consumer confidence as consequence of the proposed CCD, neither regarding consumer credit agreements concluded nationally nor cross-border. A majority of national consumer organisations responding to the survey even have a negative view in this respect. This result, however, has to be interpreted with care as only a limited number of consumer organisations responded and most of them are operating in highly developed national consumer credit frameworks such as the UK (see section 2);
- A majority of banking associations and consumer organisation also does not expect an increase in the overall demand for consumer credit products with the modified proposal for a CCD;
- Close to all national banking associations expect the range / variety of credit products to either remain similar or to decrease with the implementation of the proposal. A similar assessment was provided regarding the availability of credit products;
- A large majority of banking associations answering to the survey do not expect the modified proposal to have impact on competition, either nationally or EU-wide. It is noteworthy, however, that a slight majority of individual banks that responded to the survey (a non-representative sample, partly large banks operating in many Member States) expected a fairly significantly increase in competition in the consumer credit market cross-border EU-wide. A majority of consumer organisations that had an opinion expected a fairly significant increase in competition on national markets, and had no opinion on the development EU-wide.

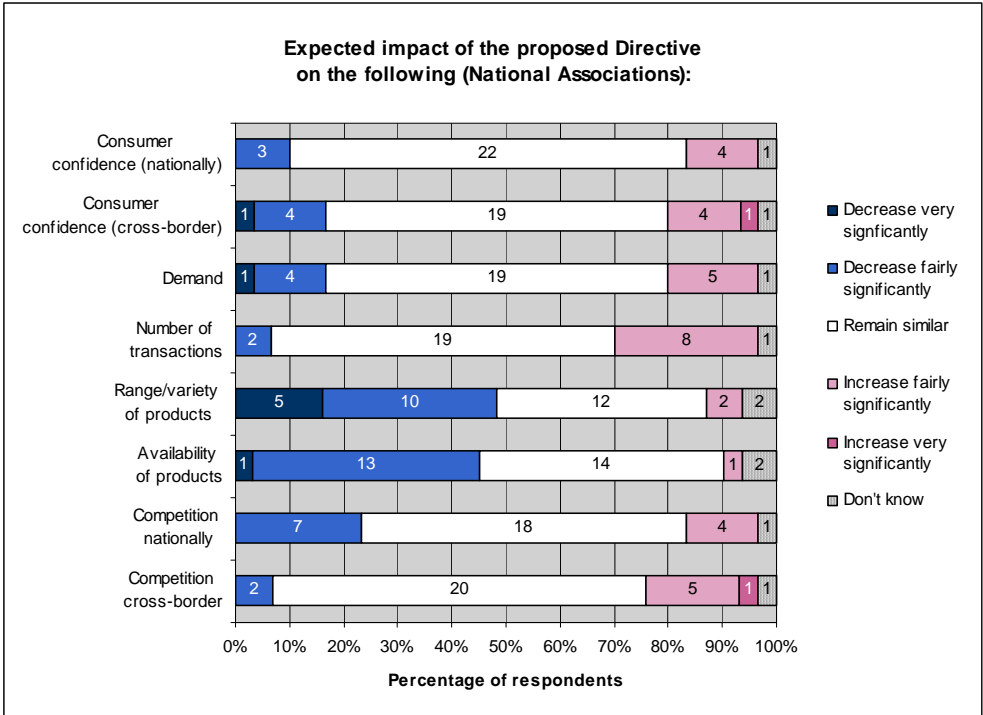
The results of the survey of *national banking associations* regarding the overall impact of the proposed CCD are presented in more detail in the graph below.

¹⁰³ Quoted from ZEW/IEP, *The Benefits of a Working European Retail Market for Financial Services*, 2002

¹⁰⁴ London Economics, *Quantification of the Macro-Economic Impact of integration of the EU Financial Markets*, November 2002, p. v

¹⁰⁵ See London Economics, *The Costs and Benefits of Integration of the EU Mortgage Markets*, August 2005; ZEW/IEP, *The Benefits of a Working European Retail Market for Financial Services - Report to the European Financial Services Round Table*, 2002, p. 12, 35

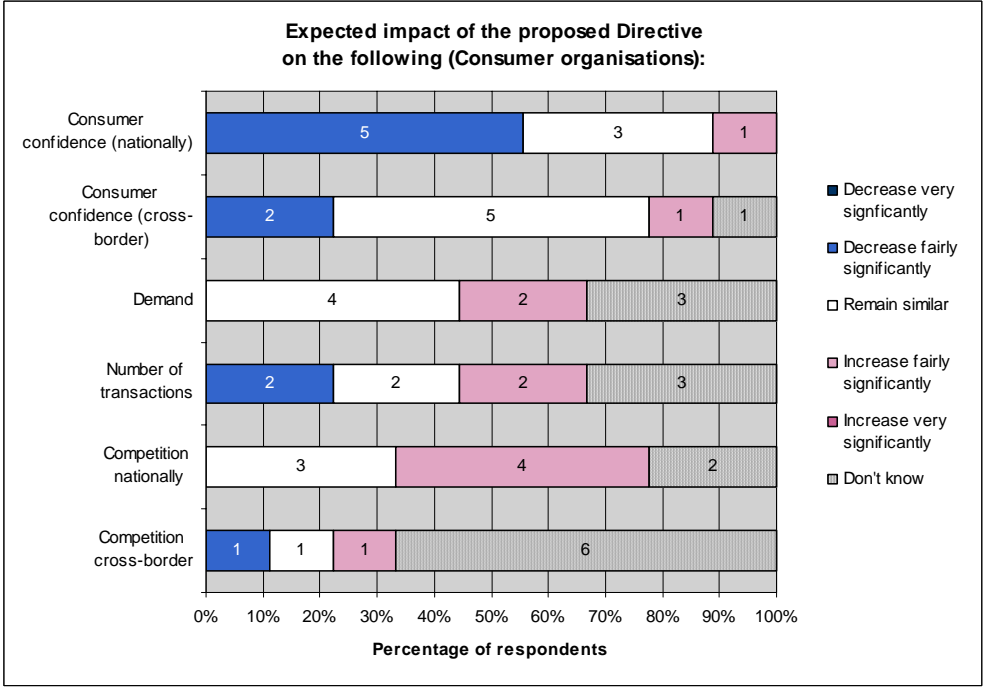
Figure 5: Overall impacts of the proposed CCD expected by national banking associations



Source: Survey of national banking associations

The results of the survey of *consumer organisations* regarding the overall impact of the proposed CCD are presented in more detail in the graph below.

Figure 6: Overall impacts of the proposed CCD expected by consumer organisations



Source: Survey of consumer organisations

Independent from the effects of the implementation of the modified proposal, banking associations were asked whether in principle they would expect cost reductions and economies of scale from selling consumer credit products in other EU Member States or not. Banking associations that answered are split regarding the question: 43% expected cost reductions and economies of scale, 46% did not (11% don't know). The National Association of German Cooperative Banks, for example, explained the negative answer to the question as follows: "If it were possible to acquire new customers for already existing/marketed products, costs would most likely decrease. However, due to the varying preferences in consumer demand in the different EU member countries, the costs would most likely increase rather than decrease, because different products would have to be offered in the individual member countries."¹⁰⁶ On the other hand, the Czech Banking Association, one of the associations that had provided a positive answer, did expect some savings, but qualified them as "not dramatic".¹⁰⁷ This highlights that economies of scale can only be realised if little extra costs and investments are involved, as another association put it: "This [...] is only possible when the contracts and methods used in one country can be used unaltered in an other country. This is presently not the case even not when the language of the countries concerned is the same."¹⁰⁸ And an individual bank that is providing consumer credit in more than ten European countries explained: "Marketing, distribution, account management and collection require personalization to take into account local languages, cultures and regulations in such a degree that economies of scale on these function do not exist among EU Member States; they do exist however in each single market. Funding, accounting, data processing (hardware only) can be and are consolidated for cost reduction."

These comments illustrate that economies of scale can only be expected if pan-European products can be developed and the legal framework allows for a high degree of standardisation of contracts and processes, and even then potentials for cost reductions may be limited from a creditors' point of view.

This leads to the following conclusion:

4. A fully integrated internal market for consumer credit can in principle be expected to lead to economic growth, more varied credit products, lower interest rates for consumers and increased market efficiency. However, the supply side of the market does not expect increased demand and therefore economic growth from the modified proposal for a Consumer Credit Directive. Also, cost reductions and economies of scale from selling consumer credit products in other EU Member States may be limited from a creditors' point of view, reducing the incentives for creditors to cross borders even with reduced legal fragmentation.

¹⁰⁶ Questionnaire Bundesverband der Deutschen Volksbanken und Raiffeisenbanken e.V.

¹⁰⁷ Questionnaire Czech Banking Association

¹⁰⁸ Questionnaire Netherlands Bankers' Association

4.6. Efficiency of consumer protection rules (duties of creditors and rights of consumers)

To what extent would the duties of creditors (information, consultation, responsible lending) and the rights of the consumer (right of withdrawal, right of early repayment), which are more broadly defined than in the existing directive, lead to more efficient consumer protection? Would it increase the cost of the credit at the consumer's expense and would it make consumer's access to cost-effective credit more difficult? Are there other micro-economic effects which can be anticipated?

Addressing the question of whether consumer protection rules foreseen in the proposed CCD are efficient responses involves two separate issues. The first is the extent to which they increase creditor costs. An increase in costs, without any offsetting benefit would raise the interest rates charged on credit, and limit competition. The measures can however be efficient if they achieve a given higher standard of consumer protection at minimum cost to creditors. Finally, and separately, there is the question of whether the level of protection represents the best trade-off between effective competition and low pricing, on the one hand, and adequate customer protection on the other.

In order to address these questions, the first part of this section discusses the rationale for protection of retail credit customers and also examines the ways in which increased levels of consumer protection can add to the costs of credit provision. The following subsections then address the impact of specific provisions of the proposed CCD, for both duties of the creditor and rights of the customer.

There are several reasons why specific rules and regulations are needed to protect customers taking out consumer credit contracts. In part this is because, in common with most other retail financial services, consumer credits are *credence goods*. This means that a consumer is unable to evaluate the whole quality and the entire risk of a contract before and even after he or she signs the contract. This leads to a distortion of the “normal” market efficiency, where prices fully reveal information, quality and risk. As a consumer cannot easily derive information about quality and risk of a financial service, a consumer may buy products at a higher price than if he or she had better knowledge.¹⁰⁹ Ideally, prices should be set in an environment in which all economic actors have the same information. A high level of information and protection for consumers reduces these problems and therefore increases economic benefits to consumers. These information asymmetries are a crucial problem for consumer protection and an efficient market, which can be addressed by various means including imposing information obligations of suppliers.

There are further welfare problems with consumer credit products associated not with information asymmetries but with social or economic constraints or simply with a failure of rational decision making. Consumers living in poverty may resort to credit in order to pay for necessities such as food or rent; without any realistic prospect of being able to repay these debts. Other consumers may fail to make a rational assessment of the consequences of taking on high levels of debt in relation to their income. In all these cases the resulting credit problems can result in great hardship, hardship that might be avoided by a more accurate assessment of their ability to repay credit. At the same time it must be recognised that restrictions on credit also impose substantial welfare costs on the poorest consumers who thereby forfeit the opportunity to manage unexpected demands on their limited resources, and who if they are unable to obtain credit from financial institutions may turn to informal and unregulated lenders offering funds at penal rates of interest with little regard of their ability to repay.

¹⁰⁹ Of course, other information asymmetries also affect creditors, which have to assess the ability of a customer to repay a credit. Lack of information about borrowers, or of effective mechanisms to ensure repayment, leads to substantial increases in interest rates and decline or even collapse of loan volumes. Lenders respond to these information problems in various ways, from the requirement for security to the creation of private credit bureaux and public credit registers, in order to share information amongst creditors.

While a high level of consumer protection is a necessary requirement for the development of a single market in consumer credit, it should be realised that domestic consumer credit markets have over several years developed their own increasingly sophisticated responses to these problems of asymmetric information and excessive indebtedness. Rules and regulations have evolved over time in different countries as credit markets have become more competitive and credit has been extended to less secure credit risks. The question therefore arises whether the level of protection achieved through full harmonisation may be somewhat from the level appropriate for the situation of an individual national market, either too protective and thus discouraging development of the market or on the other hand offering insufficient protection to the most vulnerable consumers.

4.6.1. The value chain in credit provision

The case studies provided in Annex 2 of this report present expected effects of the proposed CCD on the value chain in credit business. The value chain consists of three typical parts:

- The pre-contractual process at the front-office with the following sub-processes:
 - Customer acquisition (steps include: planning and acquisition of customers, advertising)
 - Information and consultation of customers (steps include: providing pre-contractual information on, e.g., borrowing rate, duration, instalments, fees, etc.)
 - Credit risk analysis (steps include: creditworthiness check)
 - Risk-adjusted pricing (steps include: underwriting procedure, pricing of loan)
- The process during the term of credit agreement at the front and the back-office with the following sub-processes:
 - Contract documentation (steps include: credit filing and archiving)
 - Information and consultation of customers (including customer contacts during term of contract)
 - Monitoring / risk updates (steps include: trigger servicing, monitoring and controlling risk factors throughout duration of contract)
 - Managing withdrawals / repayments (steps include: collect timely payment of interest and principal from borrowers, processing withdrawals and repayments, calculating indemnities)
- The bad-debt collection process with the following sub-processes:
 - Information and consultation of customers (including customer contact in case of default, payment delay, etc.)
 - Bad-debt collection tasks (steps include: loan refinancing and modification processes)
 - Portfolio readjustment (steps include: managing credit risk across loan portfolio)

The focus of case studies in three countries (UK, Germany, Czech Republic¹¹⁰) was to analyse the value chain in detail for two specific credit products and to determine the effects of consumer protection provisions of the CCD on the operational costs of creditors, as identified by the banks providing cost data. The operational costs, however, only partly determine the price of the credit for the consumer. Other elements that are relevant include:

- ❖ Costs of capital;

¹¹⁰ Also a bank from Poland provided data that was included in the analysis.

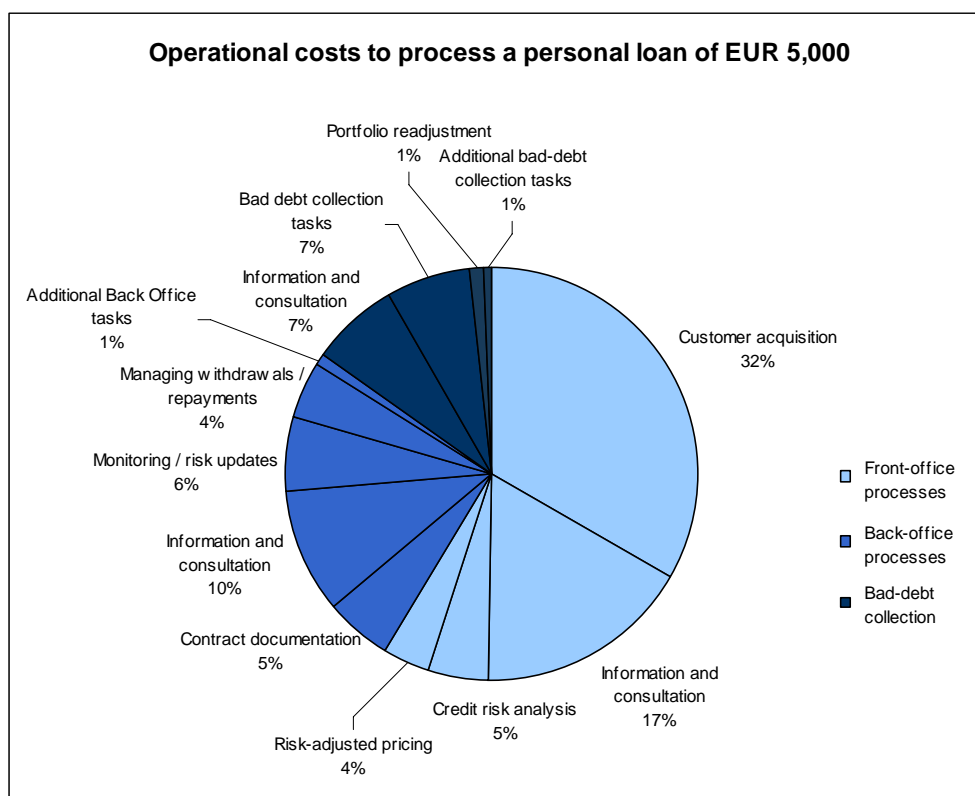
- ❖ Risk premium for the expected loss (standardised risk costs);
- ❖ Profit margin;
- ❖ Costs of distribution through credit intermediaries (e.g. fees for retailers providing POS credit products).

The relevance of the operational costs compared to the other costs elements listed depends on various factors, including on the credit size, type of product, distribution model, competitive pressure etc. This strongly limits the possibility to assess the overall impact of specific CCD provisions on the price of credit for consumers.

The case studies analysed the value chain of two typical consumer credit products: (1) a personal loan of € 5,000; and (2) an overdraft credit of € 1,000. Although the case studies indicated significant differences between individual banks, the overall picture concerning the importance of the different cost elements was remarkably similar.

The main cost elements regarding a bank's typical internal operating costs (including all direct running costs, but excluding profit margin and costs of capital) for processing, approving, and monitoring a personal loan for € 5,000 (unsecured) payable over two-years throughout the duration of its term are provided in the following graph:

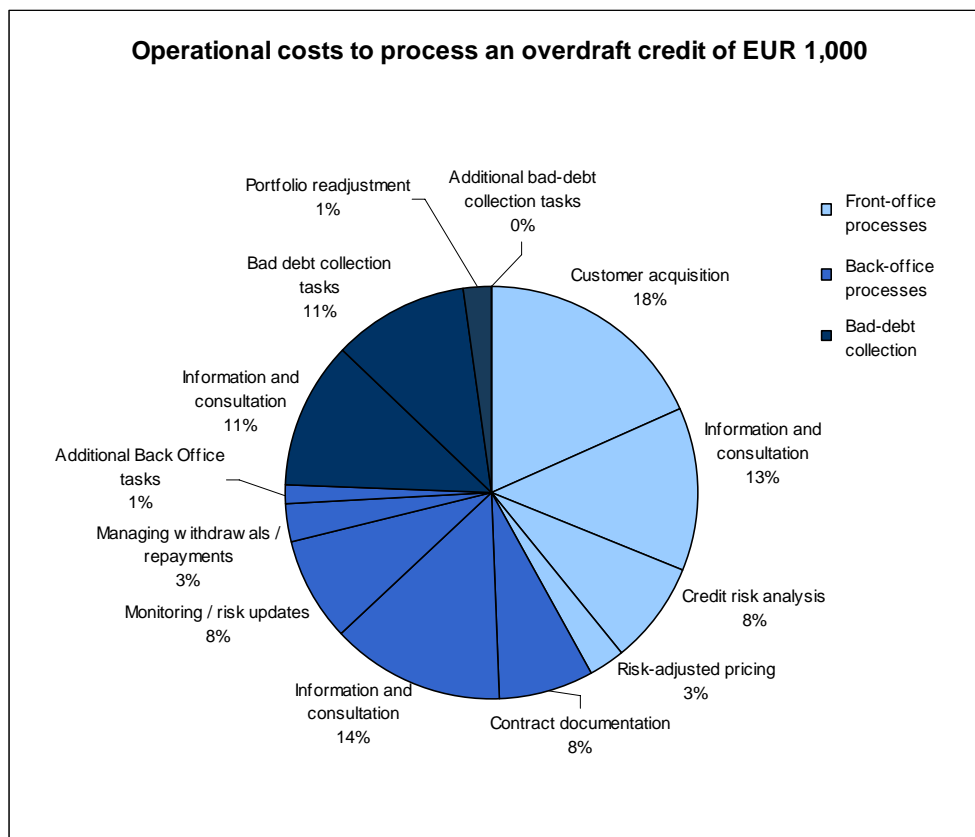
Figure 7: Current operational costs of a personal loan of € 5,000 (average)



Source: Bank data on value chain

The main elements of a bank's typical internal operating costs (including all direct running costs, but excluding profit margin and costs of capital) for processing, approving, and monitoring an overdraft facility / credit of € 1,000 (unsecured) throughout the duration of its term are provided in the following graph:

Figure 8: Current operational costs of an overdraft credit of € 1,000 (average)



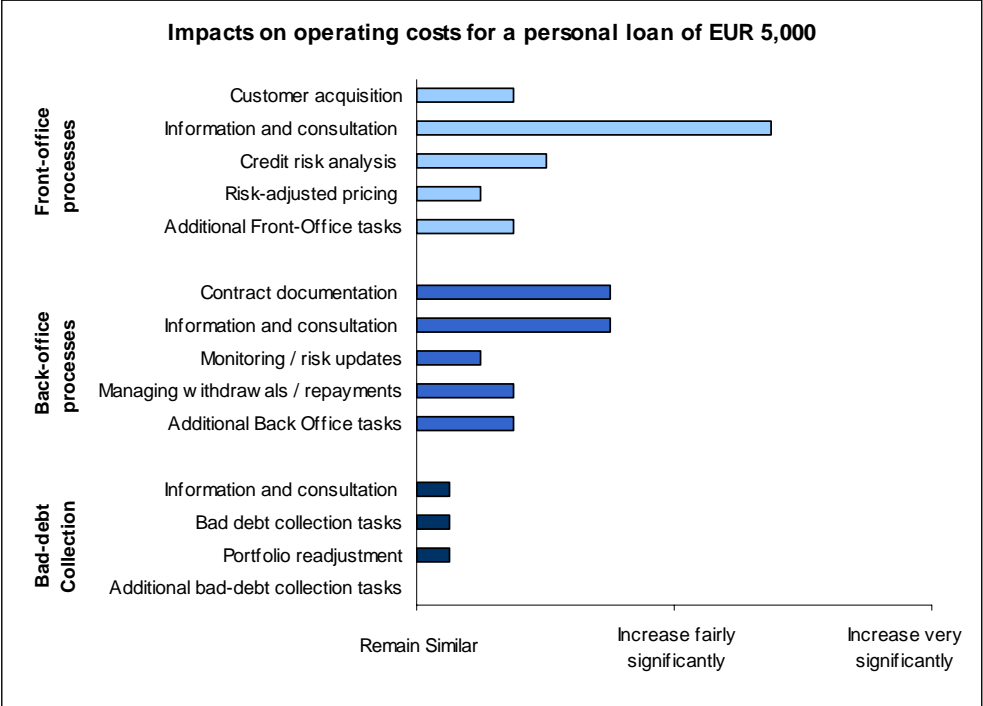
Source: Bank data on value chain

The graphs indicate the different cost structure of the two products. Overdrafts are considered a “lean” product requiring very little marketing and administrative effort. For a similar amount of credit, an overdraft credit therefore involves significantly less operational costs compared to a personal loan. The above value chain analysis indicates the importance of customer acquisition and information/consultation as cost factor in consumer credit. Main conclusions of the case studies are that harmonisation of consumer credit provisions through the proposed CCD will come with some costs to industry. Main factors that are seen as cost-relevant are:

- One-time implementation costs
 - Changing procedures and IT systems (e.g. pre-contractual information)
 - Training (e.g. concerning “duty to assist”)
 - Transitional processes regarding existing open-end contracts (e.g. overdrafts, where applicable)
- Operational costs
 - Introducing processes that are human resource intensive (“duty to assist”)
 - Need to document information (e.g. responsible lending)
 - Increased risk of litigation

The combined assessments of the banks that provided detailed data regarding their cost structure and the expected impact of the proposed CCD are presented in the following graphs:

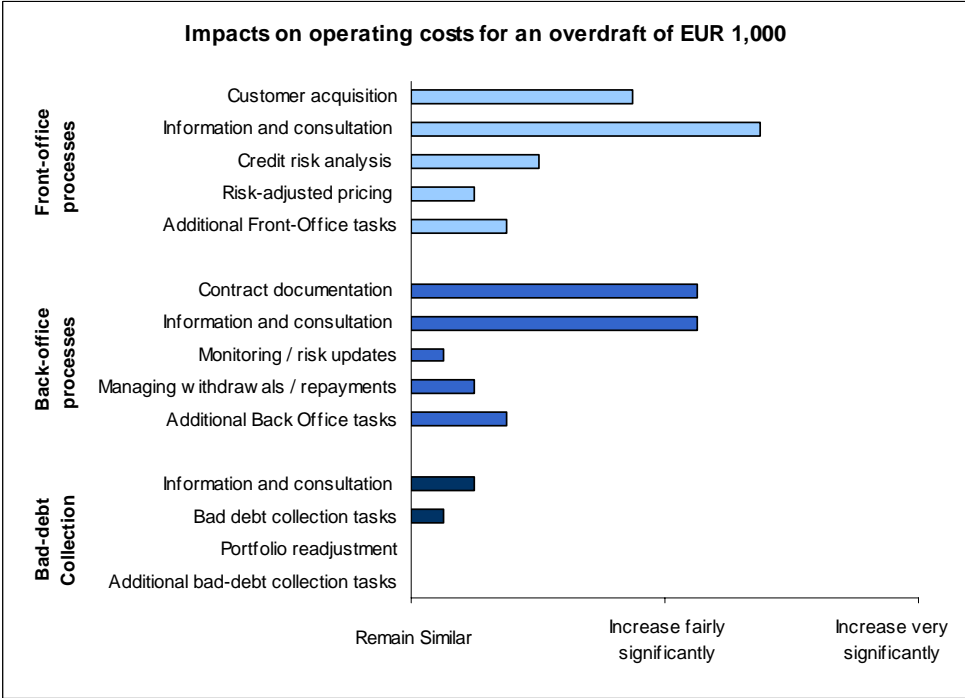
Figure 9: Impacts of proposed CCD on operational costs (personal loan of € 5,000, average)



Source: Bank assessment

The graphs illustrate that the most significant impact is expected on front-office and back-office processes. Bad debt collection processes are in most cases not expected to be affected.

Figure 10: Impacts of proposed CCD on operational costs (overdraft of € 1,000, average)



Source: Bank assessment

The major difference between the two credit products seems to be that the changes affecting operational costs of overdraft credits are assessed as more significant (especially regarding back-office processes), as several processes have to be introduced that are currently not relevant.

The following analysis focuses on provisions that have been identified as being especially relevant in terms of possible economic effects. These are:

- Advertising and pre-contractual information obligations;
- Responsible lending and duty to assist;
- Right of withdrawal;
- Right of early repayment.

4.6.2. Advertising and pre-contractual information obligations

Summary of legislative changes

Directive 87/102/EEC is fairly limited concerning advertising and pre-contractual information. The proposed CCD allows in Article 4 credit *advertisements* that indicate no interest rate or other figures relating to the cost of the credit. If however, an interest rate or such figures are indicated, “standard information” must be supplied. This relates to (a) the total amount of credit, (b) the annual percentage rate, (c) the duration of the agreement, (d) the amount, number and frequency of payments to be made and (e) any kind of fees in connection with the credit agreement in conformity with the terms thereof and which are known to the creditor. The representative example will be mandatory. Compulsory ancillary service, in particular insurance, must be mentioned in advertisements even if their costs cannot be determined in advance. In Article 5 (2) (a) – (m), the proposed Directive goes far beyond the *pre-contractual information requirements* of Directive 87/102/EEC in setting up an extensive catalogue of information to be supplied. At the same time it prohibits other information obligations to be introduced or maintained by Member States (for more details, see section 3.1).

Effects on creditors

The advertising and pre-contractual information obligations are clearly seen by creditors as having major adverse impact on their operations. A large majority of 77% of national banking associations estimated that acquiring customers can be expected to be fairly or significantly more difficult because of the requirements for standard information for advertising and pre-contractual information. Even more (93%) of the associations expected for this reason front-office costs to increase fairly or very significantly.

Banking associations and banks listed in their statements the expected effects of the proposed CCD on creditors regarding advertising activities:

- Additional administrative burden;
- Mandatory information excessive and inappropriately restricts the advertising representation of loan agreement products in practice;
- Would hinder banks in advertising; in particular regarding radio and television commercials.¹¹¹

¹¹¹ Related problems are illustrated by a banking association, pointing out that “... so much information would eventually:

1. Overload the consumer with too many details for the purpose of an advertisement, which is used to invite consumers to get in contact with the lender in order to “find out more”;
2. Be misleading for consumers who have not yet expressed any intention to enter into negotiations with the lender, i.e. at the moment they watch/read/listen to an advertisement, they have not yet engaged in any pre-contractual phase;

Statements by banking associations on the effects of pre-contractual information (other than duty to assist/responsible lending, see section 4.6.3) include, for example, that:

- Some of the information required in Article 5(2) has little to do with practice and would be almost impossible to implement.

This view was however, not universally shared. The Netherlands Bankers' Association stated that “in the Netherlands a high level of consumer protection regarding consumer credit is realised by a law that was only recently adopted. Generally speaking the draft Directive does not have dramatic consequences for the banking practice regarding consumer credit. This is true for advertising, pre-contractual assessment, annual percentage rate, responsible lending and the right to early repayment.” A similar view regarding pre-contractual information was given by the Associazione Bancaria Italiana.¹¹² This highlights the significant differences in the legal framework of different Member States that determine the degree to which the proposed CCD would require changes to operators’ practices.

Cost elements mentioned by banking associations that could be affected by the changes include changes in marketing practices, IT-systems, costs of preparing new rule books, forms and information sheets, and training. An individual bank from the UK stated that “Reform of credit advertising in the UK in 2004 resulted in very large costs and application of significant resources to implement in marketing strategies. The changes proposed would have a similar cost for no discernible benefit for the consumer”.

In several interviews the issue was raised how the wording of Article 5(2) would be interpreted when transposing the Directive. According to the modified proposal the creditor has to provide pre-contractual information “in good time” before the consumer is bound by a credit agreements. Several banks expressed concerns that this could be interpreted as prohibiting the provision of pre-contractual information and signature of the contract at one sales conversation, which would require the customer e.g. in branch banking (face-to-face) to come a second time. This would be, according to the banks, both inconvenient for the customer and costly for the banks.

Effects on consumer protection

Member States’ legislation is currently widely diverging both regarding credit advertisements and pre-contractual information requirements. Consumers in Member States that currently have less information requirements in their national legislation therefore have less easy access to information compared to consumers in countries with detailed requirements in this respect. The proposed CCD will address this imbalance and allow consumers to do a better-informed choice. A crucial question in this respect is, however, if the information to be provided in the different pre-contractual phases is understandable for consumers and likely to be taken up. Creditors for their part have significant doubts in this respect. Statements received from banking associations include:

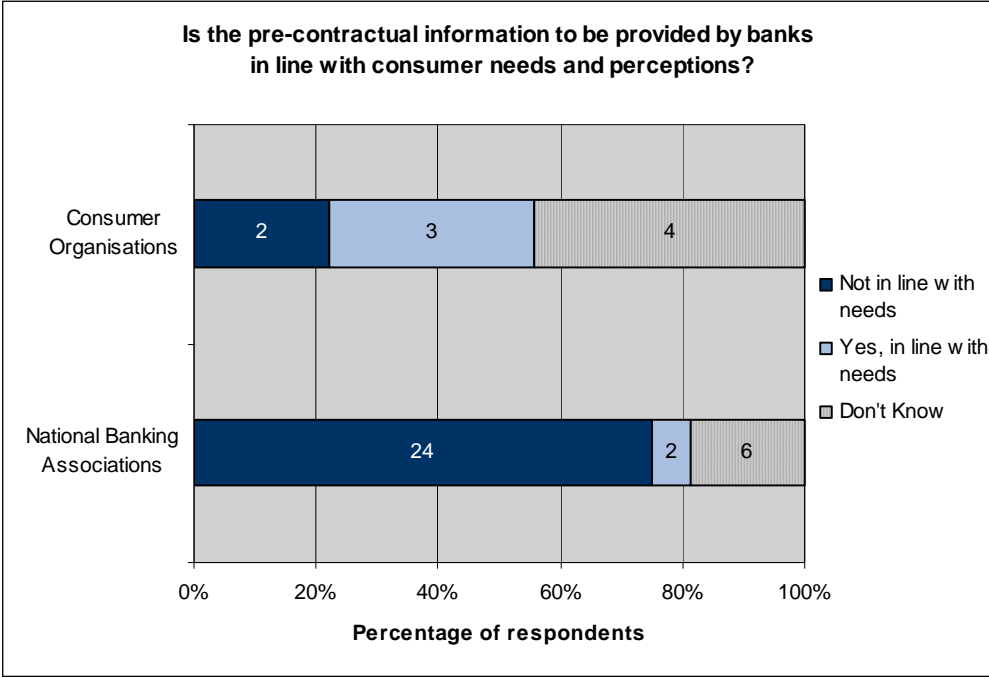
- Risk of overloading consumers with too much and duplicated information and to make products difficult to understand;
- Massive volume of information confuses consumers and requires considerable efforts at clarification on the part of the banks.

3. Be in any case impossible to provide a priori and in general terms, since many of the elements enumerated under article 4.2.a-e are identifiable only with reference to a specific consumer and once his individual file has been considered;
4. Restrict the development of marketing tools and media such as television or radio, since any advertising slot has a very limited duration and cannot possibly deliver what is required under article 4 in very short (in some cases, a few seconds) presentations.” (Questionnaire Hellenic Bank Association).

¹¹² Questionnaires Netherlands Bankers' Association and Associazione Bancaria Italiana

It is no surprise then that three quarters of responding national banking associations were of the opinion that the pre-contractual information to be provided is not in line with consumer needs and perceptions. Consumer organizations had diverging views, with the largest group marking “don’t know”.

Figure 11: Assessment of pre-contractual information requirements



Source: Survey of national banking associations and consumer organisations

Conclusion

Reducing information asymmetries is an aim that consumer credit legislation has to address and does so in many national legislative frameworks. The question is therefore mainly to which extent and what information has to be provided to have the envisaged high level of consumer information and protection, without imposing undue obligations on creditors that lead to a high administrative burden, reduce the possibility of fair marketing and create inefficiencies. It was not in the mandate of this study to assess specific informational items required in Article 4 and 5 of the proposed CCD. It is, however, possible to bring forward some general observations.

The banking industry has in various statements suggested that information requirements of the new CCD have not been tested with consumers and also no public hearing was organised to allow stakeholders to express opinions on this point. Clearly, an assessment of the effectiveness of the information on consumers based on market research would be an appropriate method to measure whether a specific item is readily understandable and can be used by consumers to compare credit products. However, testing information obligations would also require defining presentational issues, such as font size and positioning, that often have a very significant impact on perception. As one consumer organisation put it: “The comprehensibility of all that data depends significantly on a well thought and ordered and standardized presentation.”¹¹³

¹¹³ Questionnaire Verbraucherzentrale Bundesverband

An alternative approach for assessing the suitability of information obligations is to analyse best practices in Member States that have already implemented similar provisions or where relevant codes of conduct exist. For example, an UK consumer organisation reported that “... the UK credit card industry has recently introduced summary boxes as a new way of displaying the key terms and conditions of credit card products. We welcomed this development as a useful way of helping consumers to understand relevant information and we are keen to see this extended to other credit products.” The modified proposal for a CCD does not provide rules on presentational issues. In the contrary, Article 5 (2) provides that the pre-contractual information requirements can be fulfilled by handing out a copy of the draft credit agreement. This is welcomed by creditors, but may not be the best way of consumer information, as a contract does not always present the information in an easily accessible way. The proposed CCD differentiates pre-contractual information requirements only regarding overdraft facilities and certain specific credit agreements (Article 6). This raises the question of whether the universal information requirements for all other credit products under the scope of the CCD are adequate or need further differentiation. The advertisement and pre-contractual information provisions of the modified CCD could therefore raise the following efficiency issues:

- The pre-contractual information to be provided differentiates only to a limited extent between different credit products;
- Prescribing detailed information requirements in a maximum harmonisation directive leaves very little flexibility to adapt legislation to rapidly evolving markets;
- Presentational issues have not been considered sufficiently.

Consequently, efficiency of pre-contractual information could be raised by (1) defining for each product category specific information requirements, (2) have a more flexible legal approach and (3) take into account perception issues. The issue of legal flexibility will be addressed below (see section 4.7). Presentational issues would require extensive consumer research and/or the evaluation of experiences with existing legislative provisions at national level. This type of research might, for example, provide insights on the best way to present the APRC to consumers in advertising of credit products for which risk-based pricing applies. In these cases the interest rate depends on the creditworthiness of the consumer, and different approaches exist on how to prevent advertising to be misleading (e.g. by presenting representative examples or by a “typical” rate¹¹⁴).

Based on research, it would also seem possible to define requirements concerning the other elements of easily digestible pre-contractual information. A possible approach could be to require precisely defined summary boxes with key standard information (possibly with differences between the different credit product categories and including standards for presentation). Such a summary box could also be required to form part of the contract. In this case handing out a copy of the contract to the consumer would at the same time reduce the administrative burden of creditors and provide easy access to information for consumers.

The conclusion can be summarized as follows:

¹¹⁴ In the UK the creditor is required to specify the “typical” annual percentage rate (APR), which is an APR at or below which an advertiser reasonably expects, at the date on which an advertisement is published, that credit would be provided under at least 66 % of the agreements the creditor will enter into as a result of the advertisement. This differs from the “representative” example approach of Article 4 of the proposed Directive.

5. ***While provisions on advertising and pre-contractual information are indispensable for a high level of consumer protection, requirements of the proposed CCD are expected by creditors to have major adverse impact on their operations.*** Several efficiency issues are raised regarding (1) definition of product category specific information requirements, (2) flexibility of the legal approach and (3) lack of addressing perception issues. Additional consumer research and/or the evaluation of experiences with existing legislative provision at national level seems to be necessary to identify pre-contractual information that is clearly presented, easily understood and taken up by consumers (such as summary boxes etc.).

4.6.3. Responsible lending and duty to assist

Summary of legislative changes

Article 5 (1) of the proposed CCD requires the creditor and, where applicable, the credit intermediary to adhere to the principle of responsible lending. As part of this obligation the creditor has to assess the consumer's creditworthiness on the basis of accurate information provided by the latter, and, where appropriate, on the basis of a consultation of the relevant database. This assessment of creditworthiness is new to the Consumer Credit Directive and to many national legal systems. According to Article 5 (5) creditors and, where applicable, credit intermediaries have to provide adequate explanations to the consumer, in order to put the consumer in a position "to assess whether the proposed credit agreement is adapted to his needs and to his financial situation, where appropriate by explaining the pre-contractual information to be provided [...] as well as the advantages and the disadvantages associated with the products proposed". Article 5 (5), the duty to assist, is new to the Consumer Credit Directive and to many national legal systems, including Germany, the Czech Republic and the UK. An exception is, for example, Belgian law.

Effects on creditors

Creditors have a significant interest to assess the ability of a customer to repay a credit. As has been stated above, this has led to information exchange among lenders and the creation of private credit bureaux and public credit registers. Nearly all national banking associations state that pre-contractual analysis of creditworthiness is already established good banking practice in their country ("assessing creditworthiness of borrowers is the bread and butter of any kind of lending activity", stated an Italian association¹¹⁵), a view that is shared by most of the consumer organisations that had an opinion on the issue. A legal obligation in this respect is, however, not welcomed by creditors. They stated, for example, that asking lenders to keep track of this activity in order to be able to give legal evidence to this practice would be expensive and complicated and a civil law requirement would result in liability risks. Similarly, responsible lending rules of the modified proposal, including a duty to assist, are seen by nearly all banking associations as reason for a fairly or very significant increase in costs. Reasons include:

- Nearly all banking associations expect a higher effort to explain to customers the new information required and the credit decision in line with the proposed CCD;
- Credit institutions stated that they would have to document the type, content and extent of the information and advice supplied to every borrower before concluding a contract to have evidence in case the borrower subsequently claims damages on the grounds that he or she was not adequately advised;
- On the other hand, two thirds of banking associations do not expect the risk premium for the expected loss (standardised risk cost) to change through the more differentiated and individualised analysis, i.e. better assistance would according to their view *not* lead to less risk of default and related savings.

A major concern for creditors is the obligation introduced in the new CCD to explain the advantages and disadvantages of a specific product proposed. The main line of argument is that only the consumer can have an overall perception of the own financial situation and can assess what is advantageous or disadvantageous for him or her. One of the associations expressed: "... it is important to stress that a clear line has to be drawn between the provision of information (including explanations in face-to-face situations) and the provision of any other service, be it consultation, assistance or advice.

¹¹⁵ Assofin - Associazione Italiana del Credito al Consumo e Immobiliare

Whereas providing information includes giving the facts necessary to describe a product (something which can be fulfilled in online transactions), giving advice, for example, does imply some form of recommendation (something which cannot be easily fulfilled in online transactions) and increased liability.”¹¹⁶

Effects on consumer protection

Responsible lending and the “duty to assist” could potentially lead creditors to provide consumers with more personalised information on a specific credit product. This is especially significant as financial products are often complicated and the pre-contractual information provided on paper may not be adequately understood. These provisions could therefore allow consumers to do a better-informed choice. Additionally, overindebtedness of consumers has become a major social problem, for example in Germany. It is estimated that close to every tenth household in Germany is overindebted, more than 3 million households (2002). From 1994 to 2002 the number of overindebted households increased by 57%.¹¹⁷ Figures from the UK suggest that over one million adults are currently falling behind with payments for bills and credit commitments and a further two million are constantly struggling (this figure also includes payments on mortgages).¹¹⁸

Overindebtedness is a highly complex issue. From the creditor perspective, reasons for loan defaults lie outside the loan relationship and are not foreseeable (e.g. divorce, unemployment). One of the banks interviewed stated that defaults on average occurred 15 to 18 months after the signature of the contract, and it is therefore difficult to assess relevant problems early on. Also, refusing potential customers may lead to exclusion of some consumers from the possibility to take on credit. An individual bank responding to the questionnaire stated that “in order to cut in half the number of defaulted contracts would require to refuse one third of the credits actually granted: the consequences would [be] to increase the costs of credit and exclude one third of the consumers”.

Also from the perspective of organisations that provide consumer advice, assessing creditworthiness is only part of the solution.¹¹⁹ For example, Citizens Advice stated that “we are seeing [...] numerous cases of heavy overindebtedness. Indeed the incidence of such cases has perhaps grown as the system of credit scoring [in the UK] has grown and become more extensive. This evidence includes cases where lenders appear to have granted credit that was unaffordable or unsuitable for the needs of the borrower from the outset. In many of these cases we believe that the creditor would have had sufficient information to realise that this was the case but sold the credit product despite this.”¹²⁰ Several consumer organisations therefore support a responsible lending principle, although it was stated, “responsible lending provisions in the modified proposal are too vague”¹²¹, a view also shared by creditors.

¹¹⁶ Questionnaire Hellenic Bank Association

¹¹⁷ Bundesregierung, *Lebenslagen in Deutschland: Der 2. Armuts- und Reichtumsbericht* (The Federal Government’s 2nd Poverty and Wealth Report), p.50

¹¹⁸ Financial Services Authority, *Financial Risk Outlook 2007*. London: Financial Services Authority, 2007. Pg. 86

¹¹⁹ In some cases, assessing creditworthiness can even lead to problems, as the Verbraucherzentrale Bundesverband from Germany reported: “We have tremendous problems with [...] black-box [automated] assessment eg. with consumers who - correctly - shop around for offers yet face the fact that all further offers turn out to get worse. It turned out that asking for credit offers was actually assessed in a way, that consumers doing so were either declined by other banks or desperately trying to acquire even more than one credit, qualifying them a potential risk. [...] For much more than a year by now industry tries to abolish the above mentioned effect, they themselves consider a mistake - without a susceptible success so far. We still face the issue and banks consider themselves incompetent to alter the results of the automated processes.”

¹²⁰ Questionnaire Citizens Advice

¹²¹ Questionnaire Forbrugerradet (the Danish Consumer Council)

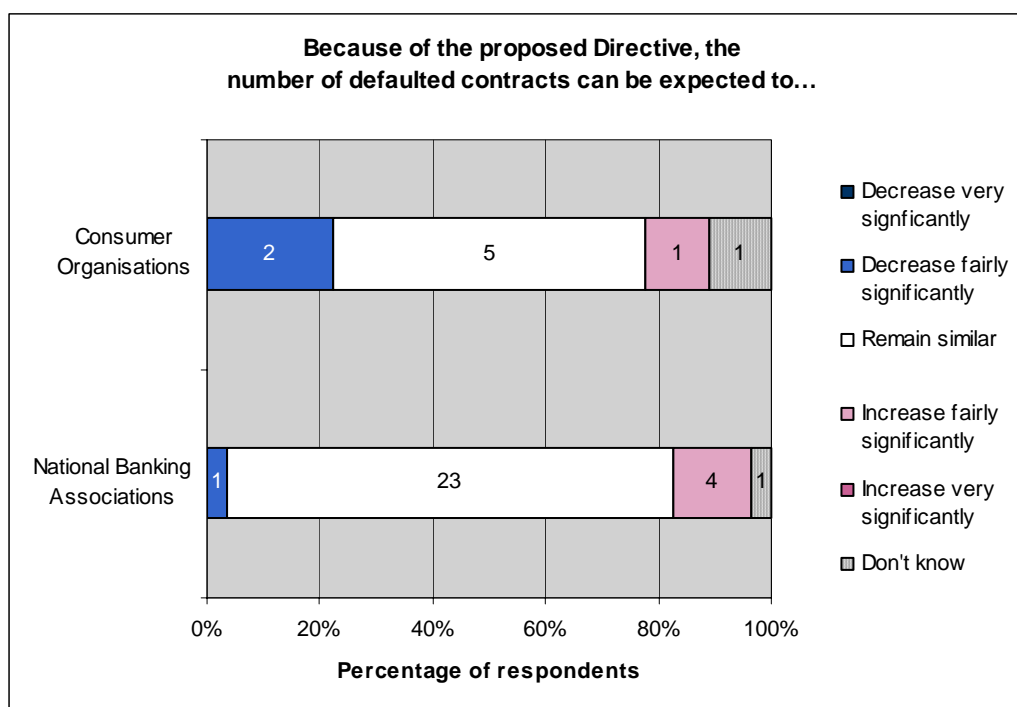
Conclusion

Both the principle of responsible lending and the “duty to assist” raise significant efficiency issues.

- Vaguely defined provisions on responsible lending and the “duty to assist” in a CCD could lead to diverging Members States’ transposition and resulting fragmentation and/or to a significant role of the courts in interpreting it – increasing the risk for liability claims in the creditor perspective;
- Vaguely described duties would also increase the administrative burden on creditors, as documentation requirements for the assistance process will depend on what precisely is requested from creditors. The less clear this is, the more lenders possibly would document to reduce related risks;
- Cross-border credit agreements might become more difficult, if assistance from creditors is required that may not speak the same language as the consumers they are dealing with;
- If provisions on responsible lending and the “duty to assist” would open the door for a significant number of civil law cases, as is feared by the banking industry, the resulting administrative burden and liability risk might be higher compared to a situation where a regulator intervenes when a creditor does not fulfil legal obligations.

Consequently, efficiency of the provisions on responsible lending and the “duty to assist” could be raised by (1) defining the concepts more precisely in legislation or accompanying guidance (2) clarifying the degree to which automated advice would be acceptable and (3) considering the role of regulators in enforcing responsible lending. With the modified proposal of a CCD as it stands stakeholders are not optimistic regarding the possibility to reduce the number of defaulted contracts. A large majority of creditors and more than half of consumer organisations expected the number of defaulted contracts to remain similar if the proposed CCD was implemented (see graph below).

Figure 12: Assessment of impact of proposed Directive on number of defaulted contracts



Source: Survey of national banking associations and consumer organisations

This rather pessimistic assessment illustrates the need to clarify what precisely is the aim of the principle of responsible lending and the “duty to assist” to be introduced (a better choice for consumers or reduction in defaulted contracts?), provide guidance accordingly and address the issue of enforcement. As Citizens Advice concluded: “responsible lending is a fairly complex concept requiring guidance developed in the light of consumer experiences with a regulator ready to intervene to prevent bad lending practices. We are not certain that the introduction of greater pre-contractual analysis of creditworthiness alone will act as a safeguard against overindebtedness if not backed up by such a structure of active regulation.”¹²²

The conclusion can be summarised as follows:

6. ***Responsible lending and “duty to assist” of the proposed CCD could contribute to a better-informed choice of consumers leading to more efficient markets. However, stakeholders do not expect them in the current form to be effective instruments in reducing the number of defaulted credit contracts.*** Both the introduction of responsible lending and “duty to assist” can be expected to increase costs of creditors, e.g. through increased documentation and information efforts. The final definition of these duties has therefore carefully to balance these costs with expected benefits. Efficiency issues are raised regarding (1) a more precise definition of the concepts (2) a clarification of the degree to which automated advice would be acceptable and (3) the role of regulators in enforcing responsible lending.

4.6.4. Right of withdrawal

Summary of legislative changes

The right of withdrawal, Article 13, is new to the Consumer Credit Directive compared to Directive 87/102/EEC. The right of withdrawal already forms part of most national consumer credit laws, with variations as to the withdrawal period and the formalities to be observed. The harmonisation relates to:

- The period of withdrawal of 14 calendar days;
- The begin of the period of withdrawal;
- The rule that the dispatching of the notice is relevant for notification in due time;
- The consumer’s payment obligations for having used the credit before exercising the right of withdrawal;
- The creditor’s duty to notify the consumer of his or her payment obligations;
- The calculation of interests due;
- The prohibition to claim any other indemnity in connection with exercising the right of withdrawal.

The proposed CCD also foresees that in case of linked transactions, when the consumer has a right to withdraw from the purchase agreement, the consumer also has a right to withdraw from the linked credit agreement. As the explanatory memorandum states, this “provision aims at avoiding that consumers have to keep a credit even when its very purpose has disappeared. However, the right to withdraw from the credit does not give a right to withdraw from the purchase agreement.”¹²³

¹²² Questionnaire Citizens Advice

¹²³ COM(2005) 483 final/2, p.7

Effects on creditors

A large majority of more than 80% of the national banking associations expect a fairly or very significant increase in costs through a right of withdrawal. Reasons given include:

- Increased administrative and liquidity management costs;
- Costs associated with the credit granting process and with recovering the debt that would not be covered by the interest due;
- Abuse of the right of withdrawal by some customers.

A significant additional concern is related to credit at the point of sale. In these cases the retailer is directly paid by the creditor, according to the terms of their mutual agreement. Creditors could decide to not release funds before the end of the withdrawal period. Consequently a retailer might in turn not deliver the goods as long as the consumer can withdraw from the credit agreement. This is because although cancelling the credit would not give the consumer a right to also withdraw from the purchase agreement, a retailer might need to recover the amount due from the consumer instead of receiving it from a bank as envisaged, or would have to take back the product leading to an increase in cost for depreciated products. According to one bank a likely market response could be “that retailers would, in such point-of-sale circumstances, request consumers to pay by credit card rather than take out an instalment loan: while the effect on credit institutions would be neutral (they would face a drop in consumer finance matched by an increase in credit card borrowing), the consumer would probably face a higher interest cost and a less structured payment discipline.”

Effects on consumer protection

The right of withdrawal is beneficial to the consumer in giving the chance to have a second thought on the contract and also “to shop around after conclusion of the agreement and possibly [...] find a better offer”.¹²⁴ It is therefore a complementary provision to the pre-contractual information provisions that have the aim to reduce information asymmetries and to allow consumers a better-informed choice. It is also conceivable that the right of withdrawal may provide a “last exit”-option for consumers that otherwise would be at risk of defaulting on the contract.

The current differences regarding the withdrawal period in Member States’ legislation are a very tangible sign of fragmentation that probably will not increase confidence of consumers in a high level of consumer protection across the EU in case these differences are known to them. The duration of the withdrawal period of 14 calendar days would bring the proposed CCD in line with the provisions of Directive 2002/65/EC concerning the distance marketing of consumer financial services. This alignment of the duration of the withdrawal period has also to be seen in the context of the ongoing review of the Consumer Acquis. In its recent Green Paper the Commission considers as an option to define one cooling-off period for all cases when the consumer directives grant consumers a right to withdraw from the contract, e.g. 14 calendar days.¹²⁵ If this option was to be chosen, a uniform duration of the withdrawal period across all relevant directives including the CCD would lead to a considerable simplification for consumers, who cannot be expected to differentiate easily between specific vertical rules.

¹²⁴ COM(2005) 483 final/2, p. 7

¹²⁵ COM (2006) 744 final, European Commission, Green Paper on the Review of the Consumer Acquis, Brussels, 08.02.2007, p. 21

Conclusion

Economic effects for creditors resulting from a right of withdrawal are increased direct costs, the significance of which depends on the number of consumers that actually would make use of this right. Whether structural market changes would occur, i.e. a switch away from instalment credits to pre-approved forms of credit such as overdrafts and credit cards, depends on the market response of retailers, which in turn is influenced by the details of the right of withdrawal currently contained in the national consumer credit legislation. An assessment of the size of the effects would therefore have to take into account the diversity of the existing national provisions. This is clearly illustrated from the results of the case-studies in three Member States regarding, e.g. a personal loan of 5000 Euro:

- In the UK, for example, one of the two banks that provided cost data assessed the effect of a 14 calendar day right of withdrawal on their cost structure as “neutral”, the other one stated that it was already current policy to voluntarily provide this right and therefore new provisions would not affect them, adding that “other [UK] banks might be affected by the changes”;
- In the Czech Republik the assessment was that there would be an “increase [in] costs”;
- In Germany three banks provided cost data and expected no change in the cost structure, as the right of withdrawal is already part of the national legislation.

Although the right of withdrawal will bring increased costs for banks in some countries, and structural effects concerning point of sale credit cannot be excluded, it will therefore also reduce a possible distortion of competition between banks located in different Member States.

On the other hand, clear benefits for consumers can be expected from this “legal instrument to protect the consumer against hasty decisions”, as one banking association put it. This is especially relevant, as the proposed CCD will also abolish the written form requirement, thereby potentially speeding up the timeframe for entering into a valid contract. Possible efficiency issues related to the right of withdrawal include:

- The consequences of withdrawal do not seem fully to be defined in the modified proposal for a CCD, e.g. regarding the question who has to pay for the costs of concluding the contract;
- Possible options to reduce the costs of the right of withdrawal for banks and mitigate related possible structural effects, while not weakening the protection of consumers.

Consequently, efficiency of the provisions on right of withdrawal could be raised by (1) defining precisely the consequences of withdrawal (2) considering options to reduce the costs of the right of withdrawal for banks and mitigate related possible structural effects, while not weakening the protection of consumers.

An option that would reduce the costs of the right of withdrawal would be to reduce the duration of the withdrawal period, as this might reduce the number of customers making use of it. However, seen the very sensible efforts to harmonise the withdrawal period across the consumer protection directives this depends on the outcome of the consultation on the Green Paper on the Review of the Consumer Acquis. A significantly shorter period of withdrawal would also reduce the practical value for consumers, who would have to be aware of this limitation and often need a certain period of time before acting to correct a “hasty decision”. Another option could be to provide the possibility to waive the right of withdrawal, a measure that would solve all mentioned problems regarding point of sale credit. The probable outcome would, however, likely be to abolish the right of withdrawal, as one could expect creditors, especially in case of point of sales credit, to require such a waiver from all consumers.

The conclusion can be summarized as follows:

7. *The right of withdrawal has a significant importance for consumers to correct “hasty decisions”. Depending on the current rules in a specific Member State the introduction of a right of withdrawal might, however, lead to increased direct costs of creditors.* These have to be considered as the costs of having a high level of consumer protection across the EU, because little room for increasing the efficiency of the provision could be identified. Also, harmonisation of the right of withdrawal would reduce a possible distortion of competition caused by the considerable fragmentation of Member States rules.

4.6.5. Right of early repayment

Summary of legislative changes

The consumer already has a right of early repayment under Directive 87/102/EEC, and this Directive also entitles the consumer to an equitable reduction in the total cost of the credit. The additional rules provided by the proposed Directive in Article 15 relate to the creditor’s claim of an indemnity. The creditor shall be entitled to claim a fair and objective indemnity for early repayment according to the amount or the calculation method set out in the credit agreement; which means that the creditor is only entitled to such a claim if this is set out in the credit agreement. No indemnity shall be claimed in two specific situations: for credit agreements where the period used to fix the borrowing rate is less than one year; and if repayment has been made under an insurance contract intended to provide a conventional credit repayment guarantee. The new rules work both ways: They limit the creditor’s right to claim an indemnity but they also prohibit more generous national rules.

Effects on creditors

In the explanatory memorandum of the proposed CCD it is argued that this provision would only entail “marginal costs for creditors”, because “creditors may charge fair and objective fees to compensate the loss”.¹²⁶ This view is not shared by approximately 60% of the national banking associations responding to the survey. In contrast, 25% of associations agree with the view expressed in the memorandum and do not expect an increase in costs, the rest has no opinion on the issue. The banks that provided cost data in the case study also had diverging views on the issue.

The banking associations that expected increasing costs provided the following reasons:

- It would no longer be possible to make a legally binding contractual agreement to waive termination rights for fixed-interest loans;
- Early repayment at any time would constitute interference in generally accepted prudential liquidity and interest rate mechanisms. It would also be for larger creditors a manual interference in an otherwise automated process and increase the overall cost of providing the loan;
- The compensation for early repayment would not cover forgone profits and therefore loan interests would increase. There was also no justification to exclude the banks entitlement to an indemnity for early repayment under certain circumstances mentioned in Article 15(2).

¹²⁶ COM(2005) 483 final/2, p. 7

Effects on consumer protection

A right of early repayment has considerable advantages for consumers, as it increases flexibility and allows changes in the pre-agreed payment schedule. It is possible to switch credit providers in case the market offers better conditions, in case that the indemnity paid is not prohibitive. It also allows the consumer to reduce the total costs of a credit in case the credit is no longer necessary, e.g. because of an improvement in income, etc. Some consumer organisations, however, criticise that the proposed Directive does not go far enough in that it “does not solve some of the most important aspects of the limited competition in retail banking such as [...] high fees for early repayment”.¹²⁷

Conclusion

Although some banks and national banking associations indicated that they do not expect significantly increased costs due to the right of early repayment of the proposed CCD because of similar rights in current national legislation in place, the majority of national associations sees this differently and expects an increase in costs. This indicates that the current fragmentation of national provisions already might distort competition. Additionally, the recent Commission sector inquiry identifies customer mobility and related switching costs as important issues. The report concludes concerning current accounts that “[t]he evidence gathered by the sector inquiry suggests that high levels of switching costs in the retail banking industry may weaken competition in two ways. Firstly, switching costs may increase banks market power, enabling them to set higher prices for established customers who appear locked in to a banking relationship. Secondly, high switching costs and low customer mobility may limit prospects for market entry in full service retail banking, notably through greenfield operations.”¹²⁸ The report also states that “[c]ustomer mobility in retail banking is likely to vary from product to product. There are indications that more shopping around is done regarding taking or switching mortgages and loans, due to higher potential price advantages.”¹²⁹ The conclusion concerning current accounts may therefore not be as valid for consumer credit as for other retail products. On the other hand, it is clear that the possibility to switch the credit provider would increase the competitive pressure, if the related fees are not prohibitively high. Therefore, the competition effects of the right of early repayment will depend to a considerable degree on what a “fair and objective indemnity” will mean in practice. Possible efficiency issues related to the right of early repayment include:

- The question whether or not the methods used to determine a “fair and objective indemnity” for early repayment will result in a fee that allows customer mobility;
- Possible options to reduce the costs of the right of early repayment for creditors, while not weakening the protection of consumers.

Consequently, efficiency of the provisions on right of early repayment could be raised by (1) providing guidance for the calculation of a “fair and objective indemnity” in a way that does not unduly inhibit customer mobility (2) considering options to reduce the costs of the right of early repayment for creditors, while not weakening the protection of consumers.

An option that might reduce the costs of the right of early repayment would be to not foresee a right of *partial* repayment. A partial repayment rather has advantages as a convenience for consumers than as an element to increase competition, because even with a partial repayment the customer remains bound to the creditor. On the other hand, in terms of costs to a creditor abolishing the right of partial repayment would probably only lead to limited savings.

¹²⁷ Questionnaire Forbrugerradet (the Danish Consumer Council)

¹²⁸ SEC(2007) 106, p. 77

¹²⁹ SEC(2007) 106, p. 70

Main costs related to a partial repayment seem to be that not all IT systems used by creditors currently foresee this possibility and therefore for a transition period more manual interference might be required, until the IT system is modified accordingly.

Several associations expected a negative effect of the right of early repayment on the availability or price of long-term fixed-interest loans. This cannot be excluded, if the calculation of the indemnity would lead to a higher rate of consumers that switch the credit providers. On the other hand, a more competitive market could be expected to lead to more and better offers for consumers, therefore also limit the possibility for price increases in the retail banking sector, a sector that has seen an increase of profitability over the last decades.¹³⁰

The conclusion can be summarized as follows:

8. ***The right of early repayment is an element of consumer protection as well as an instrument to increase competition by allowing customer mobility.*** Efficiency issues are raised regarding the need for guidance for the calculation of a “fair and objective indemnity” that does not raise barriers for switching of credit providers.

¹³⁰ The sector inquiry states that “[b]ased on operating profits as a share of gross income from all banking activity, banks in almost every Member State have become more profitable since the 1980s. From the clear overall trend of rising pre-tax profitability, it can also be inferred that retail banking profitability has risen over the long-term”, European Commission, SEC(2007) 106, p. 24

4.7. Harmonisation of legislation

4.7.1. Full harmonisation with flexibility and mutual recognition

Which economic effects on behaviour of economic players might be expected from the approach of full harmonisation with flexibility and of mutual recognition for issues where there is flexibility?

The explanatory memorandum of the modified proposal expresses the expectation that “full harmonisation remains the optimal way to establish a genuine single market in consumer credit”. To prevent new and additional barriers to the internal market, mutual recognition for some issues is foreseen to be introduced by the proposed CCD. A creditor would only have to comply, for an activity in another Member State than the one he is established in, with legal requirements of its Member State of origin and not with those of the host Member State. The memorandum also states “in general, both harmonisation and mutual recognition have contributed to EU market integration, while ensuring that consumer interests are taken into account.”¹³¹

As has been discussed in the legal analysis, creditors and consumers would have to deal with four sets of rules, if the modified proposal for a CCD were to be adopted (see section 3.2.4):

- (1) Those rules that are fully harmonised;
- (2) Those rules that are not harmonised but where the trader, under the principle of mutual recognition, can rely on the own Member State’s law if this is more generous than the law of the Member State where the consumer is domiciled;
- (3) Those issues that remain in the competence of the Member States; and
- (4) Last but not least, issues where the reach of maximum harmonisation is unclear.

The last category is problematic from both a creditor’s and a consumer’s perspective, as it can be in these cases time consuming to determine which law applies: the law of the creditor, or the law of the consumer. The relationship between the principle of mutual recognition and private international law is not clarified in the proposed Directive, raising the question whether the home country control principle can be overruled by choice of law rules.

In areas where mutual recognition applies, in the creditor’s perspective, this could be considered the optimum since it allows the creditor only to take into account its own Member State’s law. However, in the case of a conflict, it will be the courts of the Member State in which the consumer is domiciled that will apply the law of the creditor’s place of business. Thus, there remains a certain risk that these courts will apply the creditor’s law in a way that differs from the attitude of the courts in the creditor’s Member State.

From the consumer’s perspective, the principle of mutual recognition means that the diligent consumer who is aware of this principle will have to research the different implementations of the proposed Directive in order to find out the differences. Thus, the consumer will be burdened with the related transaction costs, which will be an impediment to creating consumer confidence. Advice will only be available from specialised lawyers. The consumer who is unaware of this principle will only find out about it once it is too late. This means that he or she may conclude a credit contract on the basis of false assumptions. This is especially problematic, as consumers are generally considered to only partly know the main consumer protection rules of their own country (concerning information, withdrawal, repayment annual percentage rate etc.), as both a large majority of consumer organisations and banking associations stated in the survey. If consumers need advice in the preparation of contracts they will be limited in their search and decision because local advisers, like lawyers, consumer associations, and others, have to know the law from other Member States, too.

¹³¹ COM(2005) 483 final/2, p. 7

Even if one assumes that local advice is possible in principle, it is not unlikely that the overall information costs are higher than compared to a situation where only national rules apply. In the case of any disagreement on contractual issues (concerning, e.g., payment, withdrawal, termination, repayment) the credit contract parties have to incur additional information and consultation costs on different types of rules that possibly apply.

Because of the problems described above, neither consumer organisations nor most of the banking associations are favouring mutual recognition. Consumer organisations fear that mutual recognition would have detrimental impact on consumer confidence. They also note that lenders will provide credits cross-border from the Member State with the lowest consumer protection and thereby erode both consumer protection and consumer confidence.

Comments brought forward by bank associations and individual banks are rather similar in nature. They argue that the application of mutual recognition in the context of cross-border business damages consumer confidence because the consumers have to inform themselves about consumer protection provisions in another Member State, i.e. the home country provisions of the foreign bank. Many banking associations therefore expect an increase of consumers' confusion and less comparability of products. One association also fears that "mutual recognition will create discriminations against credit institutions which are localised in MS where consumer protection is the strongest. It is likely that competition between national legislations will result in delocalisation to MS where legislation is more flexible".¹³² On the other hand, an Italian association thinks that in the long run mutual recognition could also lead to more homogenous markets: "At least in an initial phase, mutual recognition might overload consumers, as they face many different consumer protection requirements. In the longer term, the hope is that this approach will allow harmonisation of those rules that are currently not harmonised."¹³³ Only a minority of associations expresses the view that mutual recognition would directly facilitate cross-border business for credit institutions.

This leads to the following conclusion:

9. *The approach of full harmonisation with flexibility and of mutual recognition for issues where there is flexibility could lead to a 'regulatory' mix that creates confusion among consumers and affects consumer confidence adversely.* The principle of mutual recognition will add a further level of complexity because of the variety of legal orders that may apply to one contract. Especially problematic from both a creditor's and a consumer's perspective are areas where the reach of maximum harmonisation is unclear, as it can be in these cases time consuming to determine which law applies: the law of the creditor, or the law of the consumer.

4.7.2. Alternative legislative options

To what extent will full harmonisation of essential elements increase in the short term the volume of cross-border consumer credit? Is it likely to create momentum in the medium/long-term? What elements should be left to national legislation or self-regulation in Member States?

The volume of direct cross-border consumer credit is only expected by a minority of stakeholders to increase with full harmonisation of essential elements and the adoption of the proposed CCD. As has been concluded in section 4.4.3 (above), a single market for consumer credit with a substantial volume of direct cross-border consumer credit is a long-term rather than a short or medium term perspective.

Stakeholders offer a variety of views concerning the question what elements should be left to national legislation or self-regulation in Member States.

¹³² Questionnaire Association française des sociétés financières

¹³³ Questionnaire Associazione Bancaria Italiana

Several banking associations stated that maximum harmonisations should go as far as possible, as “even relatively minor complications would make the extension of cross border credit unprofitable”¹³⁴. There were, however also statements requiring that there “should be as much flexibility on the national level as possible”¹³⁵. This illustrates the dilemma of maximum harmonisation, namely that is perceived as levelling the playing field across the EU, but at the same time as being a rather inflexible instrument that does not allow to accommodate flexibility at the national level. Consumer organisation therefore tend to favour maximum harmonisation in selected core areas with minimum harmonisation in others, as the following statement illustrates: “Overall we find that being subject to the condition that the consumer protection level is high enough, information provisions and APRC calculation should be based on maximum harmonisation and the other provisions being subject to minimum harmonisation.”¹³⁶

The challenges any legal approach for a new CCD has to face include the following:

- There are very significant differences between national consumer credit markets, in terms of market size, products offered and consumer demand. This makes the type of regulatory compromise needed for maximum harmonisation in many areas very difficult, as market differences may require different approaches.
- The environment for consumer credit products is rapidly changing. New distribution channels, product innovations and consumer demands create a need for a pro-active and innovative regulatory approach.
- Last not least: Financial retail markets are, as has been stated above, largely fragmented along national lines. If this is to change, legislative action at EU level is required.

What are the legislative options at hand that could possibly lead to a more efficient and integrated internal market while avoiding some of the problems with the proposed Directive?

Option 1 - Targeted full harmonisation combined with minimum harmonisation: The current great divergence between the consumer credit laws of the Member States is to a large extent owed to the low level of consumer protection afforded by Directive 87/102/EEC. If the level of consumer protection would increase significantly with a new CCD, the incentive to maintain or adopt more stringent national legislation will decrease accordingly. Some of the concepts of the proposed Directive, in particular improved information, clarified consultation and responsible lending rules, but also the right of withdrawal and a more clearly shaped right of early repayment, could well serve this purpose. In addition to this, important issues outside the scope of the Directive would have to be addressed by Community legislation. If one follows this line of thinking, it would be sufficient to harmonise some crucial elements of the Directive fully, such as the Annual Percentage Rate. In other areas the principle of minimum harmonisation would prevail and would allow continuing development of innovative concepts at national level. Such a concept is indeed promoted by some Member States and stakeholders.

¹³⁴ Questionnaire Netherlands Bankers' Association

¹³⁵ Questionnaire Österreichischer Genossenschaftsverband

¹³⁶ Questionnaire Forbrugerraadet (the Danish Consumer Council)

Option 2 – Developing the CCD as a framework directive in combination with a comitology procedure: This could be modelled according to other directives employing the comitology procedure, or by using the Lamfalussy approach¹³⁷ for a new Consumer Credit Directive, as has been suggested by previous studies on the subject¹³⁸. The recent evaluation of the Financial Services Action Plan concludes that “the new approach to the preparation of legislation introduced under the Lamfalussy process brought significant improvements in terms of consultation, institutional co-operation, and (potentially) greater flexibility to respond to market events and there is a general appreciation of the quality of the measures finally introduced”.¹³⁹

This leads to the following conclusion:

10. Regulation of financial markets including the consumer credit market requires a certain degree of flexibility and room for innovation. Alternative legislative options for a new Consumer Credit Directive include (1) targeted full harmonisation combined with minimum harmonisation and (2) developing the CCD as a framework directive in combination with a comitology procedure. It could also be considered to prioritise institutional barriers to cross-border provision of consumer credit such as the harmonisation of credit databases.

¹³⁷ The Lamfalussy process is a 4-level approach to elaborating Community legislation. At Level 1, framework legislation setting out the core principles is adopted by the normal co-decision process. At Level 2, technical implementing measures are adopted by the Commission, on the advice of the relevant advisory committee, after a binding vote of the competent regulatory Committee representing the Member States and taking into account the European Parliament’s view. At Level 3, the appropriate advisory committee, made up of representatives of national supervisory bodies, draws up common interpretation guidelines and common standards and compares regulatory practice in the various Member States to foster convergence of supervisory practices. Level 4 is where the Commission enforces the timely and correct transposition of EU legislation into national law. See European Commission, FSAP Evaluation - Part I: Process and implementation, 2007. A full description can be found in the Lamfalussy report, http://ec.europa.eu/internal_market/finances/docs/actionplan/index/070124_part1_en.pdf

¹³⁸ J. Stuyck & T. van Dyck, Consumer Credit Directive, Briefing Note, requested by the European Parliament’s Committee on Internal Market and Consumer Protection, IP/A/IMCO/NT/2006-16, PE 373.567 and Lannoo, Karel and Almudena de la Mata Muñoz, Integration of the EU Consumer Credit Market: Proposal for a More Efficient Regulatory Model, Centre for European Policy Studies, CEPS Working Document No.213, November 2004

¹³⁹ European Commission, FSAP Evaluation - Part I: Process and implementation, 2007, http://ec.europa.eu/internal_market/finances/docs/actionplan/index/070124_part1_en.pdf p. 33

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Annex 1: Consumer attitudes towards buying consumer credit products directly cross-border

General findings

The focus groups in Great Britain, Germany and the Czech Republic¹⁴⁰ indicated relatively high reluctance to taking out credit in another member state. The participants in all three focus groups, although experienced internet shoppers, stated a certain level of discomfort when given the pre-task of shopping for credit via internet in another Member State, more so than with the other pre-tasks of cross-border Internet purchases. The main concerns regarding taking out consumer credit in another country were: language issues, currency conversion issues, practical issues, cultural differences and perception, confidence and trust issues, and security and availability concerns. A number of the focus group participants also cited being rather uninformed about EU-wide consumer protection and uninformed in general about the conditions and terms in taking out a consumer credit agreement in another country.

Eurobarometer results

The information deficit stated by the focus group participants is in line with the results of a number of Eurobarometer public opinion surveys. Indeed, in the last poll, taken in the EU 25 in 2006, a quarter¹⁴¹ of the respondents stated *insufficient or inaccurate information* as a barrier preventing them from purchasing or signing up for financial services in another European Union country compared to their own. Ranking higher than this as a concern were only *having to communicate in another language* (31%) and *lack of personal contact or signing up at a distance* (26%), points which were also mentioned by focus groups (see below). Other responses were *risk of fraud* (23%) and *lower level of consumer protection in other EU countries*, *Excessive/incomprehensible information* and *extra costs related to purchasing financial services in other EU countries*, all with 11% of the responses. Another obstacle frequently mentioned in focus groups, namely the insufficient knowledge about cross-border redress mechanisms/support, was highlighted by the Eurobarometer survey as well. Only 2% of respondents have heard of FIN-NET, 11% of the European Consumer Centres.

These trends indicated in the 2006 Eurobarometer are fairly consistent with the Eurobarometer monitoring of the issue since 2002,¹⁴² where *lack of information*, *language problems*, *too risky* and *difficulties due to the distance* were among the top five barriers identified by respondents. Interestingly though, there was a noticeable change in percentages from 2002 to 2005, indicating an increased level of comfort with cross-border consumer credit arrangements. For example, the percentage of EU15 citizens surveyed that felt there were no obstacles to cross-border trade in financial services was of 24% in 2002 and of 31% in 2005. Likewise, only 23% of respondents identified *lack of information* as a barrier in 2005, while 30% did so in 2002. Another noticeable change was with the *too risky* barrier, which went from ranking 3rd with 22% in 2002, to ranking 4th with only 14% in 2005.¹⁴³

¹⁴⁰ The focus groups were conducted by Opinion Leader Research for Civic Consulting in London, Berlin and Prague between December 14-18th, 2006.

¹⁴¹ The following Eurobarometers were used for statistics: Eurobarometer 58.1, Public Opinion in Europe: Views on Financial Services, February 2003, p.57; Eurobarometer 60.2, Public Opinion in Europe: Financial Services, January 2004, p.74; Eurobarometer 63.2, Public Opinion in Europe on Financial Services, September 2005, p.11; Eurobarometer 65.1, Consumer protection in the internal market, September 2006, p. 109.

¹⁴² All Eurobarometer surveys before 2006 refer to the EU 15 only.

¹⁴³ See Annex 3 of this report for complete Eurobarometer survey results on the cross-border use of financial services.

Focus group analysis

Despite this apparent increase in consumer confidence regarding the cross-border trade in financial services, the focus group participants were, as indicated above, much more reticent to purchasing financial services from another EU Member State than purchasing another type of good or service (e.g. flight tickets, clothing) from another Member State. Some respondents pointed out that purchasing financial services or signing a loan agreement was a complicated enough issue to deal with in person, in one's own country, to want to deal with it in another Member State. Others, even when favourable to the idea of taking out consumer credit in another country, pointed out that they felt there were minimal advantages to this compared to the extra hassle, risks and effort involved with taking out consumer credit in another Member State.

While reticence to taking out credit in another member state was noticeable in all three focus groups and the issues of trust was often mentioned as a cause for this reticence, the Czech focus group voiced the most concern. In fact, the respondents in this group also seemed reserved about the idea of taking out credit in general, as few even had a credit card. They also objected to not having personal contact with a financial adviser when taking out credit in another country.

Moreover, participants in all three focus groups were in accordance with the Eurobarometer findings in citing language as a major concern. In fact, while they felt comfortable shopping for a product across borders in another language than their mother tongue, they were more reticent when it came to financial services, and indicated the need to have integral translations of the agreements.

Participants also noted, independently of their feelings on cross-border consumer credit, that it was sometimes arduous or impossible to obtain such products from another country than that of residency. Many of the participants were unable to complete the focus group exercise of shopping for credit in another country because of this. For example, a British resident stated that he was not able to borrow from an Irish bank because he was not a resident of Ireland.

Aside from these practical issues and other technical concerns, focus group participants voiced concerns over trust and privacy issues as major barriers preventing them from purchasing consumer credit cross-border. For example, participants stated to be uncertain of what would happen to their personal data, and which laws and regulations applied to their safeguarding their private life when they purchased cross-border. A number of focus group participants indicated that they would be willing to take out a loan or another type of financial service, or at least look into it, provided they were guaranteed the same rights in another member state than at home.

Biases and preferences also played a role in the responses. For example, participants indicated feeling less secure the further the purchase was, and having preferences for certain countries, closer to home, than others.

Of all the different types of consumer credit, focus group participants, particularly the British, indicated being most favourable to obtaining a credit card in another member state, especially if this one had lower interest rates or offered advantages from a currency point of view (for example when travelling abroad and paying in euros). They also stated that they felt most secured with this type of consumer credit, as they were familiar with it and it exposed them to less risk than a loan, for instance.

Annex 2: Country studies

1.1. UK

1.1.1. Assessment of changes to the national legal framework

The UK has adopted comprehensive legislation on Consumer Credit Law (CCL) as early as 1974, with the Consumer Credit Act (CCA). After a thorough review and an intense consultation process from 2001 on, the law has been modernised through a number of legislative acts.¹⁴⁴ Firstly, it was amended in 2004 by secondary legislation, because the CCA confers wide powers to make secondary legislation in relation to issues such as advertising and contents of agreements. Secondly, the CCA itself has been amended only recently, by the Consumer Credit Act 2006, where no powers for secondary legislation existed.¹⁴⁵ This latter reform is predominantly devoted to overhaul the licensing system and the enforcement powers of the Office of Fair Trading (OFT), and to extending the jurisdiction of the Financial Ombudsman Service (FOS) to consumer credit disputes. However, it also concerns substantive law, in particular unfair consumer credit contracts. UK consumer credit law is generally recognised to avail of a high standard of consumer protection.¹⁴⁶ Due to the extensive research done before the modernisation of the law, UK law appears to be an important benchmark for the proposed Directive.

Scope of application

Personal scope of application: Generally speaking, the scope of application of the CCA is broader than that of the proposed Directive. For example, it includes partnerships consisting of two or three persons not all of whom are bodies corporate.¹⁴⁷ It also includes credit agreements entered into wholly or predominantly for business purposes as long as the credit does not exceed £ 25,000.¹⁴⁸ However, this is of no importance since the proposed Directive does not impact on credit agreements concluded between creditors and non-consumers in the terms of the Directive.

Substantial scope of application: The substantial scope of application of the CCA exceeds the Directive as well. For example, it currently covers consumer credit agreements with no limit. The former £ 25,000 of the CCA 1974 was removed with the 2006 reform.

Credit advertisement

Credit advertisement law was modernised with the Consumer Credit (Advertisements) Regulations 2004.¹⁴⁹ The new rules came into force on 31 October 2004. In their detail, they go far beyond the requirements of Article 4 of the proposed Directive.¹⁵⁰

¹⁴⁴ For an overview of the current state of the law, see House of Lords, European Union Committee, Consumer Credit in the European Union: Harmonisation and Consumer Protection, July 2006, available at <http://www.parliament.the-stationery-office.com/pa/ld200506/ldselect/lducom/210/210i.pdf>, at 23.

¹⁴⁵ For an overview, see E. Lomnicka, Consumer Credit Bill, Yearbook of Consumer Law 2007, 395 ff.

¹⁴⁶ See also House of Lords, European Union Committee, Consumer Credit in the European Union: Harmonisation and Consumer Protection, July 2006, available at <http://www.parliament.the-stationery-office.com/pa/ld200506/ldselect/lducom/210/210i.pdf>, at 23.

¹⁴⁷ Sec. 189(1) CCA as amended.

¹⁴⁸ See sec. 16B (1) CCA as amended and E. Lomnicka, Consumer Credit Bill, Yearbook of Consumer Law 2007, at 399.

¹⁴⁹ S.I. 2004 No. 1484.

The Regulations do not only regulate the content but also the design of credit advertisements. One significant difference in content is that Reg. 8 requires the creditor to give specify the “typical” annual percentage rate (APR), which is an APR at or below which an advertiser reasonably expects, at the date on which an advertisement is published, that credit would be provided under at least 66 % of the agreements he will enter into as a result of the advertisement. According to the British DTI, this differs from the “representative” example that Article 4 of the proposed Directive requires.

Information obligations

Under UK law, creditors are already required to disclose specific pre-contractual information to consumers. The information that must be given differs depending upon whether the credit agreement is to be concluded face-to-face or at a distance. In case of a face-to-face agreement, the full content of the credit agreement (see below) must be given to the consumer in a separate document before the agreement is made. This content differs from the list provided for in the proposed Directive. If the agreement is to be concluded at a distance, only certain summary information must be given and it need not be given in a separate document.

Details on the manner of disclosure are laid down in the Consumer Credit (Disclosure of Information) Regulations 2004.¹⁵¹ Reg. 4 requires information, for example, to be easily legible and distinguishable from the background; not to be interspersed with any other information or wording; to be of equal prominence except that headings may be afforded more prominence; and contained in a document which is separate from the document embodying the relevant agreement, is headed with the words “Pre-contract Information”, is on paper or on another durable medium etc.

Responsible lending

No duty of responsible lending exists in UK law. The UK Government had considered the introduction of such a principle as part of its deliberations in preparing the Consumer Credit Bill but has decided not to include this principle.¹⁵²

Duty to assist

The Duty to assist does not form part of UK law.¹⁵³

Content of the contract

The requirements as to the content of the contract of UK Consumer Credit Law were modernised in 2004.

¹⁵⁰For a detailed explanation see OFT, Credit advertising, September 2005, available at http://www.of.gov.uk/shared_of/business_leaflets/consumer_credit/oft016.pdf

¹⁵¹ S.I. 2004 No. 1481. For background information see DTI, Regulatory Impact Assessment, available at <http://www.dti.gov.uk/files/file23063.pdf>.

¹⁵² See DTI, Consumer Credit Law, A Consultation on a proposed European Consumer Credit Directive, February 2005, available at <http://www.dti.gov.uk/files/file14388.pdf>, at 28.

¹⁵³ See DTI, The Consumer Credit Act 1974 (Electronic Agreements) Order 2004, Regulatory Impact Assessment, available at <http://www.dti.gov.uk/files/file23061.pdf>, at 19.

They are detailed out in the Consumer Credit (Agreements) Regulations 1983 that were last amended in 2004.¹⁵⁴ The list of information to be supplied partly corresponds with the list enshrined in Article 5 of the proposed Directive. However, a number of additional pieces of information is required, amongst them:

- The amount of any advance payment payable;
- The constituent parts of the total charge for credit;
- Details of how and when interest charges are calculated and applied;
- Details of how payments are allocated when different rates and charges apply in different circumstances under the agreement and;
- Any scope for benefiting from tax relief.¹⁵⁵

In its Consultation Paper the DTI regards these as “critical to properly describing the nature of the credit product being provided”.¹⁵⁶

Formal requirements

The UK has already abolished the written form requirement in 2004, with the Consumer Credit Act 1974 (Electronic Communications) Order 2004.¹⁵⁷ This Order has introduced the option for creditors and consumers to agree upon the use of electronic communication.¹⁵⁸ Exceptions have only been made for default, enforcement and termination notices because they are usually issued to borrowers who have breached the credit agreement and they have a significant impact on the rights of the debtor. There is also a certain risk that consumers who experience financial difficulties (and therefore breach the credit agreement) have no longer access to the equipment or network access that enabled them to contract by electronic communication in the first place.¹⁵⁹

Right of withdrawal

UK consumer credit law has provided for a right of withdrawal since 1974 but only in situations that have involved some form of face-to-face contact and which have not been signed at the premises of the creditor or of a linked party.¹⁶⁰

¹⁵⁴ By the Consumer Credit (Agreements Amendment) Regulations 2004, S.I. 2004 No. 1482.

¹⁵⁵ For a full list see DTI, Consumer Credit Law, A Consultation on a proposed European Consumer Credit Directive, February 2005, available at <http://www.dti.gov.uk/files/file14388.pdf>, at 43.

¹⁵⁶ Consumer Credit Law, A Consultation on a proposed European Consumer Credit Directive, February 2005, available at <http://www.dti.gov.uk/files/file14388.pdf>, at 43.

¹⁵⁷ S.I. 2004 No. 3236.

¹⁵⁸ Sec. 176A(1), a document is transmitted in accordance with this subsection if

(a) the person to whom it is transmitted agrees that it may be delivered to him by being transmitted to a particular electronic address in a particular electronic form,

(b) it is transmitted to that address in that form, and

(c) the form in which the document is transmitted is such that any information in the document which is addressed to the person to whom the document is transmitted is capable of being stored for future reference for an appropriate period in a way which allows the information to be reproduced without change.

¹⁵⁹ See DTI, The Consumer Credit Act 1974 (Electronic Agreements) Order 2004, Regulatory Impact Assessment, available at <http://www.dti.gov.uk/files/file23061.pdf> no. 2.2.

¹⁶⁰ The Consumer Credit Act provides for a special regime of doorstep selling that prevails over general doorstep selling law. The full text of the Consumer Credit Regulations 2004 is available at <http://www.opsi.gov.uk/SI/si2004/20041483.htm>

Right of early repayment

The right of early repayment is specified in the Consumer Credit (Early Settlement) Regulations 2004¹⁶¹ that came into force on 31 May 2005. Reg. 4 specifies the indemnity to be claimed by the creditor to be calculated on the basis of actuarial principles. In contrast to the proposed Directive, UK does not provide for an exemption for credit agreements where the period used to fix the borrowing rate is less than one year. The UK has also introduced an applicable notice or deferment period, which is not reflected in the Directive. Under the UK regime, if a lender receives an early settlement request in writing, the settlement date becomes 28 days after receipt of the request.¹⁶² If the term of the credit agreement is more than one year, the settlement date for calculation of the rebate can be deferred for a further one month or 30 days.¹⁶³

Linked credit agreements

With a view to linked credit agreements, the UK provides for the highest level of consumer protection in Europe, the system of joint and several liability of the seller and the creditor. Under this system, the consumer is not only entitled to refuse further payment to the creditor once the goods delivered or service rendered under a linked contract is defective. More than this, the consumer can claim the return of payments made and even of damages. Under the proposed Consumer Credit Directive, the UK would be allowed to maintain its law on linked credit agreements. However, British consumers who contract with foreign creditors might be deprived of this benefit, due to the proposed principle of mutual recognition. In contrast to the Directive, UK law on linked credit agreements also applies to credit cards.

Conclusion

The proposed Directive and UK consumer credit law overlap to significant extent. Moreover, the proposed Directive provides for some features, such as the concept of responsible lending and the duty to assist, that do not form part of UK law. Overall, however, the proposed Directive appears to fall short of the level of consumer protection afforded by UK consumer credit law.¹⁶⁴

1.1.2. Overview of consumer financial services in the UK

Market situation for consumer credit

The UK consumer credit market is the largest in Europe and one of the most highly developed and sophisticated in the world.¹⁶⁵ Total gross lending for consumer credit was £17.1 billion in January 2007 (25.8 billion Euro) with amounts outstanding at £212.8 billion (321.3 billion Euro).¹⁶⁶

¹⁶¹ S.I. 2004 No. 1483.

¹⁶² Consumer Credit Regulations 2004, Reg. 5.

¹⁶³ Consumer Credit Regulations 2004, Reg. 6.

¹⁶⁴ See also the conclusions by the House of Lords, European Union Committee, *Consumer Credit in the European Union: Harmonisation and Consumer Protection*, July 2006, available at <http://www.parliament.the-stationery-office.com/pa/ld200506/ldselect/lducom/210/210i.pdf>, at 33.

¹⁶⁵ House of Lords, *Consumer Credit in the European Union: Harmonisation and Consumer Protection*. Volume I: Report. London: The Stationery Office Limited. July 2006, page 22.

Consumer credit in the UK is accessible through a variety of products. In one survey, 42% of respondents had some form of unsecured debt and the most commonly held type of credit was on credit cards.¹⁶⁷ Demand in recent years for such products is indicated below in the total amounts outstanding in January 2007 (within the major British Banking Groups):

Table 4: Amounts outstanding (£ million) in the major British Banking Groups

Date	Credit card credit	Overdraft Lending	Structured personal loans
Jan 2004	29,945	7,667	54,966
Jan 2005	33,853	8,785	60,818
Jan 2006	32,919	10,177	64,188
Jan 2007	30,070	10,023	66,284

Source: British Banker's Association.

These figures correspond to banks providing approximately half of all UK consumer credit outstanding. It suggests that overdraft lending is a relatively small asset for credit providers, though they have experienced considerable growth in recent years. Demand for structured personal loans has also experienced a relatively considerable increase, especially with consideration to amounts outstanding for credit cards.

Cross-border consumer credit contracts

Currently the percentage of the main consumer financial services that UK banks directly sell to consumers resident in another EU Member State is estimated by British banking associations to be less than 0.1% for instalment credits and leasing agreements¹⁶⁸, while transactions involving overdraft facilities and credit cards are estimated to be between 0.1% and 1%¹⁶⁹. These figures have been estimated to remain similar in the coming 5 years if no major legislative change at EU level were to happen.¹⁷⁰ Individual banks responding to the questionnaire have also expressed that they anticipate transactions sold directly to consumers resident in another EU Member State to remain similar in the next 5 years without EU legislative change.¹⁷¹

The total consumer credit transactions that British banks conduct with consumers resident in another EU Member State through branches/subsidiaries established there (including through majority holdings in local banks) is also estimated to be low.

¹⁶⁶ Bank of England. *Monetary & Financial Statistics*. Volume 11, February 2007, p.35. Converted to Euro at 1 GBP= 1.51 EUR (January 30, 2007). Seasonally adjusted

¹⁶⁷ Financial Services Authority, *Financial Risk Outlook 2007*. London: Financial Services Authority, 2007. p. 83

¹⁶⁸ This applies only to leasing agreements that create an obligation to purchase the object of the agreements.

¹⁶⁹ British Bankers Association, Consumer Credit Association of the United Kingdom in their answers to 2a in the survey of Banking Associations. The Finance and Leasing Association clarified that the Association does not have statistical data concerning the amount of credit transaction in this field.

¹⁷⁰ Estimates made by British Bankers Association, Consumer Credit Association of the United Kingdom, and the Finance and Leasing Association in their answers to 2b in the survey of Banking Associations.

¹⁷¹ Estimates made by Lloyds TSB, Barclays Bank Plc and Cattle Plc in their answers to 2b in the survey of Banking Associations.

The British Bankers' Association has estimated transactions of the main consumer financial services¹⁷² to be less than 0.1%, except overdraft facilities were estimated to be less than 2%. The Consumer Credit Association has estimated, on the other hand, that significantly more than 10% of the instalment credits offered by their members are conducted via branches/subsidiaries in other EU Member States. The British Bankers' Association estimates these figures to remain similar in the next 5 years if no major legislative change at EU level were to happen. In contrast, the Consumer Credit Association estimates that their figures will increase very significantly because they assume their members will continue to increase their scale entry business (via, e.g., subsidiaries).

Main barriers hindering the selling of consumer credit products in other Member States are perceived by UK banking associations to be mainly on the demand side (based on national and regional differences and inclinations) as well as difficulties in generating lender confidence due to intrinsic difficulties of cross-border debt recovery and consumer risk assessment.

(Over-)indebtedness

Household debt within the UK has risen dramatically in recent years, according to a recent FSA report. This reflects both an increase in the level of debt held by individual households and an increase in the number of households that have access to credit. The level of secured debt as a percentage of disposable income reached 126% in the third quarter of 2006, while unsecured debt as a percentage of disposable income amounted to 26%. A survey looking at people's financial commitments provided the following results: over 42% of respondents had some form of unsecured debt, and the median amount owed was £3,000. According to the survey, the most common type of debt held was on credit cards, with 19% not repaying their balance in full each month.¹⁷³

More significant are the figures concerning private households who struggle to repay such debts. Figures suggest that over one million adults are currently falling behind with payments and a further two million are constantly struggling (this figure also includes payments on mortgages).¹⁷⁴ In a study conducted by the Bank of England, around one in ten of households with unsecured debts found those debts to be a heavy burden, and one in five found them somewhat of a burden. The proportion finding their debts a heavy burden was a little higher in comparison to the previous year.¹⁷⁵ Evidence that consumers are increasingly struggling under heavy debt burdens can be seen from the increase in petitions filed for bankruptcy over time:

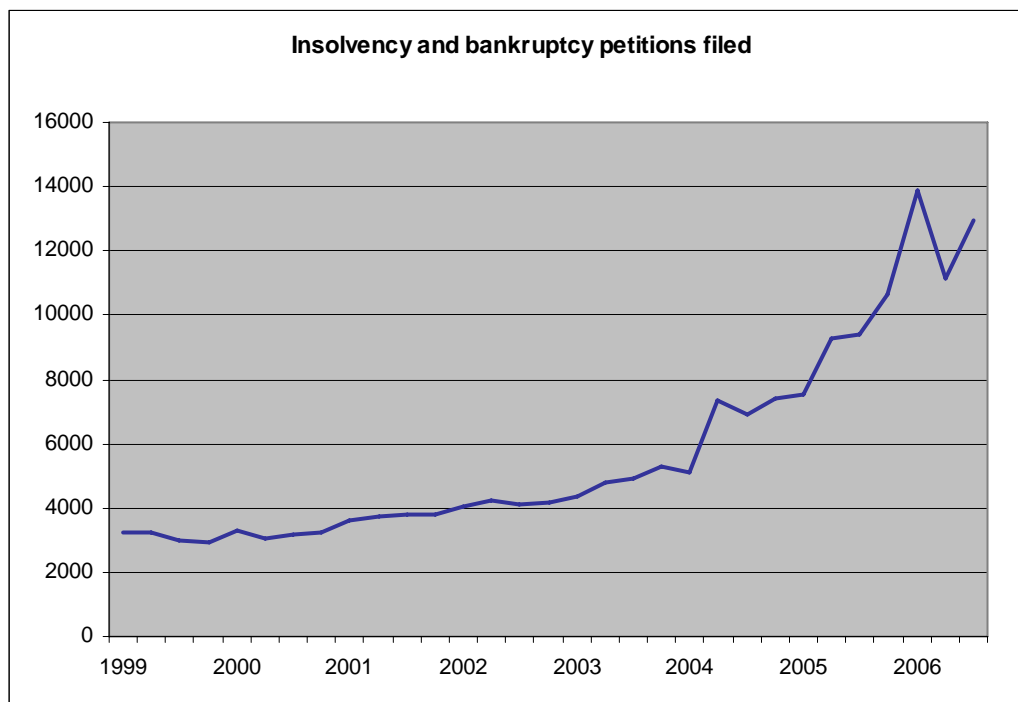
¹⁷² This includes: credit agreements under the terms of which the consumer is required to repay the credit by means of instalments; overdraft facility/credit; credit card; and leasing agreements that create an obligation to purchase the object of the agreements.

¹⁷³ Financial Services Authority, *Financial Risk Outlook 2007*. London: Financial Services Authority, 2007. p. 83

¹⁷⁴ Financial Services Authority, *Financial Risk Outlook 2007*. London: Financial Services Authority, 2007. p. 86

¹⁷⁵ Barwell, Richard, May, Orla, and Pezzini, Silvia. *The distribution of assets, income and liabilities across UK households: results from the 2005 NMG Research survey*. Bank of England Quarterly Bulletin, Spring 2006

Figure 13: Petitions filed for insolvency and bankruptcy by UK debtors (1999-2006)



Source: Department for Constitutional Affairs. *Company winding up and bankruptcy petition court statistics for third quarter 2006*. News Release, 10 November 2006.

This information is also reflected in write-offs and other revaluations made by banks on household debts, which has increased by 16% in 2006 on the previous year.¹⁷⁶ Unsecured lending (not including credit cards) accounts for the largest domestic contribution to UK bank write-offs (£3.8 billion was written off or revaluated in 2006); credit card write-offs and revaluations by banks totaled £2.8 billion.¹⁷⁷

The Consumer's attitude towards cross-border financial services

According to a Eurobarometer survey, 69% of UK consumers would not consider to obtain any financial services from another Member State in the near future.¹⁷⁸ Though this is less than the EU average (at 75%), it is still an indication of UK consumers' hesitance to go cross-border for their financial services. The following table indicates consumers' current and future attitudes to purchasing several cross-border financial services:

¹⁷⁶ Bank of England, statistical data.

¹⁷⁷ Bank of England, statistical data.

¹⁷⁸ Special EUROBAROMETER 230, Public Opinion in Europe on Financial Services, September 2005, p.10.

Table 5: UK purchases of cross-border financial products (current and future) (2003)

	Have purchased product	Have not purchased product	Would consider in the future to purchase product	Would not consider in the future to purchase product
Cross-border bank account	4%	95%	11%	79%
Cross-border credit card	3%	97%	9%	81%

Source: Eurobarometer 205/Wave 60.2, Publication: January 2004 Public Opinion in Europe, Financial Services, Report B.

Though there is an indication that cross-border transactions have been generally increasing, it is still quite clear that UK consumers are hesitant to consider consumer credit products cross-border. This picture is also reflected throughout consumers in the EU Member States.

When UK consumers were asked what they perceived to be the main barriers when purchasing or signing up for financial services from sellers/providers in another EU Member State, the main barrier indicated was *having to communicate in another language* (indicated by 27% of UK respondents). Other highly ranked barriers perceived by UK consumers were *risks related to fraud in purchasing financial services in other EU countries* (indicated by 23% of UK respondents) and *lack of personal contact when purchasing or signing up at a distance* (indicated by 20% of UK respondents).¹⁷⁹

In a focus group conducted with a sample of UK consumers¹⁸⁰, opinions reflected a general lack of trust when it comes to purchasing a financial product cross-border. One woman expressed that she would probably only buy a credit card cross-border because the risk is smaller and it is a relatively straightforward agreement to make. The participants agreed that it is also a more straightforward product to compare (i.e., it involves a simple comparison of interest rates) and that *“there are no hidden bits in there ... or any currency [fluctuations] or anything in that one – it’s quite straightforward.”* For more complicated retail lending products, participants expressed a general reluctance to purchase financial products cross-border because of the amount of detail required to give; one woman expressed that she was *“more wary actually ordering a financial service product than an actual physical item”* over the internet from another Member State.

Another strongly expressed opinion by consumers in the UK when asked to purchase a loan cross-border, all of the participants found that this option was just not available to them. One participant expressed, *“the Irish bank said oh we can’t lend you any money because you’re not a national of that country and ... asked for like a zip code and your cell number and if you haven’t got those... you just can’t proceed beyond the first stage. So you can’t – finance I couldn’t get anything from abroad.”* Several of the other participants described the same problem, entirely prohibiting the availability of these products to them as UK (i.e., non-national) consumers.

The most critical issue expressed by this group of consumers revolved around trust and lack of awareness about their consumer rights as an EU citizen in other EU Member States. As one participant articulated, *“[EU consumer protection issues] would be particularly relevant on these financial situations, where you have a cooling off period don’t you? In the UK you can change your mind up to seven days or something, agreed the loan, agreed the repayments and then suddenly think oh I can’t really afford that. You can phone them up and cancel that. Whereas I’m not sure how you can do that on the web, or even when you go abroad.”*

¹⁷⁹ EUROBAROMETER 252, Consumer Protection in the Internal Market, September 2006.

¹⁸⁰ Study carried out from Opinion Leader Research for Civic Consulting. All quotes in this section refer to comments made by participants during these focus groups.

Significantly, the majority of participants agreed that this was a major barrier in cross-border purchases of financial products and that it would be appreciably easier to trust such purchases from other countries if EU consumer rights were “*absolutely uniform across.*” When prompted, the participants did not identify any other barriers to cross-border purchases of financial services.

The view of Consumer Organisations

Consumers in the UK already have many advantages from relatively advanced consumer protection legislation. The majority of the consumer organisations in the UK responding to the questionnaire¹⁸¹ expressed a high level of dissatisfaction with the proposed Directive. These organisations communicated that not only did they doubt whether any significant benefits would be provided to consumers as a result of the proposed Directive, but also that the proposed Directive could even reduce standards already set within the UK regarding their consumer protection legislation.¹⁸² It was expressed by Citizens’ Advice and Which? that they are concerned that the proposed Directive would lower consumer confidence regarding consumer credit agreements concluded nationally; though, it should be mentioned that the National Consumer Federation expressed that they anticipated the impact of the proposed Directive would increase consumer confidence fairly significantly. The main concern of the consumer organisations is that the impact of mutual recognition and full harmonisation could undermine the benchmarks already established by UK consumer protection legislation.

Citizens’ Advice and Which? anticipate that consumer confidence regarding consumer credit agreements concluded cross-border would remain the same, they also anticipate that the number of cross-border transactions of consumer credit products would remain similar if the proposed Directive were adopted. The National Consumer Federation estimated that consumer confidence and the number of cross-border transactions of consumer credit products would increase fairly significantly.

1.1.3. Analysis of typical consumer credit transaction – personal loan

1.1.3.1. Current typical operating costs

The following table shows the estimated costs that a bank would typically incur when processing, approving and monitoring a personal loan (unsecured) for € 5,000 over a two-year contract term. The costs include all direct running costs, but exclude profit margin and costs of capital. The costs are divided into three categories corresponding to where they incur: front-office, back-office and bad-debt collection. The table shows the estimation concerning two typical banks in the UK:

¹⁸¹ Citizens’ Advice, National Consumer Federation, and Which?

¹⁸² This was particularly articulated by Citizens’ Advice.

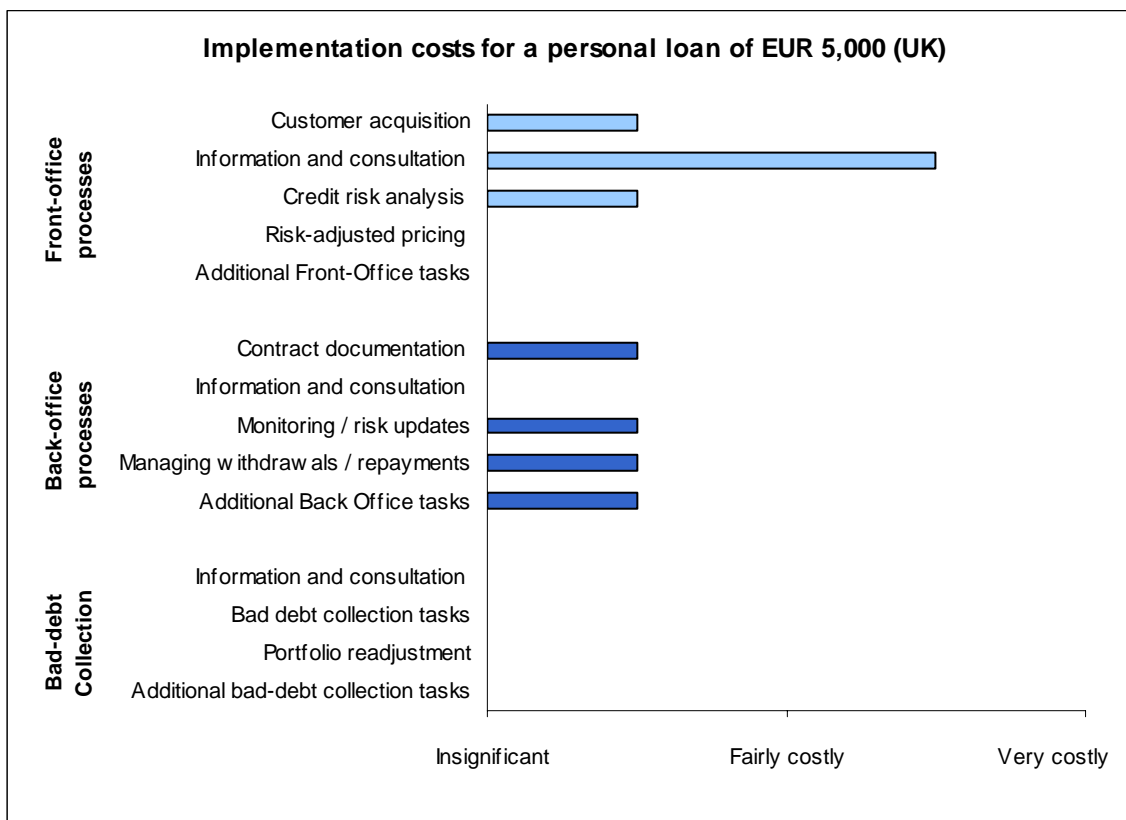
Figure 14: UK bank transaction costs related to a personal loan

		Sub-processes during lending procedure <u>WITHOUT</u> modified proposal		Estimated percent	
		Bank 1	Bank 2	Bank 1	Bank 2
FRONT-OFFICE	Customer acquisition (steps include: planning and acquisition of customers, advertising)				7%
	Information and consultation of customers (steps include: providing pre-contractual information on, e.g., borrowing rate, duration, instalments, fees, etc.)				42%
	Credit risk analysis (steps include: creditworthiness check)				1%
	Risk-adjusted pricing (steps include: underwriting procedure, pricing of loan)				6%
	Additional Front-Office tasks				n/a
	SUB-TOTAL FRONT-OFFICE COSTS				76%
BACK OFFICE	Contract documentation (steps include: credit filing and archiving)				2%
	Information and consultation of customers (including customer contacts during term of contract)				3%
	Monitoring / risk updates (steps include: trigger servicing, monitoring and controlling risk factors throughout duration of contract)				4%
	Managing withdrawals / repayments (steps include: collect timely payment of interest and principal from borrowers, processing withdrawals and repayments, calculating indemnities)				9%
	Additional Back-office tasks				n/a
	SUB-TOTAL BACK-OFFICE COSTS				24%
BAD-DEBT COLLECTION	Information and consultation of customers (including customer contact in case of default, payment delay, etc.)				18%
	Bad-debt collection tasks (steps include: determining ongoing collateral adequacy, loan refinancing and modification processes)				
	Portfolio readjustment (steps include: managing credit risk across loan portfolio)				4%
	Additional bad-debt collection tasks				4%
	SUB-TOTAL BAD-DEBT COLLECTION PROCESS COSTS				
GRAND TOTAL				100%	100%

Source: Bank estimates

1.1.3.2. Impact of modified proposal on one-time implementation costs

If the modified proposal for a Consumer Credit Directive were adopted the consequence for the following processes regarding a bank's typical **one-time, implementation costs** for a personal loan for € 5,000 payable over two-years would be as follows:



Source: Bank estimates

Front-office processes

Generally, implementation of the proposed Directive would have the most significant implications for the costs accruing during the front-office processes. The most considerable impact would produce a fairly to very significant increase in costs to banks regarding the information and consultation of customers. It is perceived that there will be a necessary increase in staff to provide personalised information to customers, eliciting anticipated changes to IT systems, policies and processes in addition to significant training expenses, including training materials.

An insignificant to fairly significant increase of costs was expected for implementation of the Directive for the customer acquisition and credit risk analysis procedures. To implement the Directive, changes to marketing materials (including websites) to include a representative example would impact costs with regard to customer acquisition. The need to have the ability to provide information on credit search to declined customers would require changes to IT systems, policies, and processes implying costs for credit risk analysis procedures for a personal loan.

With the adoption of the proposed Directive, no implementation cost was expected for risk-adjusted pricing.

Back-office processes

Cost impacts were also anticipated to implement changes of the back-office processes, though to a lesser extent than cost impacts in the front-office processes. Insignificant to fairly costly implementation costs were anticipated for the procedures related to contract documentation, monitoring and risk updates, and managing withdrawals and repayments.

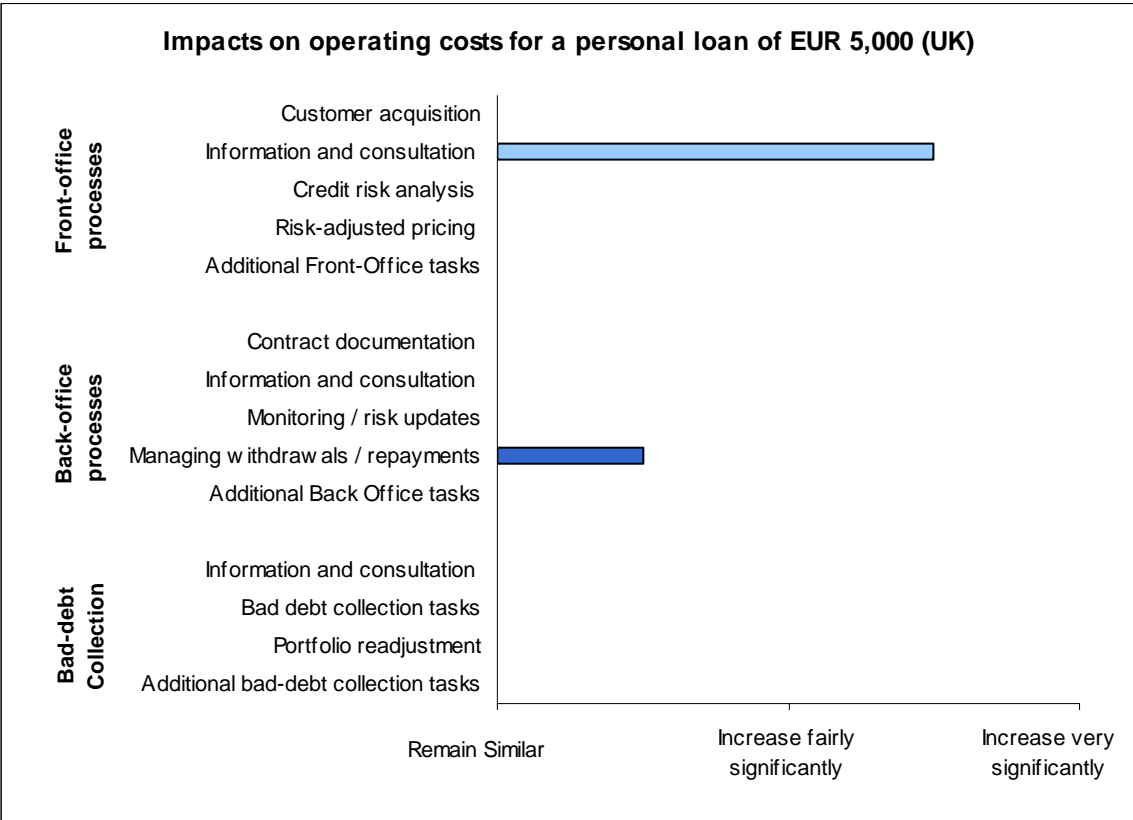
Costs pertaining to contract documentation could be experienced because of the need to provide an amortisation table as part of the contract thereby eliciting costly changes to IT systems and processes. It would also yield higher costs due to the anticipated additional paperwork, and additional storage and archives requirements. Changes to monitoring processes would elicit a cost impact for monitoring and risk updates. And it was anticipated that new early repayment rules would be expected to generate implementation costs to change IT systems, policy and processes as well as producing training materials to adapt to this new entitlement for the customer. Additionally, banks anticipated an increased liability due to the “responsible lending” provision, thereby necessitating additional storage for increased personalised information records; this would require changes to systems and process for storage and retrieval in the event of legal action by a customer.

Bad-debt collection

Banks estimate the one-time, implementation costs would be insignificant for bad-debt collection processes.

1.1.3.3. Impact of modified proposal on operating costs

If the modified proposal for a Consumer Credit Directive were adopted the consequence for the following processes regarding a bank’s typical **operating costs** for a personal loan for € 5,000 payable over two-years would be as follows:



Source: Bank estimates

Front-office processes

Operating costs would be most severely affected for front-office processes. It was estimated that costs accruing from information and consultation of customers would increase fairly to significantly. This is due to an anticipated increase in human capital costs as the staff will have to spend “significantly more time with customers” (specifically because of the ‘duty to assist’ provision).¹⁸³ As this was the most significant cost element this will result in a considerable impact on the total transaction costs for banks when processing, approving and monitoring personal loans.

All other operating costs related to front-office processes are estimated to be unaffected by the proposed Directive.

Back-office processes

Only costs related to managing withdrawals and repayments were expected to increase fairly significantly by one bank. This is resulting from the provision for early repayment, which will require additional staff resources. Banks estimated that this procedure only represents 9% of the total transaction costs for processing, approving, and monitoring a personal loan; therefore, it is considered that operating costs on the total back-office processes would not have a highly relevant impact on the total transaction cost related to personal loans.

All other operating costs related to back-office processes are estimated to be unaffected by the proposed Directive.

Bad-debt collection

Operating costs related to bad-debt collection are estimated to be unaffected by the proposed Directive as debt recovery is already regulated in the UK for almost every consumer product.

1.1.3.4. Discussion/summary of impacts

The representatives of the banks that provided cost data expressed that they anticipated a fairly significant increase in banks’ total operating costs for a personal loan should the proposed Directive be adopted. There was no information available as to whether these increased costs would signify any effect on the price to consumers for this credit loan though it was expressed that the increased implementation and operating costs would “have some unwelcome impact on the cost of the credit loan [to consumers] but not to the extent that it is ‘fairly significant’”.¹⁸⁴

The impact of the following provisions in the proposed Directive on the current cost structure are as follows:

¹⁸³ Personal communication with a member of the banking industry, February 27, 2007.

¹⁸⁴ Response to the cost analysis questionnaire by a member of the banking industry.

Creditors' obligation to provide information and consultation

It is expected by the banks that this provision will, with certainty, cause an increase in costs, in particular for hiring additional staff and training staff to enable them to provide the level of service specified in the proposed Directive, as well as additional costs for storage and retrieval of the interview records as a result of their additional liability.¹⁸⁵ Additional costs will also be incurred for staff to spend extra time with customers to fulfil the 'duty to assist' obligation, which bankers interpret that a majority of their customers will not find appropriate.

Additionally, the banks expressed their concern that their customers will even be upset by the additional information and consultation as not every customer will need this.

Creditors' obligation to responsible lending

It was expressed by the banks that responsible lending is already an important part of banking operations and that the impact on banking cost structure will not be significant; however, it was expressed that this provision would increase the administrative burden related to corroboration and checking of the information given to lenders by the customer.¹⁸⁶

Consumers' right to withdrawal

Current UK legislation does allow loans without a right of withdrawal for certain types of credit agreements. One of the two banks that provided cost data assessed the effect of a 14 calendar day right of withdrawal on their cost structure as "neutral", the other one stated that it was already current policy to voluntarily provide this right and therefore new provisions would not affect them, adding that "other [UK] banks might be affected by the changes"

Consumers' right to early repayment

One bank did not anticipate any impact on their current cost structure as they already have rights to early repayment in place. The other bank, conversely, anticipates fairly significant cost increases as a result of the change to implement this. Administering the process of partial repayment is more complicated than a full repayment, therefore additional administrative costs are expected particularly for managing withdrawals and repayments in back-office costs.

¹⁸⁵ Response to the cost analysis questionnaire by a member of the banking industry.

¹⁸⁶ Response to the cost analysis questionnaire by a member of the banking industry.

1.1.4. Overdraft

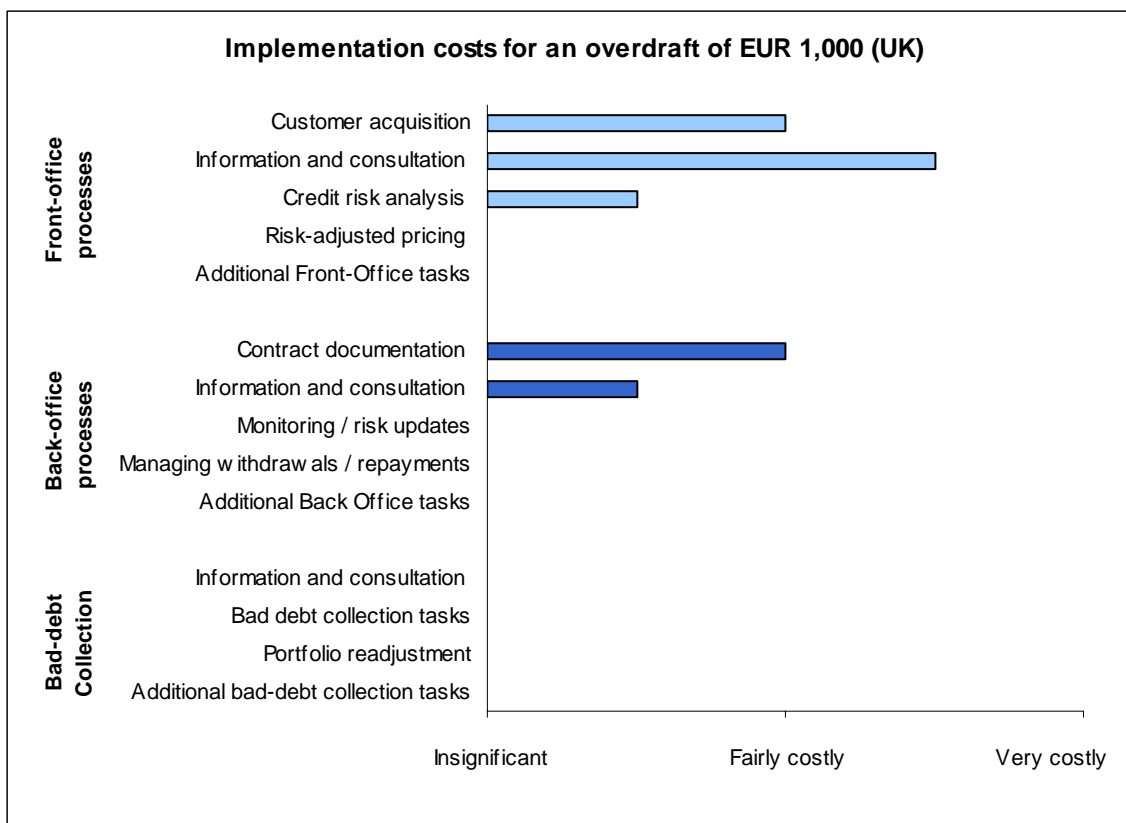
The following table shows the estimated costs that a bank would typically incur when processing, approving and monitoring a new overdraft facility/credit of € 1000 (unsecured) throughout the duration of its term. The costs include all direct running costs, but exclude profit margin and costs of capital. The costs are divided into three categories corresponding to where they incur: front-office, back-office and bad-debt collection. The table shows the estimation concerning two typical banks in the UK:

Table 6: UK bank transaction costs related to an overdraft facility

	Sub-processes during lending procedure <u>WITHOUT</u> modified proposal	Estimated percent	
		Bank 1	Bank 2
FRONT-OFFICE	Customer acquisition (steps include: planning and acquisition of customers, advertising)		17%
	Information and consultation of customers (steps include: providing pre-contractual information on, e.g., borrowing rate, duration, instalments, fees, etc.)		15%
	Credit risk analysis (steps include: creditworthiness check)		4%
	Risk-adjusted pricing (steps include: underwriting procedure, pricing of loan)		4%
	Additional Front-Office tasks		n/a
	SUB-TOTAL FRONT-OFFICE COSTS	32%	40%
BACK OFFICE	Contract documentation (steps include: credit filing and archiving)		5%
	Information and consultation of customers (including customer contacts during term of contract)		12%
	Monitoring / risk updates (steps include: trigger servicing, monitoring and controlling risk factors throughout duration of contract)		15%
	Managing withdrawals / repayments (steps include: collect timely payment of interest and principal from borrowers, processing withdrawals and repayments, calculating indemnities)		5%
	Additional Back-office tasks		n/a
	SUB-TOTAL BACK-OFFICE COSTS	68%	37%
BAD-DEBT COLLECTION	Information and consultation of customers (including customer contact in case of default, payment delay, etc.)		7%
	Bad-debt collection tasks (steps include: determining ongoing collateral adequacy, loan refinancing and modification processes)		8%
	Portfolio readjustment (steps include: managing credit risk across loan portfolio)		8%
	Additional bad-debt collection tasks		n/a
	SUB-TOTAL BAD-DEBT COLLECTION PROCESS COSTS	n/a	23%
	GRAND TOTAL	100%	100%

Source: Bank estimates

1.1.4.1. Impact of modified proposal on one-time implementation costs



Front-office processes

Implementation costs would be quite expensive as significant changes are expected for front-office processes if the proposed Directive were to be adopted. The most expensive impact would be felt for information and consultation of consumers, primarily related to increased human resource costs; staff would need to be trained to explain the pre-contractual information, including the APR and a representative sample for overdrafts. This would also elicit a change in IT systems, policies and processes including training materials. This is estimated to cause fairly to very significant implementation costs.

Fairly significant implementation costs are also expected for customer acquisition since the need to produce an APR and a representative sample would also require changes to IT systems, policies and processes. This would also impact costs for marketing materials (including websites) to include the APR and a representative sample.

Minor to fairly significant implementation costs are expected for credit risk analysis as it is expected that there will be a need to have the ability to provide information on credit worthiness to declined customers, requiring changes to IT systems, policies and processes.

No significant implementation costs are expected to be related to risk-adjusted pricing.

Back-office processes

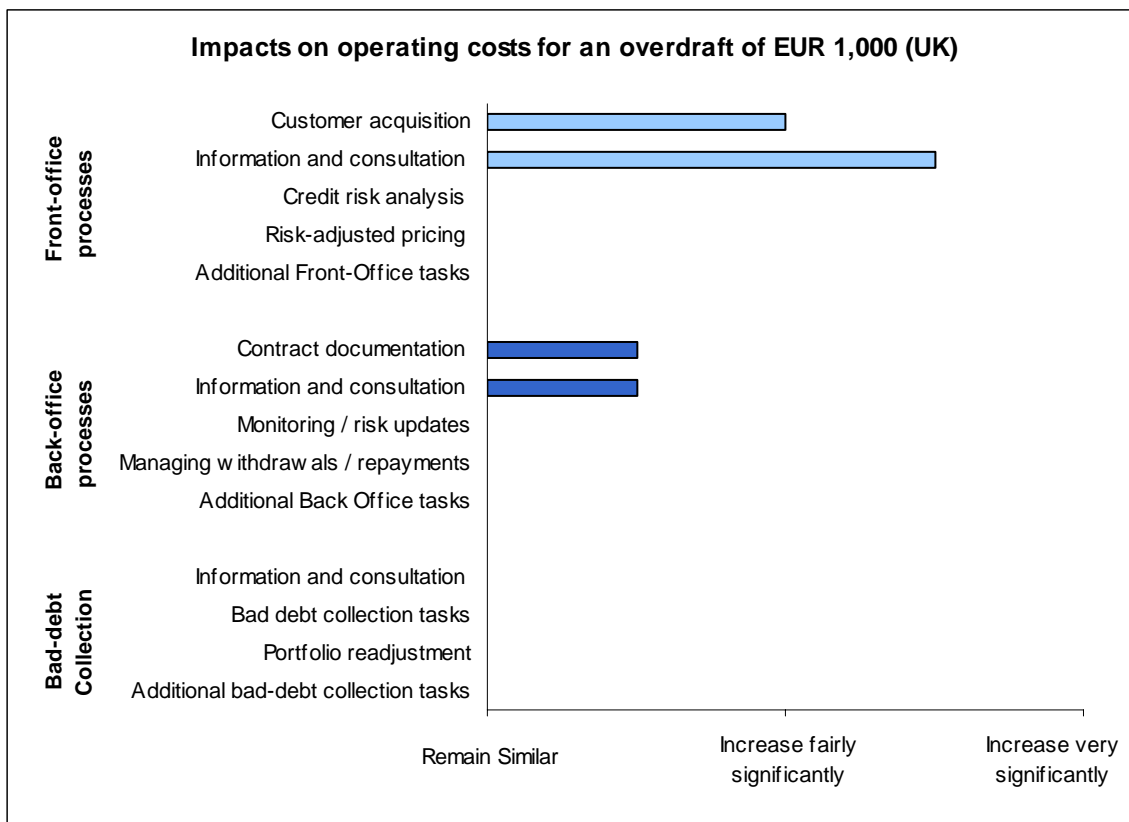
Contract documentation is expected to cause fairly costly implementation costs because of the need to document the provided pre-contractual information. Minor to fairly costly implementation costs are also expected for information and consultation.

Bad-debt collection

There are no relevant cost impacts expected for bad-debt collection processes in order to implement the provisions of the proposed Directive.

1.1.4.2. Impact of modified proposal on operating costs

If the modified proposal for a Consumer Credit Directive were adopted the consequence for the following processes regarding a bank's typical **operating costs** for the conclusion of a new overdraft facility/credit of € 1000 (unsecured) throughout the duration of its term, would be as follows:



Front-office processes

The most expensive increase in operating costs for overdraft facilities will be generated during the front-office processes. A fairly to significant increase in operating costs are expected for the information and consultation procedures; this is due to the creditors' obligation to provide additional pre-contractual information to the customers. Costs are related to additional documentation, human resources and training to explain pre-contractual information, including the APR and a representative sample.

Fairly significant increases in operating costs are also expected for customer acquisition because it is expected that there will be changes to marketing materials (including websites) for a range of products in order to meet the new APR and representative example requirements.¹⁸⁷

No cost impacts are expected for operation of credit risk analysis and risk-adjusted pricing.

Therefore, fairly to significant increases are expected for front-office processes that account for 32% of the total operating costs (costs related to both customer acquisition and information and consultation) of overdraft facilities.

Back-office processes

Operating costs for back-office processes were anticipated to be only mildly affected by the proposed Directive. Minor to fairly significant cost increases are expected for contract documentation and information and consultation of customers. These procedures represent an estimated 17% of the total operating costs for banks; therefore, cost increases in back-office processes may not alone imply a significant impact on bank's total operational costs.

Bad-debt collection

Operating costs related to bad-debt collection are estimated to be unaffected by the proposed Directive as debt recovery is already regulated in the UK for almost every consumer product.

1.1.4.3. Discussion/summary of impacts

The banks that provided cost data expressed that they anticipated a fairly significant increase in the bank's total operating costs for an overdraft facility should the proposed Directive be adopted. There was no information available as to whether these increased costs would signify any effect on the price to consumers for this credit loan though it was expressed that the increased implementation and operating costs would "have some unwelcome impact on the cost of the credit loan [to consumers] but not to the extent that it is 'fairly significant'".¹⁸⁸

Implementation costs and operating costs will both be affected by this proposed Directive and particularly costs accruing to front-office processes, which currently for this product are relatively low. More significantly, banks all expressed that the impact of the proposed Directive on overdraft facilities will not only be experienced in the costs but also in the increased inconvenience for customers and lack of appropriateness for this product. These impacts are discussed below with regard to the effect of particular provisions in the proposed Directive:

¹⁸⁷ Response to the cost analysis questionnaire by a member of the banking industry.

¹⁸⁸ Response to the cost analysis questionnaire by one of the banks.

Creditors' obligation to provide information and consultation

The creditors' obligation to provide information and consultation will result in fairly significant cost increases as well as a considerable amount of administrative burden. The following implications may be expected:

- Application of the full documentation requirements to overdrafts, potentially also for temporary excesses;
- Require provision of representative examples, even over the phone;
- Require lenders to warn a customer after two months that his overdraft may be unsuitable and advise alternative forms of finance;
- Require credit checks even in the event of 'tacit' overdrafts, or overrunning;
- Require lenders to advise in the event of rejection of an application, whereas currently it is only conducted on request;
- Possible requirement of early notification of changes in interest rates;
- Restriction of lenders' right to terminate as well as an additional complication to such a process; and
- Presentation of APRs and 'representative examples', which are inappropriate for overdrafts and meaningless to consumers.

'Open-ended' overdrafts may comprise a majority of personal overdrafts offered by banks and will then also need to fulfil the requirements of Article 26 for transition regarding their current customers. The cost implications for lenders are very significant as the number of current account customers number in the millions and the vast majority will have an agreed overdraft facility on their account (regardless of whether they use this facility or not). This would require that lenders need to identify all of these customers and the individual terms and conditions applying to each in order to comply with this requirement.¹⁸⁹ This is a substantial increase in the administrative burden for lenders, which they assert is not even to the consumers benefit. The banks interviewed anticipate that, for consumers, the proposed Directive's effect on overdrafts will entail:

- Increased costs and inconvenience because of the increased burden of the credit application and documentation process;
- Longer delays in the granting of credit, thereby reducing the accessibility of 'immediately available' facilities and especially those offered over the phone or Internet;
- A disproportionate treatment for overdrafts given the short-term nature of utilisation in most cases, and in the final analysis; and
- Higher incidence of demands for repayment and the chances of facilities being withdrawn where existing credit procedures would not require this.¹⁹⁰

The most severe impact expected would be the reduction of the availability of this product and the advantages from the convenience of this product will be diminished. This will make the product less attractive to consumers looking for immediate access to funds.¹⁹¹

¹⁸⁹ Personal email communication with a member of the banking industry, March 2, 2007.

¹⁹⁰ Response to the cost analysis questionnaire by a member of the banking industry.

¹⁹¹ Response to the cost analysis questionnaire by a member of the banking industry.

Creditors' obligation to responsible lending

It was expressed that responsible lending is already an important part of banking operations and embedded in UK legislation/regulation; therefore, this provision would only serve to increase the administrative burden related to corroboration and checking of the information given to lenders by the customer.¹⁹²

Consumers' right to early repayment

There will be no major impact from consumers' right to early repayment because there are no charges to repay overdrafts early.

¹⁹² Response to the cost analysis questionnaire by a member of the banking industry.

1.2. Germany

1.2.1. Assessment of changes to the national legal framework

German credit contract law has undergone substantial change over the last decades.¹⁹³ The so-called *Abzahlungsgesetz*, adopted as early as 1894 laid down a set of rules to protect the consumer within the field of hire purchase transactions. Setting aside minor amendments of the *Abzahlungsgesetz*, it was left for the courts to adjust the few legislative rules to modern forms of consumer credit. The first substantial change resulted from the adoption of the EC Directive 87/102/EEC which eventually led to the adoption of the *Verbraucherkreditgesetz* (Consumer Credit Act) in 1990. The *Verbraucherkreditgesetz* laid down comprehensive rules on all sorts of consumer credits in order to protect the consumer. However, the Act did not deal with a number of important issues such as excessive interest rates or violations of contractual advice duties. This was left for the courts which had to apply general civil law rules. Despite these shortcomings the 1990 Act has been highly appreciated as a major step forward in German consumer credit regulation. Only 12 years later, consumer credit law was integrated into the BGB, more precisely into §§ 491 BGB et seq. This goes along with the policy of the German legislator to merge general civil law rules and consumer law rules. However, the integration of consumer credit into the Civil Code is problematic in that a relatively homogeneous set of rules has been squeezed into the framework of the already existing rules on loan contracts.

Scope of application

Personal scope of application: Generally speaking, the scope of application of §§ 491 et seq. is broader than that of the proposed Directive at both ends of the contracts. It includes credit agreements for so-called *Existenzgründer*, that is persons who are in a process of setting up his or her business, up to € 50,000, § 507 BGB. In so far, German law has a broader notion of consumer than the Directive. On the other hand, German law also covers publicly sponsored consumer credits as long as the contracting partner to the consumer is still a private bank.¹⁹⁴ However, the proposed Directive does not affect credit agreements concluded between creditors and non-consumers in the terms of the Directive.

Substantial scope of application: The substantial scope of application of the German rules on consumer credits exceeds the Draft Directive as well. For example, it covers consumer credit agreements without any limit.

Credit advertisement

The §§ 491 ff. BGB only contain rules on the contractual rights and obligations of the parties. Under § 492 par. 1 no 5 BGB, the creditor has to provide information on the interest rates. The details are laid down in § 6 *Preisangabenverordnung* (Price Indication Order).

Credit advertising comes under the scope of application of the general law on unfair commercial practices, the *Gesetz gegen den unlauteren Wettbewerb* (UWG). The general standards on unfair and misleading advertising apply to credit advertising. There are no particular rules on credit advertising foreseen in German law, although the Member States have been granted the competence in Article 3 (9) of the Unfair Commercial Practices Directive 2005/29/EC to impose more restrictive or prescriptive standards on the credit business.

¹⁹³ For a short survey see *Ulmer* in *Münchener Kommentar zum BGB*, Vor § 491 Rn. 1 ff.

¹⁹⁴ See *Ulmer* in *Münchener Kommentar zum BGB*, § 491 Rn. 15.

However, creditors who are not respecting the mandatory information requirements of § 6 Price Indication Order on interests rates in their advertising activities may breach § 4 no. 11 UWG. This provision prohibits advertising that violates binding law which is meant to regulate the market behaviour in the interest of market participants. The new rule is of outmost importance as it makes deliberately clear that violations of price indication obligations affect the interest of consumers.¹⁹⁵

The envisaged Article 4 of the Consumer Credit Directive reaches beyond the set of information laid down in § 6 Price Indication Order. It would restrict advertising beyond the already existing limits under the German UWG.¹⁹⁶

Information obligations

§§ 491 ff. BGB do not contain particular rules on the disclosure of contractual information. Indirectly, however, the consumer is protected by the possibility to examine the mandatory minimum content of the contract (§ 492 BGB) within 14 days, as he has a right to withdraw from the contract, § 495 BGB.¹⁹⁷ Outside and beyond legislation, German courts have developed a limited set of contractual disclosure obligations. These however are only triggered off, if very special circumstances require the creditor to intervene.¹⁹⁸

In Germany, credit agreements are usually concluded on the basis of standard contract terms. Insofar, §§ 305 et seq. BGB apply, which oblige the creditor to draft contract terms in a clear and intelligible manner.

Particular disclosure requirements have been inserted into § 312b to § 312d BGB with regard to the distant selling of financial services. These provisions go back to the implementation of Directive 2002/65/EC. § 312c par. 1 obliges the creditor to provide the consumer with a whole set of information prior to the conclusion of the contract. The details are laid down in the respective BGB-Informationspflichtenverordnung. The creditor may transfer the information to the consumer via distant communication means, that is via the internet.

The proposed Article 5 reaches far beyond existing German law.

Responsible lending

No duty of responsible lending exists in German law. However, the lower courts have been discussing to what extent to what extent the creditor may engage in an obligation which reduces his income below the subsistence level. The Appellate Court of Hamm, however, insisted on the autonomy of each individual to engage in an obligation he can never fulfil.¹⁹⁹ The codification of the culpa in contrahendo in § 241 par. 1 of the German Civil Code has led to the question whether it is possible under existing law to determine an obligation of one party to take into consideration the interests of the other party.²⁰⁰

¹⁹⁵ Which was not the case before the 2004 reform, see Schaffert in Münchener Kommentar zum UWG, § 4 Nr. 11 UWG Rn. 304 et seq. and for a detailed account of the state of the art, Ernst in Münchener Kommentar zum UWG Anh. §§ 1-7 G § 6 Preisangabenverordnung

¹⁹⁶ BMJ, Zweiter geänderter Vorschlag für eine neue Verbraucherkreditrichtlinie, Deutsche Stellungnahme, March 2006, p. 12.

¹⁹⁷ See Reifner, in Handbuch zum deutschen und europäischen Bankrecht (ed. Derleder/Knops/Bamberger), § 11 Verbraucherdarlehensvertrag, Rn. 95.

¹⁹⁸ See Reifner, in Handbuch zum deutschen und europäischen Bankrecht (ed. Derleder/Knops/Bamberger), § 11 Verbraucherdarlehensvertrag, Rn. 95 with references to established case-law.

¹⁹⁹ OLG Hamm, judgment of 6/7/1988, WM 1988, 1236.

²⁰⁰ For a full account of the debate in German legal doctrine, see Udo Reifner, Verantwortliche Kreditvergabe im europäischen Recht, in Luc Thevenoz & Norbert Reich (eds), *Liber amicorum Bernd Stauder*, Zurich and Baden-Baden 2006., 383 ff., as

Duty to assist

German law does not know a duty to assist, neither generally notwithstanding the type of contract concerned nor in credit agreements. Any change in the Directive meets resistance from the German Ministry of Justice, in particular with regard to Article 5 (5).²⁰¹

Content of the contract

§ 492 BGB par. 1 no. 1-5 enlists the set of information that the contractual declaration of the consumer must contain:

- The net amount of credit, respectively the upper limit of the credit,
- The total amount of all instalments needed to redeem the credit, if the total amount is already determined at the time the contract is concluded (with exceptions in case the total amount cannot be determined),
- the modes of repayment or, if no rule is foreseen, the conditions under which the contract can be cancelled,
- the interest rate, as well as administration costs or costs for a credit intermediary,
- the annual percentage rate,
- the costs for a so-called Restschuldversicherung (credit agreement that covers the open instalments in case of non-repayment by the consumer due to death, insolvency or unemployment) or any other insurance, which is concluded in the context of the consumer credit agreement,
- securities to be established.

It is important to recall that the annual percentage rate does not normally cover possible insurance costs. That is why the two types of information have been kept separate. However, if the insurance is mandatory, it has to be integrated into the calculation of the annual percentage rate.²⁰²

The proposed Article 5 of the Directive reaches beyond the existing information requirements.

Formal requirements

§ 492 par. 1 requires that the credit agreement is concluded in writing. Sentence 2 of the same section explicitly states that credit agreements cannot be concluded by electronic means. German law understands the written form as an essential mechanism to protect consumers.

The abolition of the written form meets strong rejection by academics and also from the German Ministry of Justice.²⁰³

well as Peter Rott, *Mitverantwortung des Kreditgebers bei der Kreditaufnahme – Warum eigentlich nicht?*, *Zeitschrift für Bank- und Kapitalmarktrecht* 2003, 851 ff.

²⁰¹ BMJ, Zweiter geänderter Vorschlag für eine neue Verbraucherkreditrichtlinie, Deutsche Stellungnahme, March 2006, p. 14, 18.

²⁰² See *Ulmer* in *Münchener Kommentar zum BGB*, § 492 Rn. 69 et seq.; *Reifner*, in *Handbuch zum deutschen und europäischen Bankrecht* (ed. *Derleder/Knops/Bamberger*), § 11 Verbraucherdarlehensvertrag, Rn. 130, 133.

²⁰³ BMJ, Zweiter geänderter Vorschlag für eine neue Verbraucherkreditrichtlinie, Deutsche Stellungnahme, March 2006, p. 22; in the same sense *Udo Reifner*, *VuR* 2004, 87.

Right of withdrawal

Since 1990, German law has granted the consumer a right to withdrawal. It may now be found in § 495. The consumer may withdraw from the contract within 14 days after its conclusion. However, credit agreements where the consumer is entitled to cancel the contract at any time without period of notice and without additional costs are exempted from the right to withdrawal, § 495 par. 2.

Right of early repayment

§ 504 BGB grants the consumer the right to early repayment of instalment credits. The overall idea is that the consumer is credited the amount of those costs which have not been used and are no longer used due to the abbreviated duration of the contract.²⁰⁴ However, the creditor may at least claim the costs for the first nine months. This is largely in line with the proposed Article 15 of the Directive, although the true difficulty results from the way in which the credited amount is calculated.²⁰⁵

Linked credit agreements

German law contains fairly detailed rules on linked credit agreements. The key rule may be found in § 358 par. 3 s. 1 BGB. Linked agreements are those which form a commercial unit. In the German point of view, the credit agreement has to 'serve' partly or in full the financing of a sales or service contract.²⁰⁶ This is suggested to be the case if the supplier finances the contract himself or herself, or in case of financing by a third party, if the creditor involves the supplier into the preparation or the conclusion of the credit agreement. According to the German courts, the consumer perspective is crucial: If the trader and the creditor present themselves as a unit, the two contracts are linked. The courts do not require a pre-existing agreement between the trader and the creditor but also apply §. 358 par. 3 BGB to factual co-operation.²⁰⁷ A long-standing relationship between the trader and the creditor is not necessary either.²⁰⁸ Furthermore, § 359 BGB does not require the consumer to take action against the trader first. Instead, he can raise objections from his relationship with the trader immediately against the creditor.

German law therefore represents a system that is not outside the scope of the Directive but that is far more stringent than Article 14 (2) of the proposed Directive and that does not comply fully with Article 14 (3) either. Thus, Germany would have to reduce the level of consumer protection quite drastically by narrowing down the definition of a linked agreement for both the purposes of Article 14 (1) and (2)²⁰⁹ and by making the creditor's liability merely subsidiary to the trader's liability.

²⁰⁴ See Ulmer in Münchener Kommentar zum BGB § 504 Rn. 1.

²⁰⁵ See with regard to German law, Ulmer in Münchener Kommentar zum BGB, § 4 504 Rn. 9 and 10, but see on the uncertainties, BMJ, Zweiter geänderter Vorschlag für eine neue Verbraucherkreditrichtlinie, Deutsche Stellungnahme, März 2006, p. 28.

²⁰⁶ Reifner, in Handbuch zum deutschen und europäischen Bankrecht (ed. Derleder/Knops/Bamberger), § 11 Verbraucherdarlehensvertrag, Rn. 155.

²⁰⁷ See BGH, Neue Juristische Wochenschrift (NJW) 2003, 2821.

²⁰⁸ See BGH (DE), NJW 1971, 2303.

²⁰⁹ BMJ, Zweiter geänderter Vorschlag für eine neue Verbraucherkreditrichtlinie, Deutsche Stellungnahme, March 2006, p. 11. For details, see Peter Rott, Maximum Harmonisation and Mutual Recognition *versus* Consumer Protection: The Example of Linked Credit Agreements in EC Consumer Credit Law, *The European Legal Forum* 2006, I-61 ff. See also Anne Danco, Die Novellierung der Verbraucherkreditrichtlinie, *Wertpapier-Mitteilungen* (WM) 2003, 853, at 860.

Alternatively, Germany would have to introduce a UK-type system of joint and several liability that is clearly more stringent than the current system and that has always been rejected by German lawyers.²¹⁰ These rules are only narrowed down for secured credit contracts which lie outside the scope of the proposed Directive.

Conclusions

The draft proposal reduces consumer protection with a view to formal requirements and to linked credit agreements. Furthermore, it does not deal with a number of important consumer policy issues (such as guarantees, mortgage credits). Where it goes beyond current German consumer credit law, for example in requiring responsible lending, the maximum harmonisation spirit may set a low ceiling to consumer protection.

1.2.2. Overview of consumer financial services in Germany

Market situation for consumer credit

The total of consumer credits in Germany in the past four years has been rather stable, but the volume of instalment credits was growing in the same time (from 118.6 billion to 130.6 billion EUR).

Figure 15: Evolution of consumer credits in Germany in the past four years:

Year	Total consumer credits (in billion EUR)	Instalment credits (in billion EUR)	Overdraft facilities/Credits* (in billion EUR)
2003	230.9	118.6	21.6
2004	237.0	129.2	19.9
12/2005	234.0	130.1	18.8
12/2006	228.4	130.6	17.6

Source: Deutsche Bundesbank, Monthly Report of 15th February 2007, p33.

**Debet-Salden auf Lohn-, Gehalts-, Renten- und Pensionskonten.*

About three years ago, German banks once again discovered instalment credits as a lucrative financial product. Additionally, “real” credit cards offering a loan to consumers which can be paid back by instalments, started entering the German market during the last years.²¹¹ Currently, consumers mainly use debit-cards in combination with an overdraft facility.

²¹⁰ For critical comments on that option, see Danco, Anne, Die Novellierung der Verbraucherkreditrichtlinie, *Wertpapier-Mitteilungen* (WM) 2003, 853, at , at 855 *et seq.*

²¹¹ Interview with a German bank.

Cross-border consumer credit contracts

Currently the percentage of the main consumer financial services²¹² that German banks directly sell to consumers resident in another EU Member State is estimated by German banking associations to be less than 0.1%.²¹³

The total consumer credit transactions that German banks conduct with consumers resident in another EU Member State through branches/subsidiaries established there (including through majority holdings in local banks) is also estimated to be very low. The National Association of German Cooperative Banks estimates transactions to be less than 1% for instalment credits, overdrafts and credit cards; though they estimate transactions to be less than 0.1% for leasing products. Similarly, the Savings Banks Association estimates transactions cross-border through branches/subsidiaries for all consumer credit products to be less than 0.1%.²¹⁴ The Bundesverband deutscher Banken and the Bankenfachverband did not give any estimation to this subject due to the lack of own statistical data.

Concerning the Cooperative banks, only a few banks actually have branches in other EU Member States. The holdings in banks in other countries are generally minority interests.²¹⁵

Some main barriers hindering the selling of consumer credit products in other Member States are differences in language and culture and credit risk for lenders in not having access to information to assess creditworthiness²¹⁶.

Credit contracts are generally only sold directly to consumers cross-border through branches which are situated in German border regions.²¹⁷ One important barrier is also the uncertain legal situation in other EU-Member States from a German perspective. Additionally, the adaptation of the products and contracts to other legal systems and the adaptation of the necessary software-systems to manage the credits is costly.²¹⁸

(Over-)indebtedness

Indebtedness is a standard process in everyday life. It means that a household (or enterprise) chooses to take on repayment obligations for financial resources obtained from a bank or another creditor. Overindebtedness means the impossibility to repay all debts fully and on time.

²¹² This includes: credit agreements under the terms of which the consumer is required to repay the credit by means of instalments; overdraft facility/credit; credit card; and leasing agreements that create an obligation to purchase the object of the agreements.

²¹³ Bundesverband deutscher Banken e.V., Deutscher Sparkassen-und Giroverband, Bundesverband Öffentlicher Banken Deutschlands(VÖB), Bundesverband der Deutschen Volksbanken und Raiffeisenbanken e.V. (National Association of German Cooperative Banks), Answer 2a to the survey of Banking Associations. The Bundesverband deutscher Banken clarified that the Association does not have statistical data concerning the amount of credit transactions in this field.

²¹⁴ Deutscher Sparkassen-und Giroverband, Answer 3a to the questionnaire for the Banking Associations. The Bankenfachverband estimates the participation of foreign EU-banks on the German consumer credit market between 20% and 30%.

²¹⁵ Bundesverband der Deutschen Volksbanken und Raiffeisenbanken e.V. (National Association of German Cooperative Banks), Answer 3a to the survey of Banking Associations.

²¹⁶ Bundesverband deutschen Banken e.V. and Deutscher Sparkassen-und Giroverband, Answer 6 to the questionnaire for the Banking Associations.

²¹⁷ Bundesverband der Deutschen Volksbanken und Raiffeisenbanken e.V. (National Association of German Cooperative Banks), Answer 2a to the survey of Banking Associations and Interview with a German bank on 19th February 2007.

²¹⁸ Interview with a German bank on 19th February 2007.

Whether and when it occurs is a function of current and future income and assets as well as design features of the loan contract (interest rate, fees, repayment schedule, etc.).²¹⁹

Over the last two decades overindebtedness has become one of the major social problems in Germany. It is estimated that close to every tenth household is overindebted, in absolute numbers 3.13 million households (2002). From 1994 to 2002 the number of overindebted households increased by 57%.²²⁰

About 70% of all debts are owed to banks and other lenders, 42% to enterprises, 42% to public administrations and 27% to telecommunication companies (an overlap is possible, because a borrower may have different lenders).²²¹

The causes for overindebtedness are mainly unemployment (23% in West Germany and 46% in the New Länder), insufficient income (8 % in West Germany and 29% in the New Länder), separation/divorce (23% in West Germany and 19% in the New Länder), business failure (20% in West Germany and 16% in the New Länder) and excessive consumption / uneconomic personal financial management (21% in West Germany and 27% in the New Länder).²²²

The Consumer's attitude towards cross-border financial services

In Germany, there is still a high level of reluctance to obtain cross-border financial services in the future: 85 % of German respondents to a Eurobarometer survey²²³ published in September 2005 said that they do not consider to obtain any services from other Member States in the near future.²²⁴

In the focus groups conducted with consumers from Germany, Czech Republic and UK to identify barriers that prevent them from purchasing goods and services from other Member States (see Annex 1), the participants were asked if they would accept a consumer credit from a financial institution based in another EU country. This elicited a strong reaction among respondents in terms of raising strong underlying emotional issues and a range of practical problems. Here are two statements from German consumers:

“It depends on the country. Austria or Switzerland or Denmark I would maybe consider. But not in Greece or elsewhere...That's because of the feeling of security. First of all, the language is an issue. And accessibility. If I had it, I could quickly travel to Denmark. But the further away it is the less secure it is.”

“I don't know anyone who got a credit from Spain or elsewhere, or who told me that it was a positive experience”.

The view of Consumer Organisations

The Federation of German Consumer Associations (VZBV) expects that the number of defaulted contracts will decrease fairly significantly because of the provisions of the modified proposal.

²¹⁹ Haas, Oliver J., International Labour Organization (2006). Overindebtedness in Germany, p.3, 4.

²²⁰ Bundesregierung, Lebenslagen in Deutschland: Der 2. Armuts- und Reichtumsbericht (The Federal Government's 2nd Poverty and Wealth Report), p.50

²²¹ Haas, Oliver J., International Labour Organization (2006). Overindebtedness in Germany, p.8.

²²² Data from Bundesregierung, Lebenslagen in Deutschland Der 2. Armuts- und Reichtumsbericht (The Federal Government's 2nd Poverty and Wealth Report), p.51

²²³ The European Commission (Directorate-General Press and Communication) organises general public opinion, specific target groups, as well as qualitative (group discussion, in-depth interview) surveys in all Member States, The Eurobarometer Web site address is: http://europa.eu.int/comm/public_opinion

²²⁴ Eurobarometer (2005). Special Eurobarometer 230, Public Opinion in Europe on Financial Services, September 2005, p.10

They feel that proper information will avoid all those preventable cases of default due to a misunderstanding of costs and conditions of a contract. Of course there will still be other influences and unpreventable events such as a change in the borrower's financial capabilities that might occur.²²⁵

Concerning the main barriers hindering consumers from engaging in cross-border transactions of consumer credit products, they think that the following additional measures related to an enhancement of consumer confidence (not included in the modified proposal) are needed:

- Responsible lending as a legal principle;
- Ensuring consumers' language will be used and obtainable - including the time after contracting;
- Protection of consumers as guarantors;
- Written form of contract for protective rulings;
- APRC indication with risk-based pricing - offers from X % - provision that prevents luring of consumers with conditions actually nobody or insignificant numbers of consumers may obtain;
- Comparable and standardized information.²²⁶

1.2.3. Analysis of typical consumer credit transaction – personal loan

1.2.3.1. Current typical operating costs

The following table shows the estimated costs that a bank would typically incur when progressing, approving and monitoring a personal loan (unsecured) for € 5,000 over a two-year contract term. The costs include all direct running costs, but exclude profit margin and costs of capital. The costs are divided into three categories corresponding to where they incur: front-office, back-office and bad-debt collection. The table shows the estimation concerning two banks.

²²⁵ Answer from vzbv to Question 11 of the questionnaire for Consumer Associations.

²²⁶ Answer from vzbv to Question 17 of the Questionnaire for Consumer Associations and interview on 23rd of February 2007.

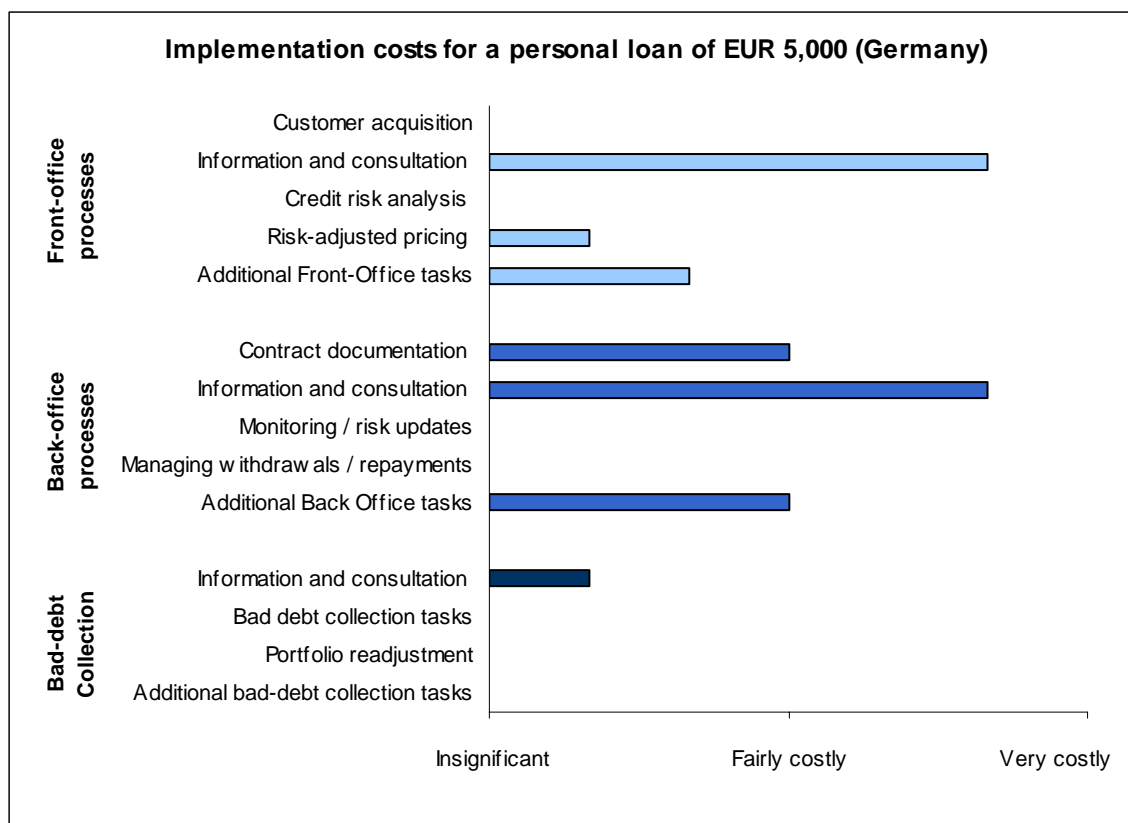
Figure 16: Estimated typical operating costs for a personal loan for € 5,000

Sub-processes during lending procedure <u>WITHOUT</u> modified proposal		Estimated percent		
		Bank 1	Bank 2	Bank 3
FRONT-OFFICE	Customer acquisition (steps include: planning and acquisition of customers, advertising)	47 %		20 %
	Information and consultation of customers (steps include: providing pre-contractual information on, e.g., borrowing rate, duration, instalments, fees, etc.)	8 %		25 %
	Credit risk analysis (steps include: creditworthiness check)	1 %		5 %
	Risk-adjusted pricing (steps include: underwriting procedure, pricing of loan)	1 %		2 %
	Additional Front-Office tasks			
	SUB-TOTAL FRONT-OFFICE COSTS	57 %	60 %	52%
BACK OFFICE	Contract documentation (steps include: credit filing and archiving)	5 %		20 %
	Information and consultation of customers (including customer contacts during term of contract)	5 %		20 %
	Monitoring / risk updates (steps include: trigger servicing, monitoring and controlling risk factors throughout duration of contract)	9%		3%
	Managing withdrawals / repayments (steps include: collect timely payment of interest and principal from borrowers, processing withdrawals and repayments, calculating indemnities)	5 %		2%
	Additional Back-office tasks			
	SUB-TOTAL BACK-OFFICE COSTS	24 %	30%	45%
BAD-DEBT COLLECTION	Information and consultation of customers (including customer contact in case of default, payment delay, etc.)	9 %		1 %
	Bad-debt collection tasks (steps include: determining ongoing collateral adequacy, loan refinancing and modification processes)	9 %		1 %
	Portfolio readjustment (steps include: managing credit risk across loan portfolio)	1 %		1 %
	Additional bad-debt collection tasks			
	SUB-TOTAL BAD-DEBT COLLECTION PROCESS COSTS	19 %	10%	3%
GRAND TOTAL		100%	100%	100%

Source: Bank estimates

1.2.3.2. Impact of modified proposal on one-time implementation costs

If the modified proposal for a Consumer Credit Directive were adopted (COM 2005 483 of October 2005) the consequence for the following processes regarding a bank's typical **one-time, implementation costs** for a personal loan for € 5,000 payable over two-years would be as follows:



Source: Bank estimates

Front-office processes

There is no or only a small impact expected concerning the costs for customer acquisition because of the new rules for advertising. On the other hand, with regard to information and consultation, the one-time, implementation costs are expected to be fairly costly for large banks and very costly for smaller banks because of the necessary implementation and training of the staff with regard to the new rules. There are no supplementary costs expected from the consulted large bank for credit risk analysis and risk-adjusted pricing. The small bank expects fairly significant one-time implementation costs for risk-adjusted pricing. One large bank also expects very high costs for the set-up, monitoring and documentation of new processes which are related to the modified proposal for a Consumer Credit Directive.

Back-office processes

Banks expect a fairly significant to very high impact on the costs with regard to training their staff on the new information and consultation rules.

Additionally, there is a fairly significant to very high impact expected by the two large banks concerning the adaptation of workflows and computer software because of the future need to document the information/consultation process and because of the necessary adaptation of the structure of the contract and provision of new data as well as for the calculation of the APRC.

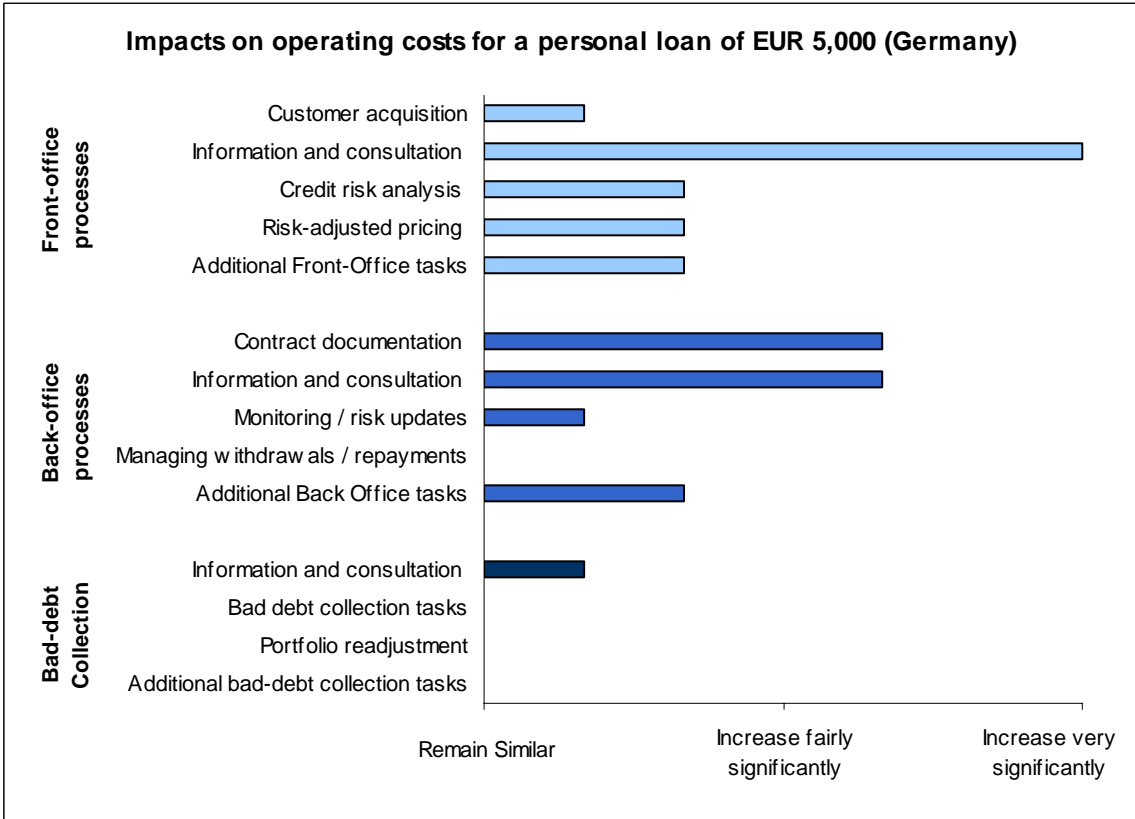
Other back-office processes will only have insignificant one-time, implementation costs.

Bad-debt collection

Regarding bad-debt collection, one bank estimates that one-time, implementation costs would be insignificant, while another bank did expect a fairly significant impact for information and consultation costs. The third bank did not make an assessment.

1.2.3.3. Impact of modified proposal on operating costs

If the modified proposal for a Consumer Credit Directive were adopted (COM 2005 483 of October 2005) the consequence for the following processes regarding a bank’s typical **operating costs** for a personal loan for € 5,000 payable over two-years would be as follows:



Source: Bank estimates

Front-office processes

All three consulted banks assess that the information and consultation costs may increase very significantly because more time will be needed to inform customers and for one bank there is a lack of clarity whether one session will be sufficient or if the modified proposal requires two advisory sessions because of the need to inform “in good time before” the contract is concluded (Art. 6, 1 of the modified proposal).²²⁷

The current costs for customer acquisition will remain the same for the large banks, the smaller bank expects a fairly significant increase.

Very significant additional front-office costs are expected by one large bank because of the need to document the information and consultation process.

Concerning other tasks like credit risk analysis and risk-adjusted pricing, there are no impacts expected by the consulted two large banks whereas the smaller bank expects a very significant increase of these operating costs.

Back-office processes

Concerning the contract documentation and the information and consultation, two banks expect that the costs will increase very significantly. The third (large) bank felt, that these costs will remain the same.

In field of the monitoring and updates of risks, a fairly significant increase on operating costs is expected by one large bank. The reason for this is the risk of liability due to the creditor’s obligation of responsible lending. The other two banks expect the cost to remain the same.

One consulted large bank expects a very significant increase of additional front-office tasks for the monitoring.

Bad-debt collection

In these processes, one consulted large bank estimates the change of the operating costs would be insignificant whereas the other large bank didn’t know the impact on the cost. Only the smaller bank estimates a fairly significant increase of the information and consultation costs while the other bad-debt collection costs would remain the same.

1.2.3.4. Discussion/summary of impacts

The interviewed credit institutions estimate, that the adoption of the modified proposal would impact the operating costs for a personal loan fairly to very significantly and would fairly to very significantly affect the costs for consumers. The main cost factors are:

- an increase in the duration of the consultation process and additional bureaucratic burden caused by the creditors’ obligation to provide information and consultation;
- liability risks because of the creditors’ obligation to responsible lending.

The consulted German banks feel that the provisions of the modified proposal will not improve their ability to enter other markets in the EU. One reason is, because this already happens to a certain extent through their branches, the other is, that one bank operates only regionally.

²²⁷ Interview with a bank on 19th February, 2007.

The impact of the following provisions in the modified proposal on the current cost structure are as follows:

Creditors' obligation to provide information and consultation

The credit institutions believe that the very comprehensive information requirements will cause additional bureaucratic burden and will lead to longer duration of the consultation interviews: The requirement to provide consumers with "adequate explanations" about "the advantages and disadvantages associated with the products proposed" before every single agreement is concluded would give rise to a considerable additional administrative burden and associated costs.²²⁸ Furthermore, the consulted banks expect fairly significant costs for the adaptation of their computer software and workflows, adaptation of the contracts, monitoring, documentation of the consultation and information procedure and training of the staff.

Creditors' obligation to responsible lending

Banks already examine the creditworthiness of potential borrowers today. This is required by German supervision law but above all because of their own interest of limiting the risk of default. A civil law requirement to assess creditworthiness would, however, result in substantial liability risks for credit institutions which bears a cost. When payment difficulties arise, they must always expect to be held responsible for having obtained insufficient information on the personal and financial situation of the consumer when concluding the contract²²⁹.

Consumers' right to early repayment

The practical relevance of early repayment rules in the context of consumer credits as defined by the proposal, is limited. The contrary is the case with mortgage loans, this is why credit institutions would like coherent rules for both sorts of credits²³⁰.

Consumers' right to withdrawal

The right of withdrawal is already established under German law, so there will be no change to the current situation.

1.2.4. Overdraft

1.2.4.1. Current typical operating costs

The following table shows the estimated costs that a bank would typically incur when processing, approving and monitoring a new overdraft facility/credit of € 1000 (unsecured) throughout the duration of its term. The costs include all direct running costs, but exclude profit margin and costs of capital.

²²⁸ Answer of DSGVO and Bundesverband Deutscher Banken to Question 11; Interview with a German bank on February 19th, 2007.

²²⁹ Answer of DSGVO and Bundesverband Deutscher Banken to Question 12. Interview with a German bank on February 19th, 2007.

²³⁰ Answer of DSGVO to Question 22; Interview with a German bank on February 19th, 2007.

The costs are divided into three categories corresponding to where they incur: front-office, back-office and bad-debt collection. The table shows the estimations given by two banks.

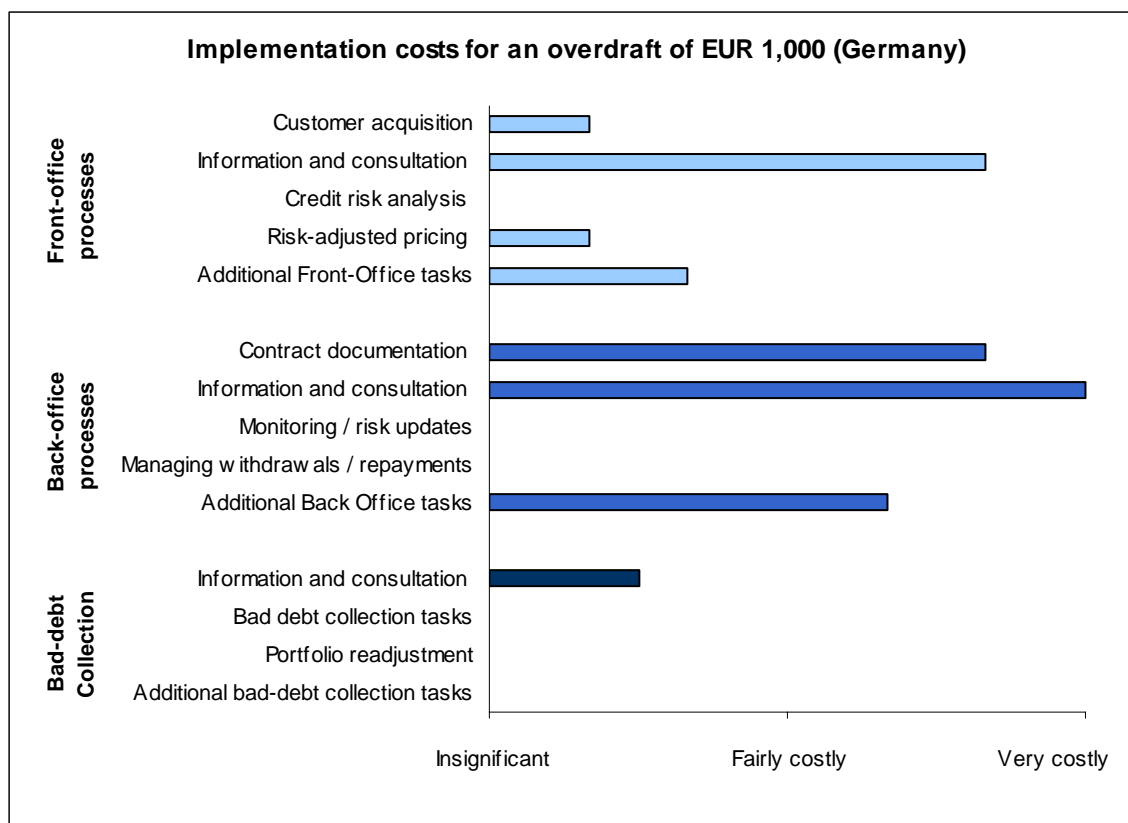
Table 7: Estimated typical operating costs for an overdraft facility

Sub-processes during lending procedure <u>WITHOUT</u> modified proposal		Estimated percent		
		Bank 1	Bank 2	Bank 3
FRONT-OFFICE	Customer acquisition (steps include: planning and acquisition of customers, advertising)	24 %		10 %
	Information and consultation of customers (steps include: providing pre-contractual information on, e.g., borrowing rate, duration, instalments, fees, etc.)	6 %		15 %
	Credit risk analysis (steps include: creditworthiness check)	10 %		5 %
	Risk-adjusted pricing (steps include: underwriting procedure, pricing of loan)	0 %		2 %
	Additional Front-Office tasks	5 %		..%
	SUB-TOTAL FRONT-OFFICE COSTS	45 %	70 %	32 %
BACK OFFICE	Contract documentation (steps include: credit filing and archiving)	0 %		35 %
	Information and consultation of customers (including customer contacts during term of contract)	5 %		25 %
	Monitoring / risk updates (steps include: trigger servicing, monitoring and controlling risk factors throughout duration of contract)	0%		3%
	Managing withdrawals / repayments (steps include: collect timely payment of interest and principal from borrowers, processing withdrawals and repayments, calculating indemnities)	0 %		2 %
	Additional Back-office tasks			
	SUB-TOTAL BACK-OFFICE COSTS	5 %	20%	65 %
BAD-DEBT COLLECTION	Information and consultation of customers (including customer contact in case of default, payment delay, etc.)	30 %		1 %
	Bad-debt collection tasks (steps include: determining ongoing collateral adequacy, loan refinancing and modification processes)	20 %		1 %
	Portfolio readjustment (steps include: managing credit risk across loan portfolio)			1 %
	Additional bad-debt collection tasks			
	SUB-TOTAL BAD-DEBT COLLECTION PROCESS COSTS	50 %	10 %	3 %
GRAND TOTAL		100%	100%	100%

Source: Bank estimates

1.2.4.2. Impact of modified proposal on one-time implementation costs

If the modified proposal for a Consumer Credit Directive were adopted (COM 2005 483 of October 2005) the consequence for the following processes regarding a bank's typical **one-time, implementation costs** for a personal loan for € 5,000 payable over two-years would be as follows:



Front-office processes

One consulted large bank expects a fairly costly impact concerning customer acquisition, because of the new rules for advertising and information. The other two banks do not expect a change in their acquisition costs.

Additionally, banks expect fairly to very significant one-time implementation costs for information and consultation because the new rules on information and consultation have to be implemented and the staff has to be trained.

Back-office processes

The consulted credit institutions expect very high implementation costs for information and consultation because of the necessary adaptation of workflows and computer software and the monitoring

- because there is a need to document the information/consultation process (duty to assist);

- because the structure of the contracts will have to be changed and new contracts will have to be formulated. For the time being, there is no separate contract concerning the overdraft facility. The customer concludes the overdraft credit by overdrawing his account. With the modified proposal the contractual procedure will have to be changed into a more formal procedure.

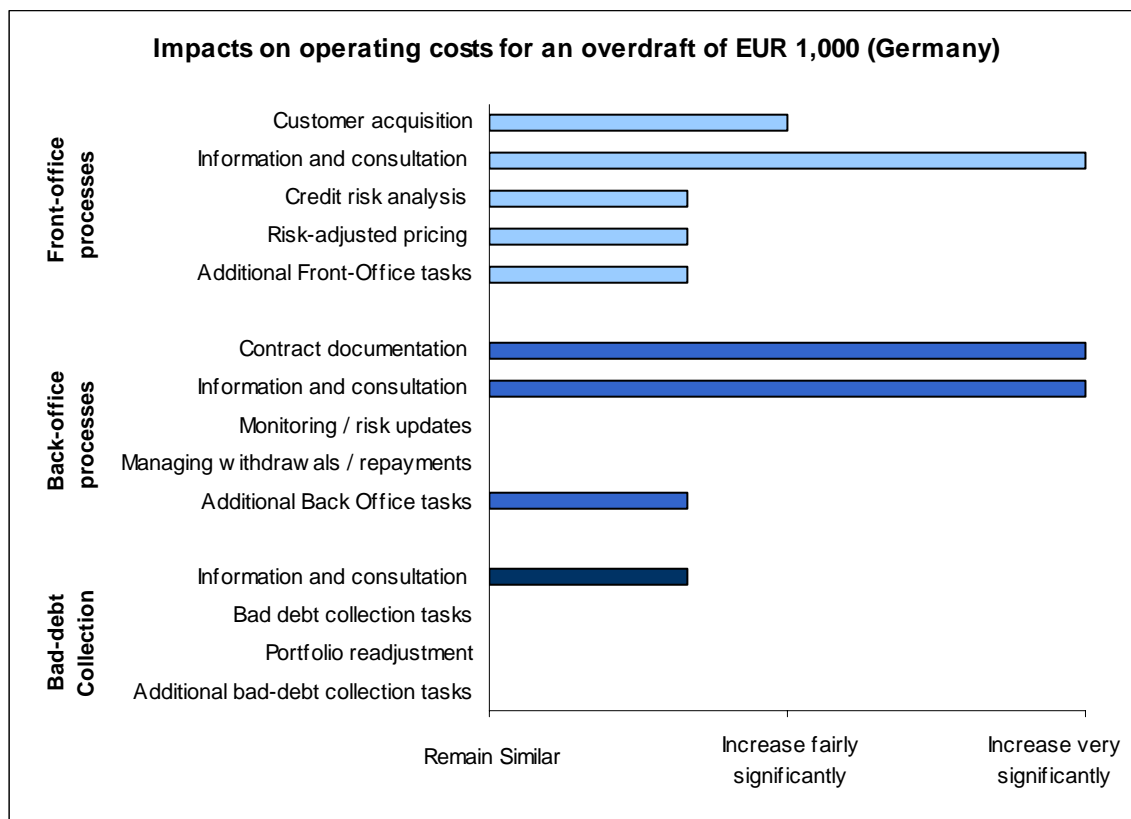
In addition, banks expect fairly to very significant implementation costs because of the new obligation of contract documentation.

Bad-debt collection

Only the smaller bank estimates a fairly significant increase of the information and consultation costs while the other bad-debt collection costs would remain the same.

1.2.4.3. Impact of modified proposal on operating costs

If the modified proposal for a Consumer Credit Directive were adopted (COM 2005 483 of October 2005) the consequence for the following processes regarding a bank's typical **operating costs** for the conclusion of a new overdraft facility/credit of € 1000 (unsecured) throughout the duration of its term, would be as follows:



Front-office processes

All three consulted credit institutions expect a very significant increase of information and consultation costs because customers have to be informed and advised on the product. Additionally, this process will have to be documented. Moreover, one large bank expects a very significant increase of the consumer acquisition costs because the advertisements may have to be modified. The other two banks estimate, that these cost will remain similar or increase fairly significantly. Concerning the credit risk analysis and the risk-adjusted pricing, two banks assess the cost to remain similar whereas the smaller bank expects them to increase very significantly.

Back-office processes

There is a very significant increase expected by all three consulted banks concerning the costs for contract documentation and the information/consultation duties. Until now banks don't conclude separate contracts for overdraft facilities/credits. Currently the client is regularly informed about the conditions of his overdraft facility/credit on the statements of account. With the modified proposal, new contracts will have to be established and customers have to be informed and consulted. Further on, one (large) bank expects that the costs for monitoring will increase very significantly.

Bad-debt collection

Two banks assessed that there may be some fairly significant increasing costs because of necessary information and consultation on overdraft agreements whereas the third bank did not know which impact the modified proposal will have on the bad-debt collection costs.

1.2.4.4. Discussion/summary of impacts

Currently, overdraft facilities/credits are a low-cost product for German banks. The conclusion of the overdraft facility/credit requires very little formality for customers as well as for banks. The bank offers the overdraft facility when the customer opens his or her giro account and is informed about the conditions (e.g., the frame of the credit and the interest rate). It is then up to the customer to conclude the overdraft credit contract de facto by overdrawing the account (e.g. through withdrawal or money transfer). With the modified proposal, the pre-contractual and contractual procedure would have to be modified into a much more formal procedure which would lead to very significant costs.

The consulted credit institutions estimate that the adoption of the modified proposal would increase the operating costs for an overdraft facility/credit fairly to very significantly and would affect the costs of this credit loan fairly to very significantly for consumers. The main cost factor is the creditors' obligation to provide information and consultation which will cause additional bureaucratic burden and the creditors' obligation to responsible lending because of liability risks. One of the consulted banks fears, that it will not be possible anymore, to offer this product to their clients, or only with very bad conditions.²³¹

The consulted three German banks are of the opinion that the provisions of the modified proposal will not improve their ability to enter other markets in the EU.

The impact of the following provisions in the modified proposal on the current cost structure are as follows:

²³¹ Answer of a large German bank to Question 4 d.

Creditors' obligation to provide information and consultation

Banks expect that there will be a very significant impact because the pre-contractual and contractual procedures will have to be modified into a much more formal procedure which implies very significant costs. As the required time for the fulfilment of these tasks is independent to the amount of the credit, smaller loans will have disproportional high costs. As a result these smaller loans will become much more expensive or they will not be offered any more.

Creditors' obligation to responsible lending

Banks emphasise that they already examine the creditworthiness of potential borrowers today and are lending in a responsible way. The new liability risks which are linked with the principle of responsible lending will according to their view lead to an additional bureaucratic burden which bears significant cost. Therefore loans will become more costly and the policy of giving loans will become more restrictive.

Consumers' right to early repayment

There will be no impact, because the existing overdraft facility/credit already allows the flexible use and repayment at any time.

Consumers' right to withdrawal

The right of withdrawal is already established under German law, so there will be no change to the current situation.

1.3. Czech Republic

1.3.1. Assessment of changes to the national legal framework

Consumer credit is one of the last fields of consumer law that was introduced in the Czech law before the EU entry. Directive 87/102/EEC („Directive“) was transposed by means of Act No. 321/2001 Coll. („Act“) dated 17 August 2001, becoming effective on 1 January 2002. The Act has not been amended since then. It must be emphasized that of all the fields of Czech law that were to be harmonized, were only changed step-by step. The harmonization process in the field of financial services was one of the slowest and remained at the minimal level of consumer protection as required by the Directive.

Scope of application

Personal scope of application: In principle, the Czech and European legal provisions do not differ. The beneficiary of the credit is the consumer whose definition, which corresponds to the definition in Directive 87/102/EEC, is narrower than the general definition contained in the Civil Code. Only a natural person who does not act within the framework of its business or other entrepreneurial activity during the validity of the credit agreement may be deemed a consumer. Unlike the Directive, the Czech law expressly stipulates that the status of the consumer remain unchanged during the entire existence of the credit agreement. The definition of the provider of the credit, and thus of the creditor, corresponds to that contained in the Directive (see Article 2/b, c).

Substantial scope of application: Deviations from Directive 87/102/EEC are marginal. The amount of the consumer credit may vary from EUR 160 to EUR 26 000. The range of the amount of a consumer credit is thus somewhat broader than in the Directive (cf. Article 2/1/f and Article 1/2/e). On the other hand, the opportunity to conclude a consumer credit is more restricted, as the above-mentioned provision of the Act caps the amount of the credits under individual agreements to the same amount as in the event of single credits, provided that the purpose of the individual credit agreements is the same. The remaining provisions render the Czech legal framework more restrictive, excluding a number of credits granted, e.g., to cover unfulfilled liabilities under credit agreements, to cover payments made by the consumer beyond the scope of the purchase price for the transfer of funds and maintenance of accounts designed to repay the consumer credit etc., from consumer credits. On the other hand, the Czech law lacks the restrictions allowed under Article 2/3,4 of the Directive.

Advertisement

The Act is limited to the minimum level foreseen in Article 3 of the Directive and transpose it literally (see Section 3 of the Act).

Information

The information duty stipulated in Article 6 of Directive 87/102/EEC has been introduced into Czech law. The Act contains no provisions for this duty.

Responsible lending

The Act does not recognize this category.

Duty to assist

The Czech legal regulation has no provision establishing the duty of providing a consulting service or any advice for the benefit of consumer.

Formal requirements

The Act (sec.4/1) provides for mandatory written form. Non observance means nullity (voidans) of the credit contract (sec.40/1 Civil Code). However, mandatory written form does not rule out per definitionem the possibility to conclude contracts by way of electronic means, as the Act acknowledges explicitly that the credit contract can be concluded by cable telex or electronic means (sec.40/4 Civil Code).

Content of contract

The Act introduces the duty to determine the annual interest rate of the costs regarding the conditions, under which the annual rate can be adjusted. Moreover, it is established that the regulation may not depend on the consumer's will alone (Section 4/2/b).

The maximum amount of the consumer credit has to be indicated as well as individual payments, the obligation to inform the consumer on changes of the percentage rate and amount of the consumer credit, the right to pay the credit back in advance, the terms and conditions regarding termination of the agreement and the method of payment.

Withdrawal from agreement

The Act does not provide consumer with this opportunity, neither it establishes the general provisions on protection of consumer in the Civil Code, nor it allows the right to withdraw from the consumer credit agreement.

Whilst it is plain that Directive 87/102/EEC does not oblige Member States to introduce a right to withdrawal, but it must be read so as to impose on Member States a duty to grant the consumer equivalent rights which in their effect come near to the right to withdrawal.

Right of early repayment

The Act grants the consumer in line with Directive 87/102/EEC (Art 8), the right of early repayment. The purpose of the Directive (equitable reduction of the costs), hardly can be reached due to a very vague clause of the Act („prevention of disproportional profit“).

Linked credit agreements

The Act is highly compatible with the Directive. It regulates entitlements of the consumer entering into a credit agreement in connection to an agreement on purchase of goods or provision of services. This is contained in the provisions of Sections 7-10 and Section 11.

Conclusions

Section 6 protects the consumer in cases where the agreement does not contain certain particulars. Here the consumer credit is considered to bear interest equivalent to the discount interest rate valid at the time of the conclusion of the credit agreement, as published by the Czech National Bank. Other stipulations in the consumer credit become void, once the effect consumer has notified the missing particulars to the creditor. The Act also covers relations regarding the conclusion of a credit agreement in connection with the existence or the conclusion of sales contracts.

Since the current Czech legal framework provides only for the minimum, as required under the Directive 87/102/EEC, the draft proposal brings many novelties to Czech law as it goes beyond the existing law.

1.3.2. Overview of consumer financial services in the Czech Republic

Market situation for consumer credit

In the past 10 years, the instalment credit market has been growing in the Czech Republic. There is an annual increase of 20%. Also the volume of mortgage credits is growing continuously. The reasons are the growing economy and the low inflation in the country. The expectation of credit institutions with regard to the increase of consumer credits is positive.²³²

Cross-border consumer credit contracts

Currently the percentage of the main consumer financial services²³³ that Czech banks directly sell to consumers resident in another EU Member State is estimated by the Czech Banking Association to be less than 1% for instalment credits, overdraft facilities and credit cards, and less than 2% for leasing. The Czech Leasing and Finance Association estimates the total of the main consumer financial services that their members directly sell to consumers to be less than 0.1% as they are primarily oriented towards domestic consumers.²³⁴

The estimated total of consumer credit transactions that banks conduct with consumers resident in another EU Member State through branches/subsidiaries established there (including through majority holdings in local banks) is less than 2%.²³⁵ These transactions are generally conducted through branches/subsidiaries in Slovakia where some major banks have a local presence due to historical reasons.²³⁶ The Czech Leasing and Finance Association estimates the total with regard to their members to be less than 0.1%.²³⁷

²³² Interview with a Czech bank of February 2007, Interview with the Czech Banking Association on 9th March, 2007.

²³³ This includes: Credit agreements under the terms of which the consumer is required to repay the credit by means of instalments, Overdraft facility/credit, Credit card, Leasing agreements that create an obligation to purchase the object of the agreements.

²³⁴ The Czech Leasing and Finance Association, Answer to question 2a of the survey.

²³⁵ The Czech Banking Association, Answer to Question 3a of the survey.

²³⁶ The Czech Banking Association, Answer to Question 3a of the survey.

²³⁷ The Czech Leasing and Finance Association, Answer to question 3a of the survey.

(Over-)indebtedness

Czech household debt has continuously increased in the last years. The ratio of household debt to gross disposable income has increased from 12.1% in 2000 to 18.2% in 2003.²³⁸ Such rapid growth has led many borrowers to default on loans. The number of property seizures tripled from 2002 to 2003, to 155,000 cases, and is likely to grow by 10 percent a year.²³⁹

A Eurobarometer Survey about EU- Candidate Countries²⁴⁰ discussed the problem of people borrowing more money than they can repay and asked the participants if the indebtedness of the population is an known problem in their own country. Forty-four percent of the interviewed Czech citizens said that indebtedness is a problem in their country.²⁴¹

The Consumer's attitude towards cross-border financial services

The above mentioned Eurobarometer Survey about EU- Candidate Countries²⁴² asked if citizens of the 2004 member countries have obtained financial services from a European Union firm that is not operating in their country of residence. Five percent have a bank account at a company located in another EU country. As to future plans 14% of Czechs have the intention to obtain a credit card in another EU member country in the future.

When asked about obstacles to seeking financial services in other EU only 19% of Czechs believe that there are no obstacles within the EU when obtaining financial services in another EU country.²⁴³

In the focus groups conducted with consumers from Germany, Czech Republic and UK (see Annex 1) to identify barriers that prevent them from purchasing goods and services from another Member States, the Czech participants who were asked if they would accept a consumer credit from a financial institution based in another country were negative about this idea. One of the main barriers for this attitude was the lack of a personal contact:

"I'd mind the contact. You have your own personal banker here. Whenever I have a problem, I can contact him and he helps me. Simply, they can help me with the paperwork in case I do not understand it. In this case you'd have to go to Germany to fix the problem. And it would become expensive by calling to Germany."

The view of Consumer Organisations

The Consumers Defence Association of the Czech Republic expects that the number of defaulted contracts will remain similar because of the provisions of the modified proposal. They are afraid that in practice the information duties will not be fulfilled sufficiently by the creditors.

²³⁸Source: Czech National Bank, http://www.cnb.cz/www.cnb.cz/en/monetary_policy/inflation_reports/boxes_annexes/zpinflace_04_october_b2.html

²³⁹ Czech Business weekly: Banks take lion's share of booming credit market, Jana Mlčochová, 21. 03. 2005 <http://www.cbw.cz/phprs/2005040627.html>

²⁴⁰ Candidate Countries Eurobarometer 2003.5, Financial Services

²⁴¹ In the EU-15 countries, a significantly higher proportion perceives indebtedness as characteristic problem. Almost three fourths (73%) of the EU-15 citizens believe indebtedness is a problem in their own country, while 14% say it is not.

²⁴² Candidate Countries Eurobarometer 2003.5, Financial Services, p. 62

²⁴³ 30% of the citizens of the 2004 member countries share the opinion that there is no obstacle to his or her personal use of financial services anywhere within the European Union.

They feel that the principle of responsible lending is important because lenders will be obliged to analyse more carefully the creditworthiness of their clients. This is currently not always the case in the Czech Republic.²⁴⁴

Concerning the main barriers hindering consumers from engaging in cross-border transactions of consumer credit products, they think that the following additional measures related to an enhancement of consumer confidence (not included in the modified proposal) are needed:

- Comparable and standardised information;
- Uniform rules on information and exercise of withdrawal.²⁴⁵

1.3.3. Analysis of typical consumer credit transaction – personal loan

1.3.3.1. Current typical operating costs

The table shows the estimated costs that a bank would typically incur when processing, approving and monitoring a personal loan (unsecured) for € 5,000 over a two-year contract term. The costs include all direct running costs, but exclude profit margin and costs of capital. The costs are divided into three categories corresponding to where they incur: front-office, back-office and bad-debt collection.

²⁴⁴ Interview with Consumers Defence Association of the Czech Republic on 7th of March 2007.

²⁴⁵ Interview with Consumers Defence Association of the Czech Republic on 7th of March 2007.

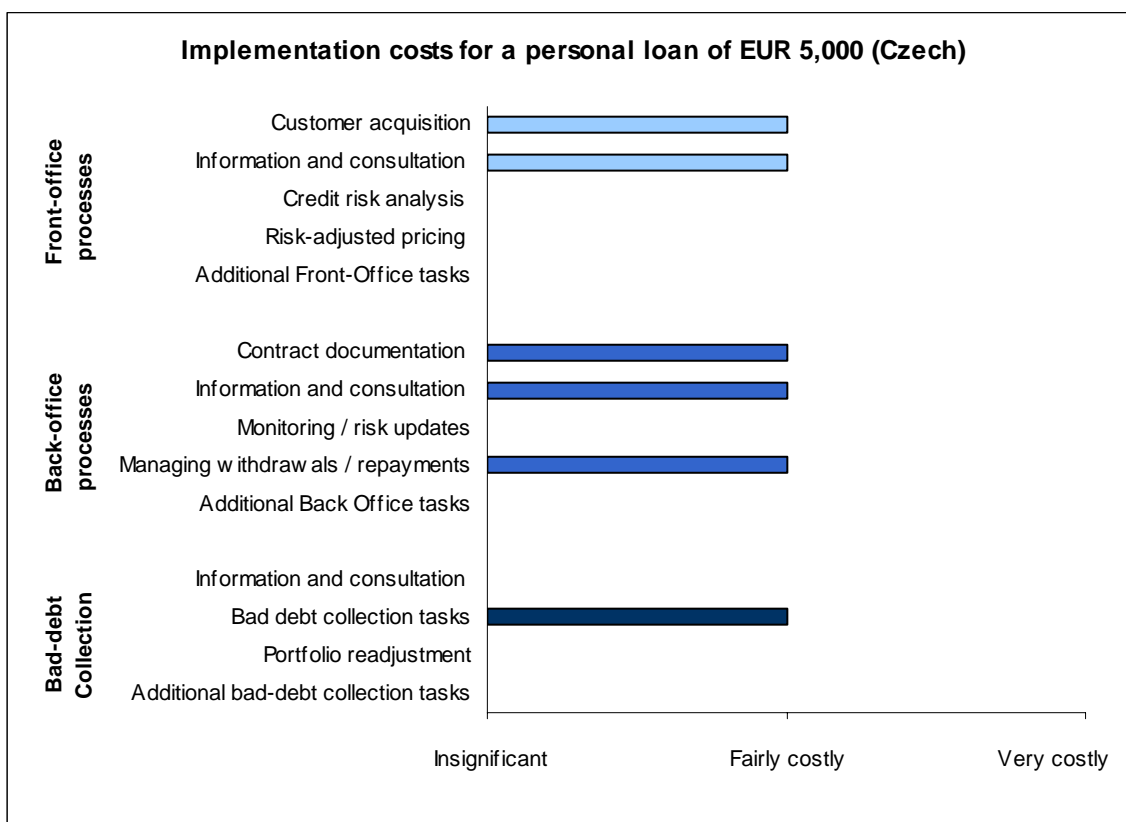
Table 8: Czech bank transaction costs related to a personal loan

	Sub-processes during lending procedure <u>WITHOUT</u> modified proposal	Bank1
FRONT-OFFICE	Customer acquisition (steps include: planning and acquisition of customers, advertising)	41%
	Information and consultation of customers (steps include: providing pre-contractual information on, e.g., borrowing rate, duration, instalments, fees, etc.)	11 %
	Credit risk analysis (steps include: creditworthiness check)	2 %
	Risk-adjusted pricing (steps include: underwriting procedure, pricing of loan)	0 %
	Additional Front-Office tasks	0 %
	SUB-TOTAL FRONT-OFFICE COSTS	54 %
BACK OFFICE	Contract documentation (steps include: credit filing and archiving)	2 %
	Information and consultation of customers (including customer contacts during term of contract)	19 %
	Monitoring / risk updates (steps include: trigger servicing, monitoring and controlling risk factors throughout duration of contract)	17 %
	Managing withdrawals / repayments (steps include: collect timely payment of interest and principal from borrowers, processing withdrawals and repayments, calculating indemnities)	0 %
	Additional Back-office tasks	0 %
	SUB-TOTAL BACK-OFFICE COSTS	38 %
BAD-DEBT COLLECTION	Information and consultation of customers (including customer contact in case of default, payment delay, etc.)	6 %
	Bad-debt collection tasks (steps include: determining ongoing collateral adequacy, loan refinancing and modification processes)	2 %
	Portfolio readjustment (steps include: managing credit risk across loan portfolio)	0 %
	Additional bad-debt collection tasks	0 %
	SUB-TOTAL BAD-DEBT COLLECTION PROCESS COSTS	8 %
	GRAND TOTAL	100%

Source: Bank estimates

1.3.3.2. Impact of modified proposal on one-time implementation costs

If the modified proposal for a Consumer Credit Directive were adopted (COM 2005 483 of October 2005) the consequence for the following processes regarding a Czech bank's typical **one-time, implementation cost** for a personal loan for € 5,000 payable over two-years are expected to be as follows:



Source: Bank estimates

Front-office processes

The interviewed bank expects fairly costly one-time, implementation costs concerning customer acquisition and information/consultation because new processes have to be created and implemented and there will be a need for more documentation. Additionally, new advertising material has to be produced and staff training is required to accommodate the new rules for information and consultation. For the credit risk analysis the bank expects only insignificant implementation costs because the existing scoring systems will remain the same.

Back-office processes

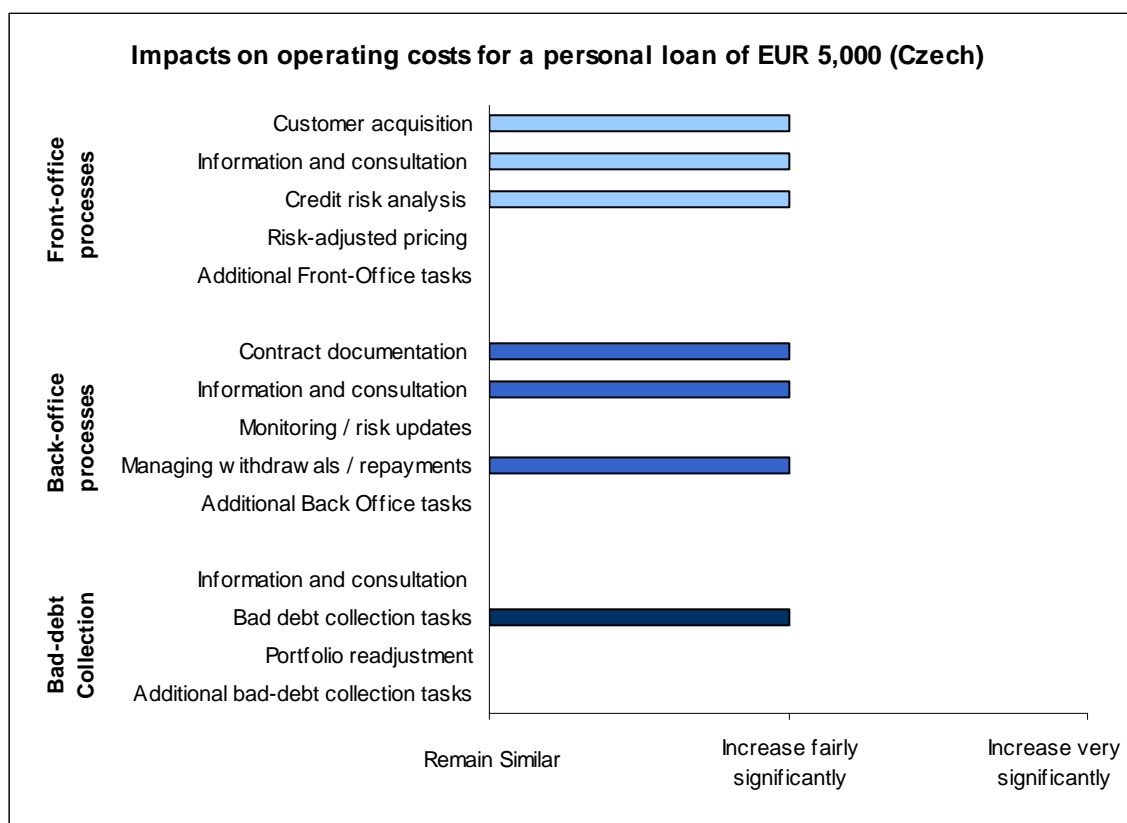
The bank expects fairly costly implementation costs for the contract documentation, the information and consultation of customers and the managing of withdrawals. The reasons for this are the necessity to create new work-flows to adapt the computer systems. Additionally, the interviewed bank expects an additional bureaucratic burden concerning the contract documentation and the documentation of the information and consultation.

Bad-debt collection

Concerning bad-debt collection processes, the bank expects fairly significant implementation costs with regard to the bad-debt collection tasks because of the new provisions on responsible lending.

1.3.3.3. Impact of modified proposal on operating costs

If the modified proposal for a Consumer Credit Directive were adopted (COM 2005 483 of October 2005) the consequence for the following processes regarding a bank's typical **operating costs** for a personal loan for € 5,000 payable over two-years were expected to be as follows:



Source: Bank estimates

Front-office processes

An interviewed Czech bank estimates that the customer acquisition costs may increase fairly significantly because supplementary information has to be provided in the advertisement. This would be relevant if the information duty leads, for example, to higher print costs than currently because more space is needed for advertisement.

Additionally, a fairly significant increase of the operating costs for information and consultation of customers is expected. The reason is the need to provide more information to the client and the obligation to document the consultation and information procedure. In addition more time will be needed for the consultation of customers.

The large bank expects also a fairly significant increase of the operating costs for the credit analysis because of the provisions on responsible lending and the liability risks of the bank. If the modified proposal were adopted, more detailed analysis would be needed which would lead to more costs.

Concerning the risk-adjusted pricing, no impacts are expected from the interviewed bank.

Back-office processes

The interviewed large bank estimates that the operating costs for contract documentation and information/consultation of customers may increase fairly significantly because the modified proposal leads to more documentation and information duties.

Also the operating costs for managing the withdrawals and repayments are expected to increase fairly significantly because of new the right of withdrawal which has to be launched.

Bad-debt collection

The bank expects a fairly significant increase of the costs for the bad-debt collection tasks because of the provisions of responsible lending and the possible bank's liability.

1.3.3.4. Discussion/summary of impacts

The interviewed bank estimates that the adoption of the modified proposal would impact the operating costs for a personal loan fairly significantly and would affect the costs fairly significantly for consumers. The main cost factors are:

- an increase in the duration of the consultation process and the related additional bureaucratic burden caused by the creditors' obligation to provide information and consultation;
- liability risks because of the creditors' obligation to responsible lending;
- the management of the execution of the right of withdrawal.

The impact of the following provisions in the modified proposal on the current cost structure are as follows:

Consumers' right to early repayment

Czech law already specifies that consumers may already pay back their loan before the end of the contract. The banks may ask for a fair indemnity but no penalty. Therefore the modified proposal would not lead to a different situation.

Consumers' right to withdrawal

At this time, the right of withdrawal does not exist in the Czech Republic. Therefore the interviewed Czech banks expect an impact on their current cost structure and mainly on the costs for the refinancing of the loan.²⁴⁶ Additionally, there will be implementation costs for this new process due to new monitoring systems, reserving/booking systems and document managing systems.²⁴⁷

²⁴⁶ The Czech Leasing and Finance Association, Answer to question 21 of the survey and Interview with a Czech bank on 27th February, 2007.

²⁴⁷ The Czech Banking Association, Answer 21 to the survey of Banking Associations.

Creditors' obligation to provide information and consultation

In the Czech Republic banks already follow the principle of responsible lending, according to the view of the bank interviewed. Therefore it is difficult to estimate the economic impact of this provision.²⁴⁸

The impact of the modified proposal on overdraft credit was assessed to be similar as with regard to the instalment credit and has therefore not been repeated here.

²⁴⁸ Interview with a Czech bank on 27th February, 2007.

Annex 3: Survey questionnaire

The following survey questionnaire was aimed at banking associations. The questionnaire to consumer organisations contained similar questions, but omitted questions that were only relevant for banking associations (e.g. related to expected impacts on costs).

**ANALYSIS OF THE MODIFIED PROPOSAL FOR A DIRECTIVE OF THE EUROPEAN PARLIAMENT
AND OF THE COUNCIL ON CREDIT AGREEMENTS FOR CONSUMERS AMENDING COUNCIL
DIRECTIVE 93/13/EC
[COM (2005) 483]**

*

SURVEY OF BANKING ASSOCIATIONS

Please return filled questionnaire by email to survey@civic-consulting.de before

28.2.2007

(please return in Word format and do not pdf document)

INTRODUCTION

Civic Consulting has been commissioned by the European Parliament to conduct an economic analysis on the impact of the proposal for a Directive on credit agreements for consumers. This study will serve as supportive material during the deliberations in the framework of the second reading of the co-decision procedure of the Parliament. In the framework of this study Civic Consulting is conducting a survey of European and national stakeholder organisations.

The information you provide through this questionnaire will be crucial in assessing the possible positive and negative impacts of the modified proposal for a Consumer Credit Directive. We therefore greatly appreciate your contribution.

If you have any further questions, do not hesitate to contact:

Kristen Schubert (survey@civic-consulting.de) Phone: +49-30-2196-2295 Fax: +49-30-2196-2298

IDENTIFICATION DATA

1. Please identify yourself:

a. Name of association:

Please specify

b. Type of organisation:

EU level banking association National banking association Bank Other

c. Located in (country):

Please specify

d. Questionnaire completed by (name of person, position, contact details):

Please specify

A: CURRENT SITUATION

Transactions with consumers in other Member States

Definitions: “*Direct cross-border transaction*” is a transaction between a bank and a consumer in two different EU Member States (i.e., the product is not sold through branches, subsidiaries, or majority holdings of your member banks in the country where the consumer is resident). In contrast, “*selling of consumer credit products in other EU Member States*” refers to both direct cross-border transactions and selling to consumers resident in other EU countries through local branches, subsidiaries, and majority holdings of your member banks.

2. What are the main financial services that your member banks directly sell to consumers cross-border?

- a. Please estimate the percentage of total consumer credit transactions that member banks conduct within your country directly with consumers resident in another EU Member State:

	% of total consumer credit transactions of your member banks					
	less than 0.1%	less than 1%	less than 2%	less than 5%	less than 10%	more than 10%
Instalment credit*	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Overdraft facility	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Credit card	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Leasing**	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Notes: * Credit agreements under the terms of which the consumer is required to repay the credit by means of instalments; ** Only leasing agreements that create an obligation to purchase the object of the agreement.

Please specify

- b. How do you expect the number of direct cross-border transactions with consumers to change in the next 5 years if no major legislative change at EU level were to happen?

Decrease very significantly ²⁴⁹	Decrease fairly significantly	Remain similar	Increase fairly significantly	Increase very significantly	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

²⁴⁹ In this questionnaire, this scale refers approximately to the following percentages: Decrease very significantly (reduction of > 10 %); Decrease fairly significantly (reduction of 10% - 3%); Remain similar (+ / - 3%); Increase fairly significantly (increase of 3% - 10%); Increase very significantly (increase of > 10%).

3. What are the main financial services provided by your members to consumers through branches / subsidiaries in other EU Member States?

- a. Please estimate the percentage of total consumer credit transactions that your member banks conduct with consumers resident in another EU Member State through branches / subsidiaries established there (including through majority holdings in local banks):

	% of total consumer credit transactions of your member banks					
	less than 0.1%	less than 1%	less than 2%	less than 5%	less than 10%	more than 10%
Instalment credit*	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Overdraft facility	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Credit card	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Leasing**	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Notes: * Credit agreements under the terms of which the consumer is required to repay the credit by means of instalments; ** Only leasing agreements that create an obligation to purchase the object of the agreement.

Please specify

- b. How do you expect the number of transactions with consumers through branches in other EU Member States to change in the next 5 years if no major legislative change at EU level were to happen?

Decrease very significantly	Decrease fairly significantly	Remain similar	Increase fairly significantly	Increase very significantly	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

4. Do your member banks actively indicate in marketing activities the country in which they are registered in direct cross-border transactions with consumers in other EU Member States?

Yes No Don't know

Please specify

5. Do your member banks offer consumer credit products with different characteristics when selling nationally and when selling in other EU Member States?

Yes No Don't know

Please specify

6. What are the main barriers – from your point of view – hindering selling of consumer credit products in other EU Member States?

Barrier for member banksto directly sell to consumers cross-border	... establishing themselves in other Member States
Differing <u>stages of development of consumer credit</u> in different Member States	<input type="checkbox"/>	<input type="checkbox"/>
Credit <u>risk for lenders</u> in not having access to information to assess creditworthiness	<input type="checkbox"/>	<input type="checkbox"/>
Differences in <u>language and culture</u>	<input type="checkbox"/>	<input type="checkbox"/>
Difficulties in <u>penetrating a local market</u>	<input type="checkbox"/>	<input type="checkbox"/>
Differences in national legislation which are <u>in the scope</u> of the modified proposal for a Consumer Credit Directive	<input type="checkbox"/>	<input type="checkbox"/>
Differences in national legislation <u>outside the scope</u> of the modified proposal for a Consumer Credit Directive	<input type="checkbox"/>	<input type="checkbox"/>
Problems related to <u>tax, restrictive local employment laws and practices, access to local payment systems</u> , etc.	<input type="checkbox"/>	<input type="checkbox"/>
Problems occurring from provisions of <u>international private law</u>	<input type="checkbox"/>	<input type="checkbox"/>
Consumers' personal <u>preference for national lenders</u>	<input type="checkbox"/>	<input type="checkbox"/>
Different <u>structure of consumer demand</u> in different MS	<input type="checkbox"/>	<input type="checkbox"/>
Lack of consumer <u>confidence in a brand</u>	<input type="checkbox"/>	<input type="checkbox"/>
Lack of adequate <u>marketing strategies</u>	<input type="checkbox"/>	<input type="checkbox"/>
Lack of full monetary <u>harmonisation</u> within the EU	<input type="checkbox"/>	<input type="checkbox"/>
Other: <i>Please specify</i>	<input type="checkbox"/>	<input type="checkbox"/>

7. In your experience, do you think that consumers located in your country know the main consumer protection rules that are currently in place in your country (concerning information, withdrawal, repayment, annual percentage rate etc., if applicable)?

- Yes No Partly Don't know

Please specify

Current online transactions and facilities

8. Do you think that electronic payment opportunities (online) lead customers to undertake direct cross-border transactions in consumer credit products?

- Yes No Don't know

Please specify

9. Do you expect cost reduction and economies of scale for your member banks from selling consumer credit products in other EU Member States?

Yes No Don't know

Please specify

If yes:

Do the Internet and online-banking facilities play a crucial role in acquiring directly new customers that are resident in other EU Member States?

Yes No Don't know

Please specify

10. Do you expect that information and consultation that your member banks provide to consumers can be most easily managed online, via branch banking (face-to-face), via phone banking or via postal banking?

Online Branch banking (face-to-face) Phone banking Postal banking

Please specify

B: IMPACT OF THE MODIFIED PROPOSAL FOR A CONSUMER CREDIT DIRECTIVE

The following questions refer to a situation that the modified proposal of the European Commission for a Directive on Credit Agreements for Consumers is implemented [COM (2005) 483 of October 2005]:

Specific impacts

11. Which consequences do you expect from the standard information for advertising and pre-contractual information specified in the modified proposal for a Consumer Credit Directive?

a. Acquiring new customers can be expected to be:

Significantly more difficult	Fairly more difficult	Similar	Fairly easier	Significantly easier	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify

b. Front-office costs can be expected to:

Decrease very significantly	Decrease fairly significantly	Remain similar	Increase fairly significantly	Increase very significantly	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify

12. Do you think that the requirement for pre-contractual assessment of creditworthiness specified in the modified proposal for a Consumer Credit Directive sets new standards throughout the banking industry in your country or is it already established good banking practice?

- Pre-contractual analysis of creditworthiness sets new standards for the banking industry
- Pre-contractual analysis of creditworthiness is already established good banking practice

Please specify

13. How do you expect that the risk premium for the expected loss (standardised risk costs) will change by the more differentiated and individualised analysis specified in the modified proposal for a Consumer Credit Directive?

Risk premium for the expected loss (standardised risk costs) can be expected to:

Decrease very significantly	Decrease fairly significantly	Remain similar	Increase fairly significantly	Increase very significantly	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify

14. What do you expect are the consequences of the new calculation of annual percentage rates and other pre-contractual information requirements specified in the modified proposal for a Consumer Credit Directive?

- a. Do you think that the new calculation of annual percentage rates (with the inclusion of costs that have to be included under the modified proposal for a Consumer Credit Directive) increases the comparability of credit offers for consumers?

Yes No Don't know

Please specify

- b. Do you think that consumers are able to understand the significance of the new calculation of annual percentage rates as proposed in the modified proposal for a Consumer Credit Directive?

Yes No Don't know

Please specify

- c. Do you think that consumers are able to understand the other pre-contractual information that is to be provided by the banks specified in the modified proposal for a Consumer Credit Directive?

Yes No Don't know

Please specify

- d. Do you think consumers will be enabled through the new pre-contractual information requirements of the modified proposal for a Consumer Credit Directive to know more about their individual situation (e.g., risk, financial consequences)?

Yes No Don't know

Please specify

15. Do you expect a higher effort to explain to your customers the new information required and the credit decision in line with the requirements of the modified proposal for a Consumer Credit Directive?

Yes No Don't know

Please specify expected additional effort, if any

16. Is the information that is to be provided by banks on the basis of the new modified proposal for a Consumer Credit Directive in line with consumer needs and perceptions?

a. Pre-contractual information

Yes, in line with needs Not in line with needs Don't know

Please specify

b. Information to be provided during the term of the credit agreement

Yes, in line with needs Not in line with needs Don't know

Please specify

17. Will it be necessary to provide more information to customers during the term of the credit agreement as a consequence of the modified proposal for a Consumer Credit Directive?

Yes, more information to be provided No, as it is currently Don't know

Please specify expected additional information effort, if any

If yes,

Is this a consequence of the responsible-lending rules (including duty to assist) contained in the modified proposal for a Consumer Credit Directive?

Yes No Don't know

Please specify

18. Which consequences do you expect from responsible-lending rules (including duty to assist) in the modified proposal for a Consumer Credit Directive for costs of your member banks?

Costs of member banks can be expected to:

Decrease very significantly	Decrease fairly significantly	Remain similar	Increase fairly significantly	Increase very significantly	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify types of costs that you expect will change

19. Which consequences of the modified proposal for a Consumer Credit Directive do you expect for the documentation of the credit decision process?

Please specify

20. Do you expect that the right of withdrawal in the modified proposal for a Consumer Credit Directive will lead to a higher consumer demand for consumer credit products?

Yes No Don't know

Please specify

21. Which consequences do you expect from the right of withdrawal in the modified proposal for a Consumer Credit Directive for back-office costs and extraordinary risk costs (liquidity risk, interest risk)?

Back-office costs and extraordinary risk costs (liquidity risk, interest risk) can be expected to:

Decrease very significantly	Decrease fairly significantly	Remain similar	Increase fairly significantly	Increase very significantly	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify

22. Do you expect that the rules on early repayment in the modified proposal for a Consumer Credit Directive lead to a higher consumer demand for consumer credit products?

Yes No Don't know

Please specify

23. Which consequences do you expect from the rules on early repayment in the modified proposal for a Consumer Credit Directive for back-office costs and extraordinary risk costs?

Back-office costs and extraordinary risk costs (liquidity risk, interest risk) can be expected to:

Decrease very significantly	Decrease fairly significantly	Remain similar	Increase fairly significantly	Increase very significantly	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify

24. Do you think that with the modified proposal for a Consumer Credit Directive the credit risk analysis has to be done only before the contract is signed or also periodically during the term of the credit agreement?

- Only before the contract is signed Also, periodically during the term of the agreement

25. How are contract costs affected by a more sophisticated servicing and monitoring during the term of credit agreement?

Contract costs can be expected to:

- | | | | | | |
|-----------------------------|-------------------------------|--------------------------|-------------------------------|-----------------------------|--------------------------|
| Decrease very significantly | Decrease fairly significantly | Remain similar | Increase fairly significantly | Increase very significantly | Don't know |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Please specify

26. How do you expect the number of defaulted contracts will change because of the provisions of the modified proposal for a Consumer Credit Directive?

The number of defaulted contracts can be expected to:

- | | | | | | |
|-----------------------------|-------------------------------|--------------------------|-------------------------------|-----------------------------|--------------------------|
| Decrease very significantly | Decrease fairly significantly | Remain similar | Increase fairly significantly | Increase very significantly | Don't know |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Please specify

27. How are costs affected by a change in the number of defaulted contracts possibly caused by the modified proposal for a Consumer Credit Directive?

Related costs can be expected to:

- | | | | | | |
|-----------------------------|-------------------------------|--------------------------|-------------------------------|-----------------------------|--------------------------|
| Decrease very significantly | Decrease fairly significantly | Remain similar | Increase fairly significantly | Increase very significantly | Don't know |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Please specify

Overall impacts

28. Do you expect that consumer confidence in concluding a consumer credit agreement will increase as a consequence of the higher protection expected?

- a. Please assess the impact of the modified proposal for a Consumer Credit Directive on consumer confidence regarding consumer credit agreements concluded nationally (i.e., lender and consumer resident in Member State). Consumer confidence can be expected to:

Decrease very significantly	Decrease fairly significantly	Remain similar	Increase fairly significantly	Increase very significantly	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify

- b. Please assess the impact of the modified proposal for a Consumer Credit Directive on consumer confidence regarding consumer credit agreements directly concluded cross-border (i.e., lender from your Member State and consumer from another). Consumer confidence can be expected to:

Decrease very significantly	Decrease fairly significantly	Remain similar	Increase fairly significantly	Increase very significantly	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify

29. Would you expect an increase in the overall demand for consumer credit products with the modified proposal for a Consumer Credit Directive?

- a. Demand for consumer credit products can be expected to:

Decrease very significantly	Decrease fairly significantly	Remain similar	Increase fairly significantly	Increase very significantly	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify

- b. If you marked increase: Do you expect that an increased demand results from cross-border transactions or from your national market?

- Increased demand mainly because of cross-border transactions
- Increased demand mainly because of national transactions
- Increased demand from *both* cross-border and national transactions

Please specify

30. How do you expect the number of direct cross-border transactions related to consumer credit products to change in the next 5 years if the modified proposal for a Consumer Credit Directive is adopted?

The number of cross-border transactions can be expected to:

Decrease very significantly	Decrease fairly significantly	Remain similar	Increase fairly significantly	Increase very significantly	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify

31. Which consequences of the modified proposal for a Consumer Credit Directive do you expect for the range / variety of credit products?

The range / variety of credit products can be expected to:

Decrease very significantly	Decrease fairly significantly	Remain similar	Increase fairly significantly	Increase very significantly	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify

32. Which consequences of the modified proposal for a Consumer Credit Directive do you expect for the availability of credit products?

The availability of credit products can be expected to:

Decrease very significantly	Decrease fairly significantly	Remain similar	Increase fairly significantly	Increase very significantly	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify

33. Do you expect increasing competition in the consumer credit market as a result of the modified proposal for a Consumer Credit Directive?

- a. Please assess the impact of the modified proposal for a Consumer Credit Directive on competition in the consumer credit market nationally. Competition can be expected to:

Decrease very significantly	Decrease fairly significantly	Remain similar	Increase fairly significantly	Increase very significantly	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify

- b. Please assess the impact of the modified proposal for a Consumer Credit Directive on competition in the consumer credit market cross-border EU-wide. Competition can be expected to:

Decrease very significantly	Decrease fairly significantly	Remain similar	Increase fairly significantly	Increase very significantly	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify

34. What impacts do you expect from the approach of full harmonisation with flexibility and of mutual recognition for issues where there is flexibility...

- a. ...with respect to consumers?

Please specify

- b. ...with respect to your member banks?

Please specify

- c. What elements should be decided at the national level?

Please specify

35. What additional measures, not included in the modified proposal for a Consumer Credit Directive, are needed to overcome the main barriers hindering the establishment of a single market concerning consumer credit products?

- a. What are additional measures needed to reduce barriers for your member banks to directly sell to consumers cross-border?

Please specify

- b. What are additional measures needed to reduce barriers to your member banks to establish themselves in other EU Member States (including through majority holdings in local banks)?

Please specify

Annex 4: Respondents to the surveys

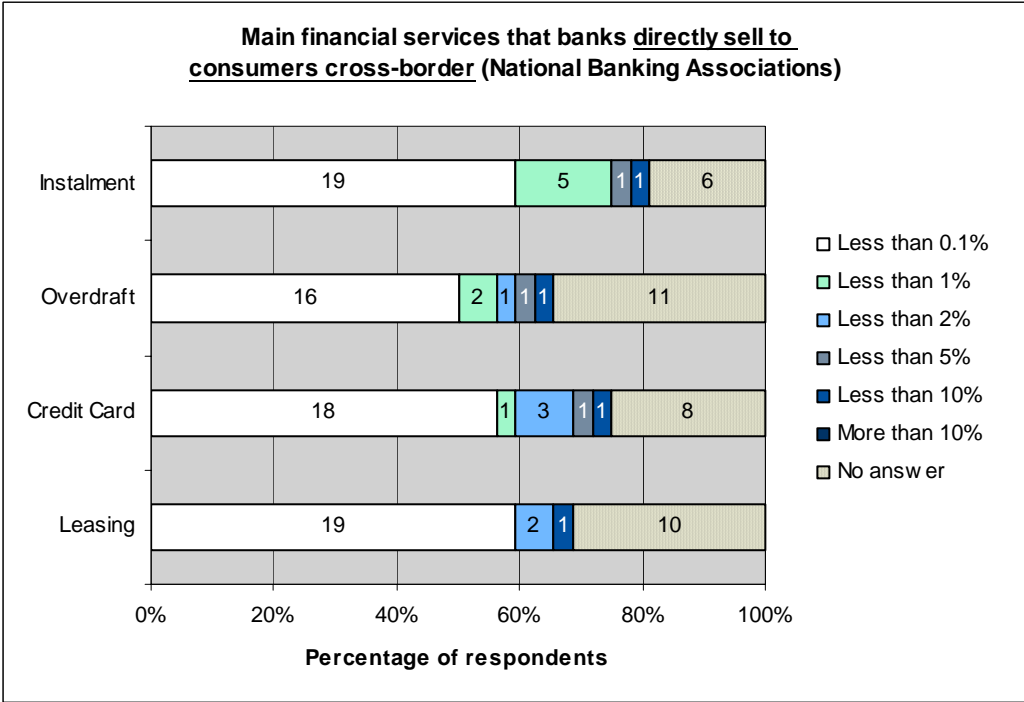
National Banking Associations	Location
Asociación Nacional de Establecimientos Financieros de Crédito (ASNEF)	Spain
Associação de Instituições Crédito Especializado (ASFAC)	Portugal
Association Française des Sociétés Financières (ASF)	France
Association of Cyprus Commercial Banks (ACCB)	Cyprus
Associazione Bancaria Italiana (ABI)	Italy
Associazione Italiana del Credito al Consumo e Immobiliare (Assofin)	Italy
Austrian Bankers' Association	Austria
Austrian Savings Banks Association	Austria
Bankenfachverband e.V.	Germany
British Banking Association (BBA)	UK
Bundesverband deutscher Banken e. V.	Germany
Bundesverband Öffentlicher Banken Deutschlands (VÖB)	Germany
Confederación Española de Cajas de Ahorros	Spain
Conference of Financial Companies in Poland (KPF)	Poland
Consumer Credit Association of the United Kingdom (CCAUK)	UK
Deutscher Sparkassen- und Giroverband e. V.	Germany
Estonian Banking Association (EBA)	Estonia
Fachverband der Raiffeisenbanken	Austria
Federation Bancaire Francaise (French Banking Federation)	France
Federation of Finnish Financial Services	Finland
Finance & Leasing Association (FLA)	UK
Hellenic Bank Association (HBA)	Greece
Irish Banking Federation (IBF)	Ireland
National Association of German Cooperative Banks (Bundesverband der Deutschen Volksbanken und Raiffeisenbanken e.V. - BVR)	Germany
Netherlands Bankers' Association (NVB)	Netherlands
Österreichischer Genossenschaftsverband Schulze-Delitzsch	Austria
Polish Bank Association (ZBP)	Poland
Slovak Banking Association	Slovakia
Spanish Banking Association	Spain
Swedish Bankers' Association	Sweden
The Czech Banking Association (CBA)	Czech Republic
Verband der österreichischen Landes-Hypothekenbanken	Austria
Association of Danish Mortgage banks	Denmark
Association of German Pfandbrief Banks	Germany
Council of Mortgage Lenders	UK

Other Credit Providers	Location
Cattles plc	UK
OP Bank Group Central Cooperative (Group of cooperative banks)	Finland
The Czech Leasing and Finance Association	Czech Republic
Union Professionnelle du Crédit (U.P.C.) / Beroepsvereniging van het Krediet (B.V.K.)	Belgium
European Level Associations	
European Association of Co-operative Banks	
European Federation of Building Societies	
Individual Banks	
AIG Bank Polska SA	Poland
Banco Bilbao Vizcaya Argentaria (BBVA)	Spain
Bank Austria Creditanstalt AG	Austria
Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse Aktiengesellschaft	Austria
Barclays Bank Plc	UK
Česká spořitelna	Czech Republic
Cetelem	France
GE Money Bank	Austria
HypoVereinsbank	Germany
Kreissparkasse Ravensburg	Germany
Lloyds TSB, London	UK
Rabobank Nederland	Netherlands
RCI Banque	France
RLB NÖ-Wien AG	Austria
Royal Bank of Scotland	UK
<i>Also other banks provided responses that wished not to be named</i>	
Consumer / Citizen Advice Organisations	
Citizens' Advice	UK
Consumers Defence Association of the Czech Republic	Czech Republic
Forbrugerradet (the Danish Consumer Council)	Denmark
National Consumer Federation	UK
Romanian Association for Consumers' Protection	Romania
Test-Achats	Belgium
The Consumer Council of Norway	Norway
Verbraucherzentrale Bundesverband (Federation of German Consumer Organisations)	Germany
Which?	UK

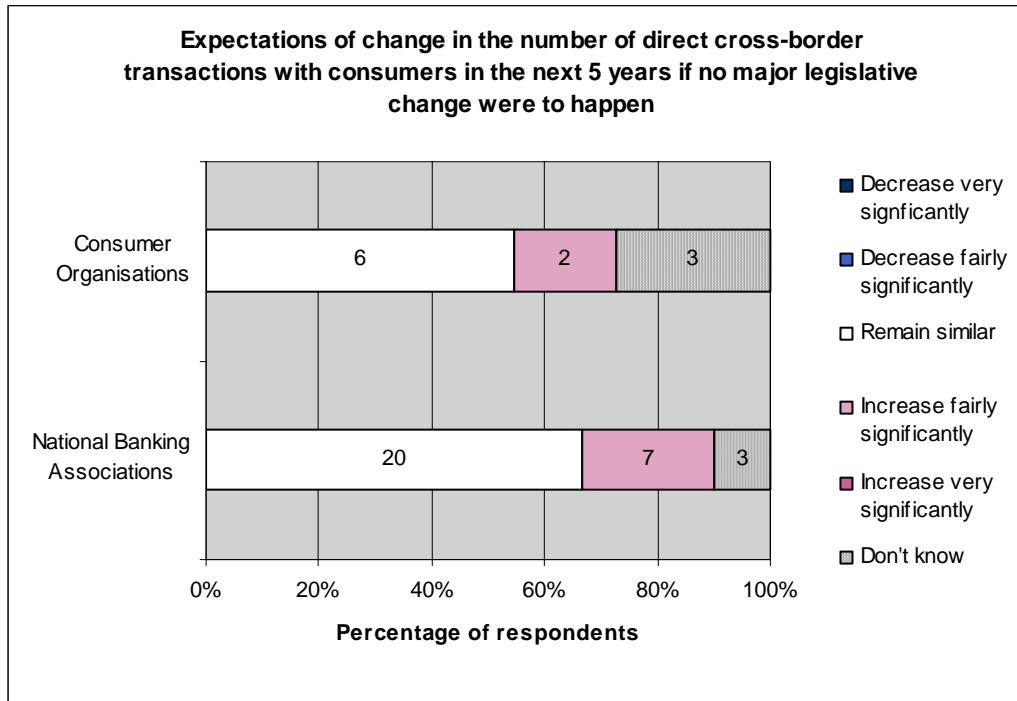
Annex 5: Results of surveys

2. What are the main financial services that your member banks directly sell to consumers cross-border?

a. Please estimate the percentage of total consumer credit transactions that member banks conduct within your country directly with consumers resident in another EU Member State:

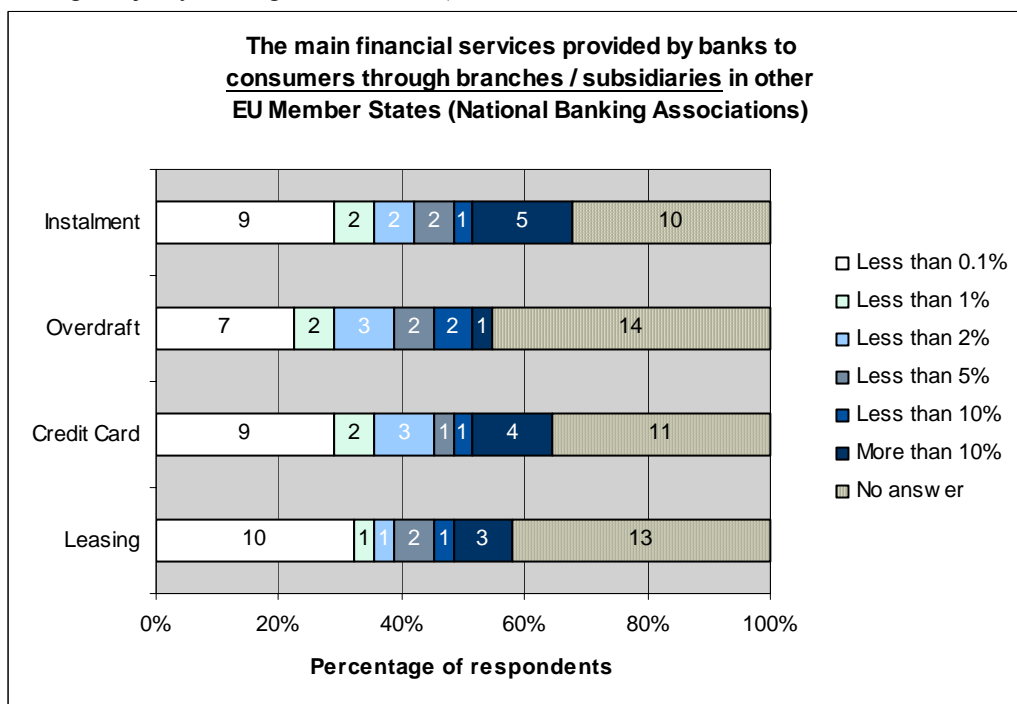


- b. How do you expect the number of direct cross-border transactions with consumers to change in the next 5 years if no major legislative change at EU level were to happen?

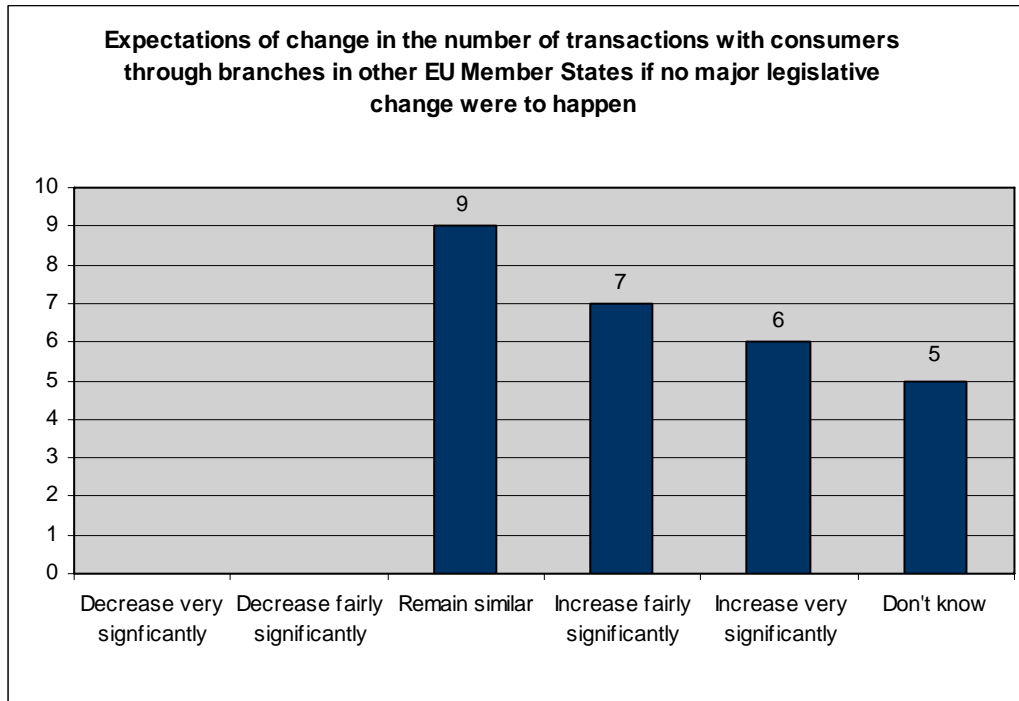


3. **What are the main financial services provided by your members to consumers through branches / subsidiaries in other EU Member States?**

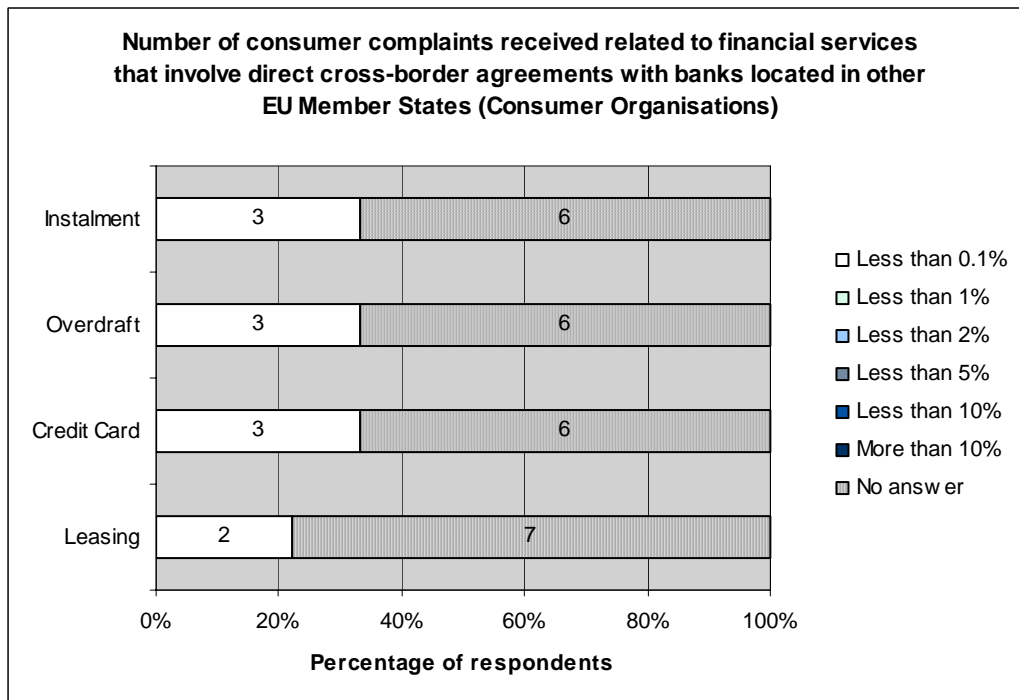
- a. Please estimate the percentage of total consumer credit transactions that your member banks conduct with consumers resident in another EU Member State through branches / subsidiaries established there (including through majority holdings in local banks):



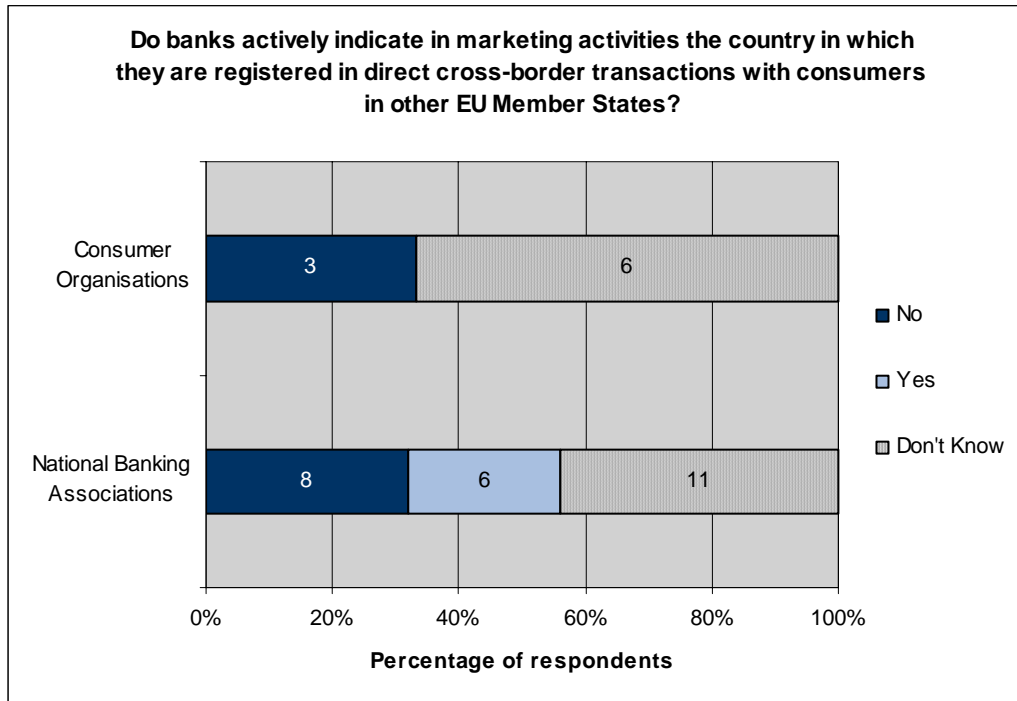
- b. How do you expect the number of transactions with consumers through branches in other EU Member States to change in the next 5 years if no major legislative change at EU level were to happen?



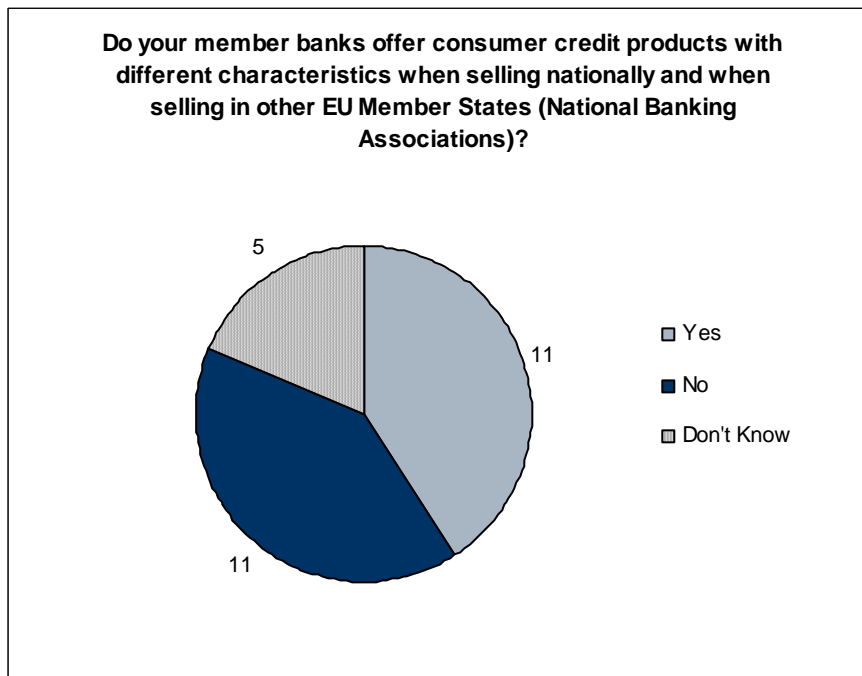
- c. What is the number of consumer complaints that you have received related to financial services that involve direct cross-border credit agreements with banks located in other EU Member States? (*questionnaire consumer organisations, question 3*)



4. Do your member banks actively indicate in marketing activities the country in which they are registered in direct cross-border transactions with consumers in other EU Member States?

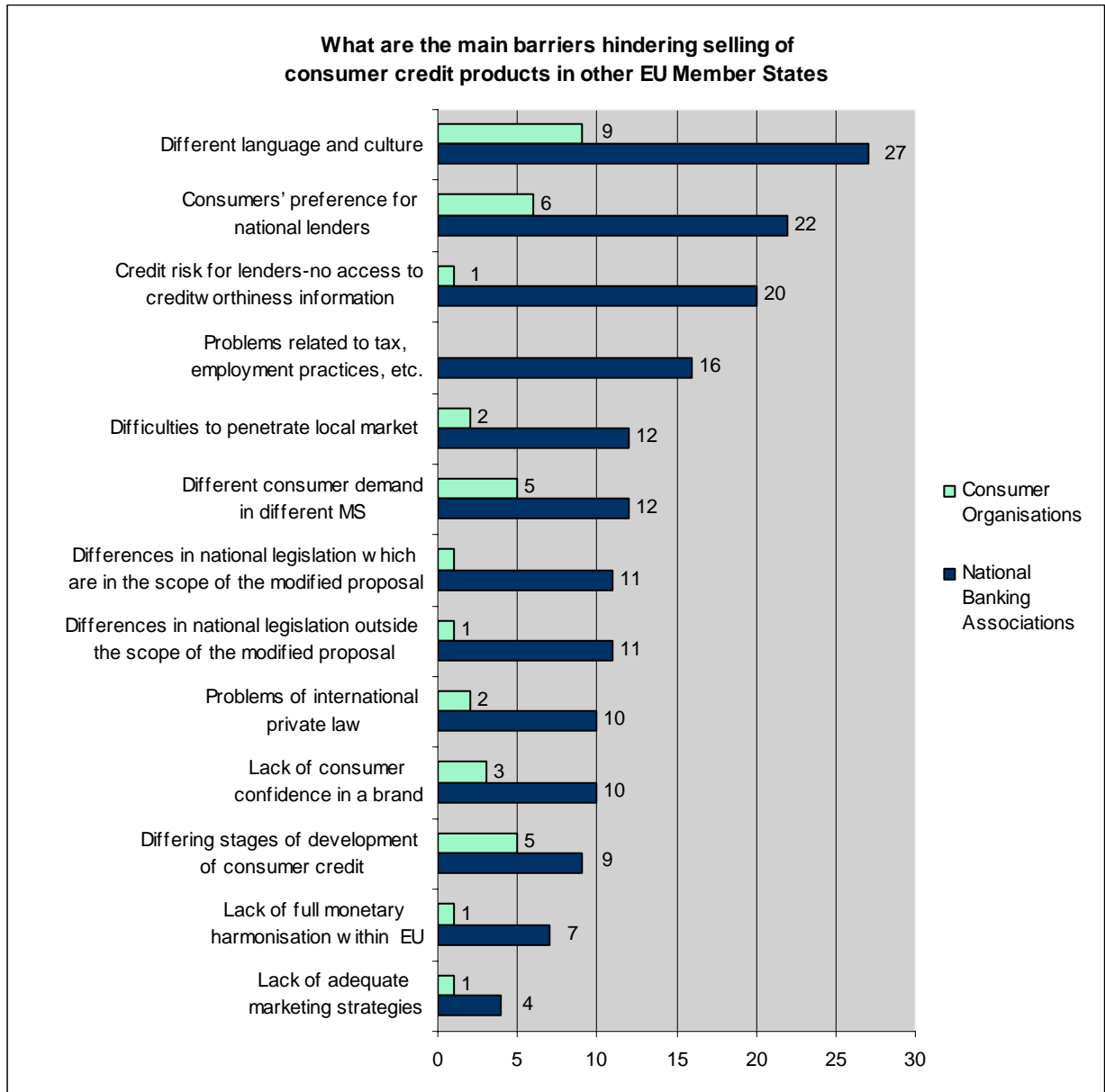


5. Do your member banks offer consumer credit products with different characteristics when selling nationally and when selling in other EU Member States?



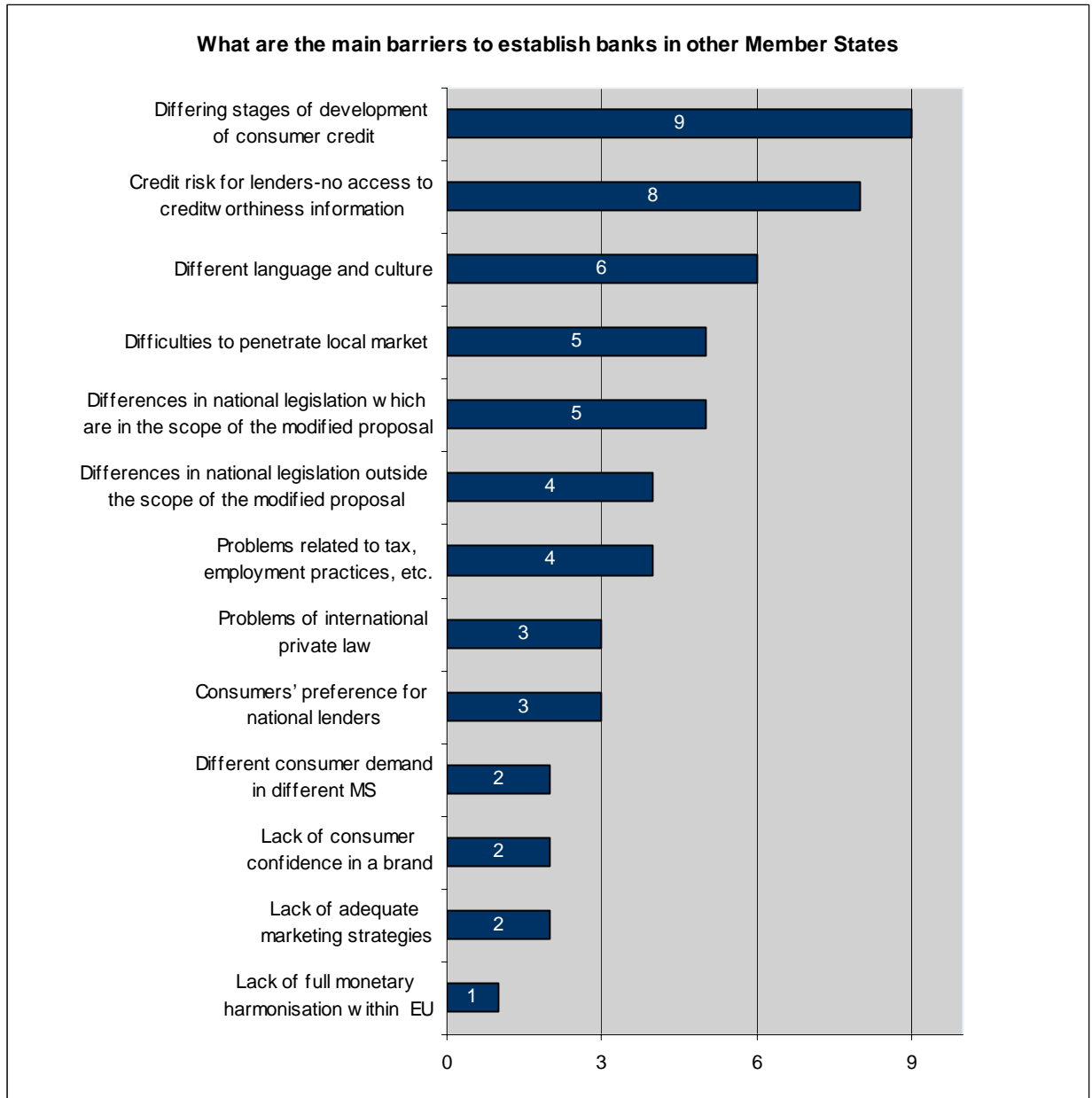
6. What are the main barriers – from your point of view – hindering selling of consumer credit products in other EU Member States?

Barrier to directly sell to consumers cross-border

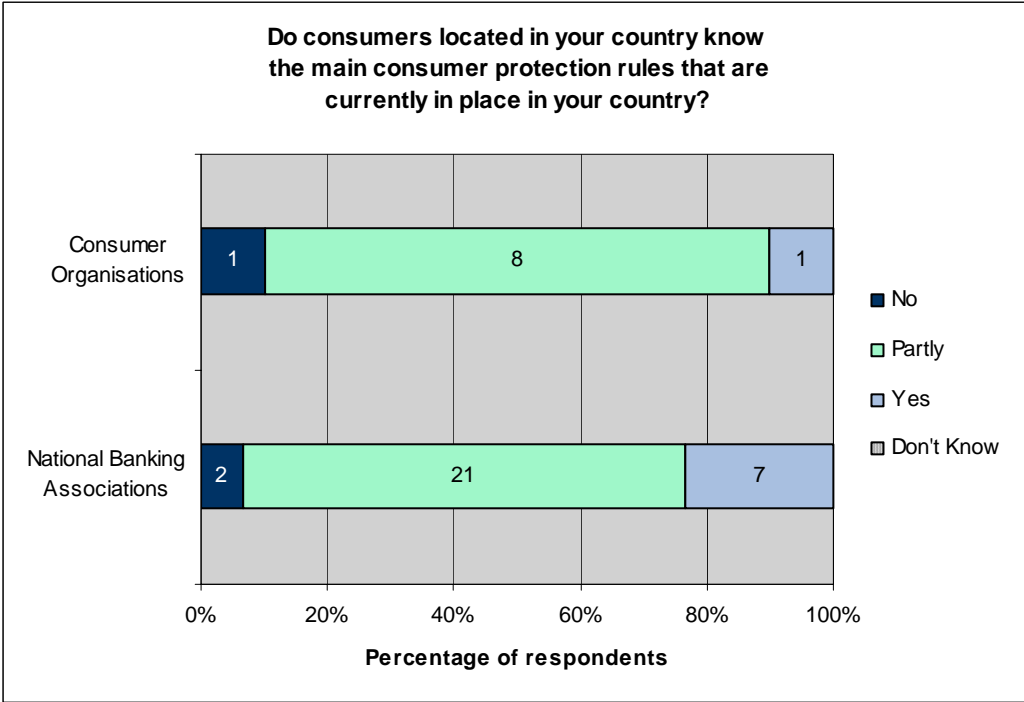


Please note that the questionnaire for banking associations referred to *Barriers for member banks to directly sell to consumers cross-border*, whereas the questionnaire for consumer organizations referred to *Barriers hindering consumers from engaging in direct cross-border transactions related to consumer credit products with lenders in other EU Member States*.

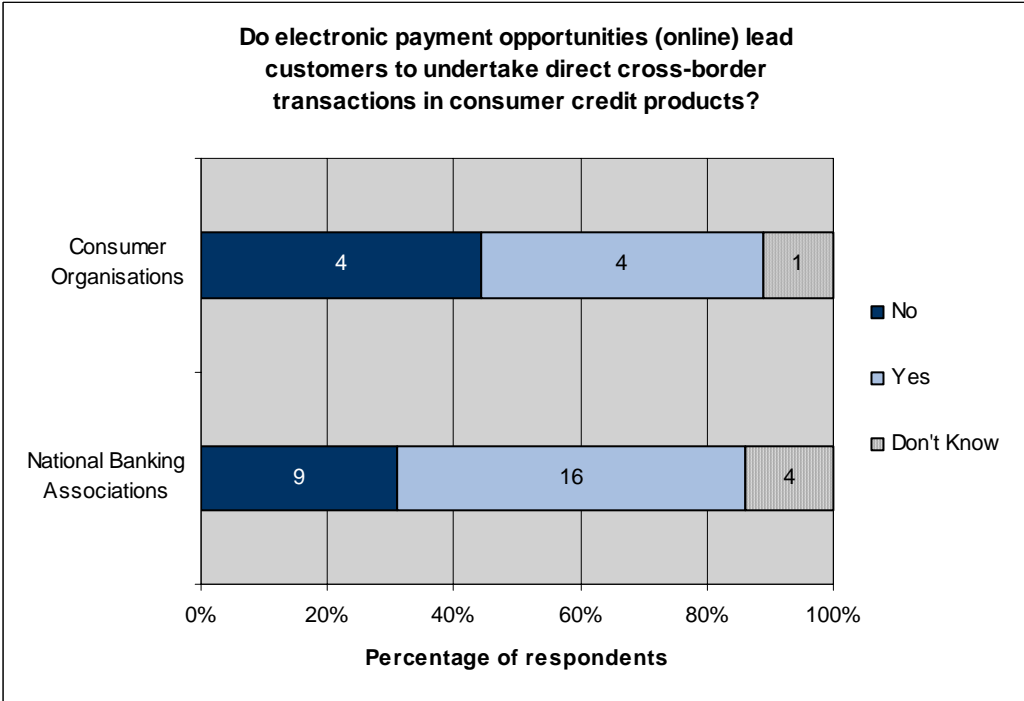
Barrier to establishing themselves in other Member States



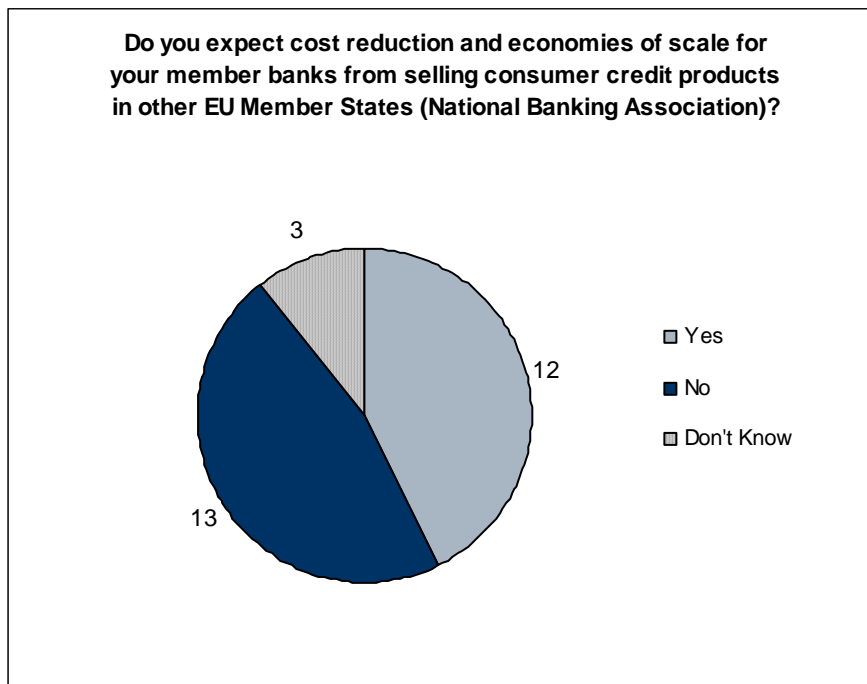
7. In your experience, do you think that consumers located in your country know the main consumer protection rules that are currently in place in your country (concerning information, withdrawal, repayment, annual percentage rate etc., if applicable)?



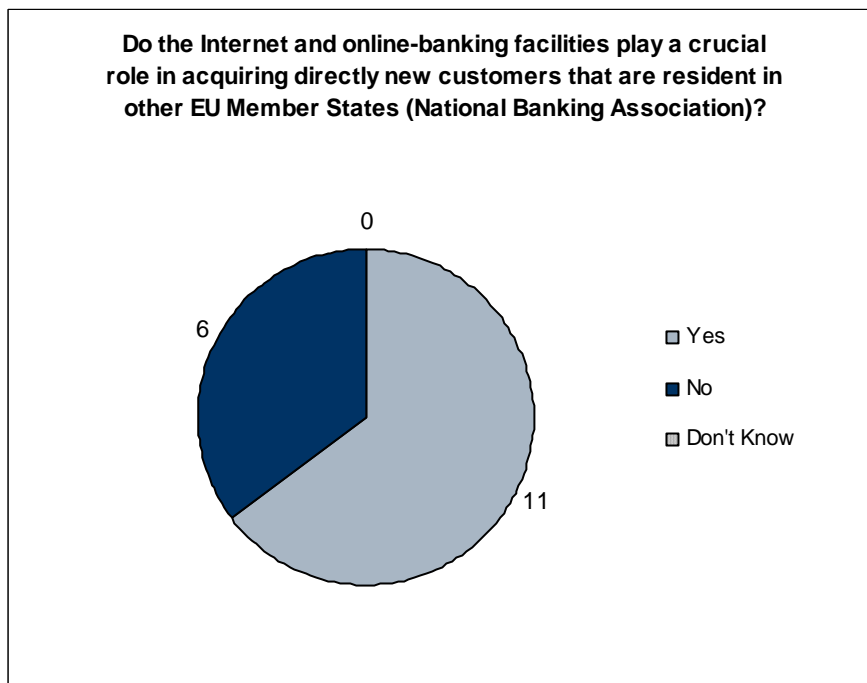
8. Do you think that electronic payment opportunities (online) lead customers to undertake direct cross-border transactions in consumer credit products?



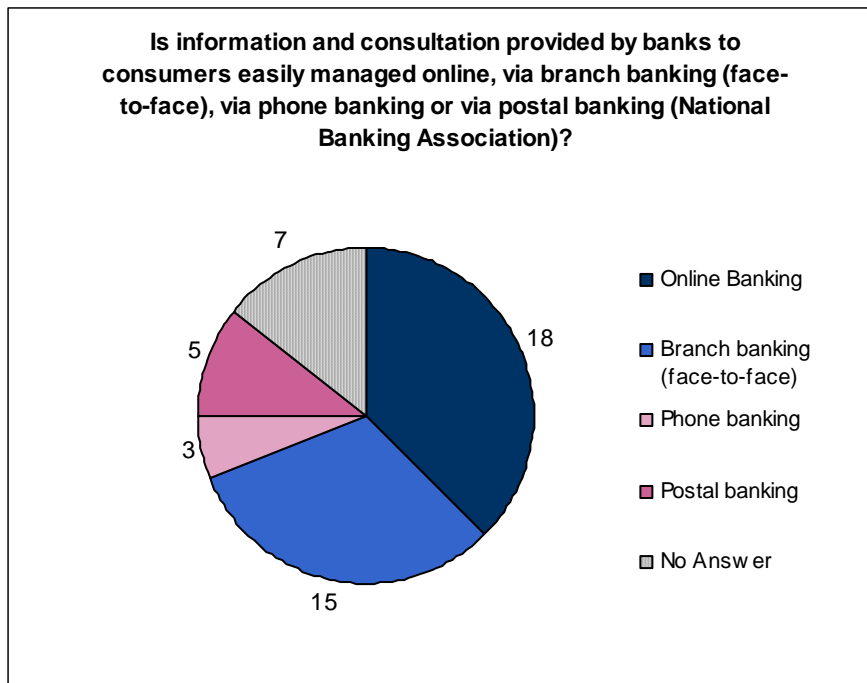
9. Do you expect cost reduction and economies of scale for your member banks from selling consumer credit products in other EU Member States?



If yes: Do the Internet and online-banking facilities play a crucial role in acquiring directly new customers that are resident in other EU Member States?

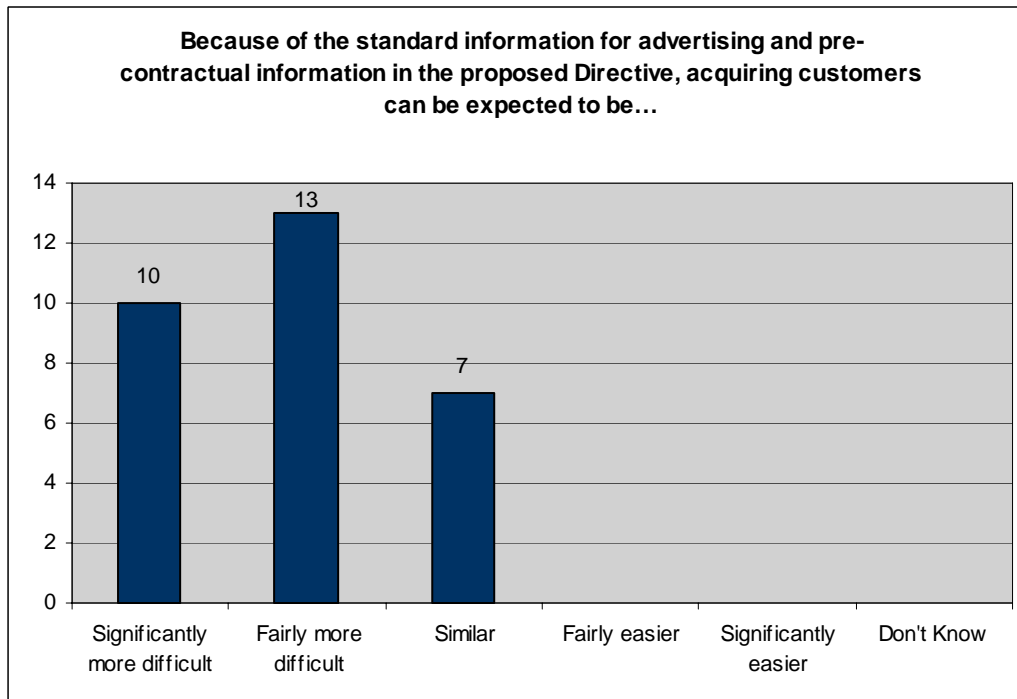


10. Do you expect that information and consultation that your member banks provide to consumers can be most easily managed online, via branch banking (face-to-face), via phone banking or via postal banking?

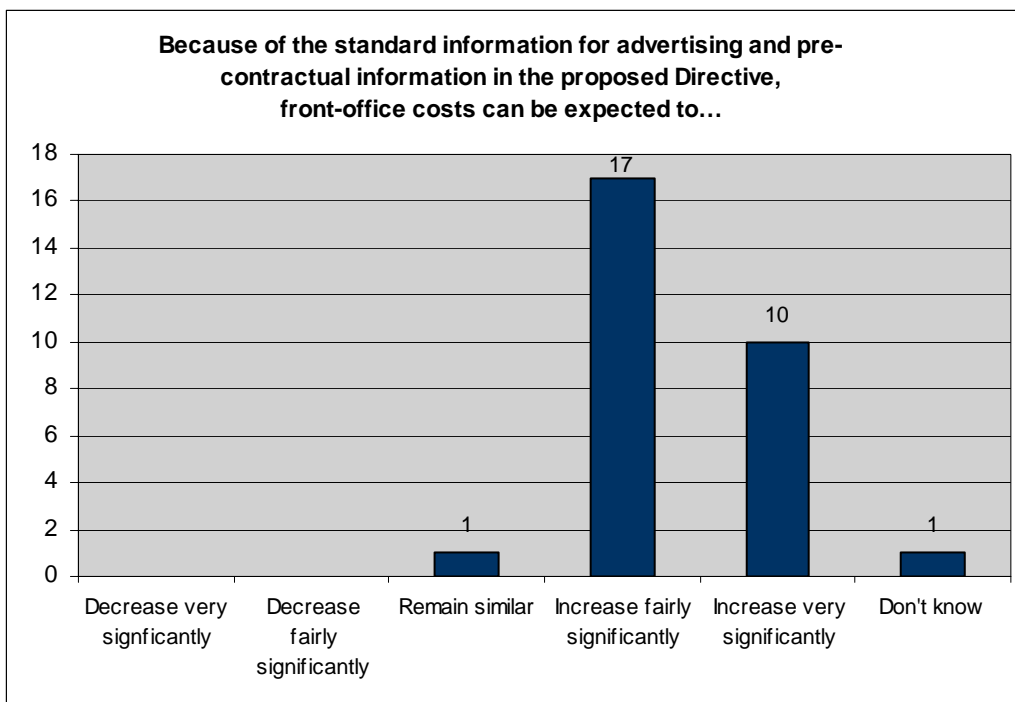


11. Which consequences do you expect from the standard information for advertising and pre-contractual information specified in the modified proposal for a Consumer Credit Directive?

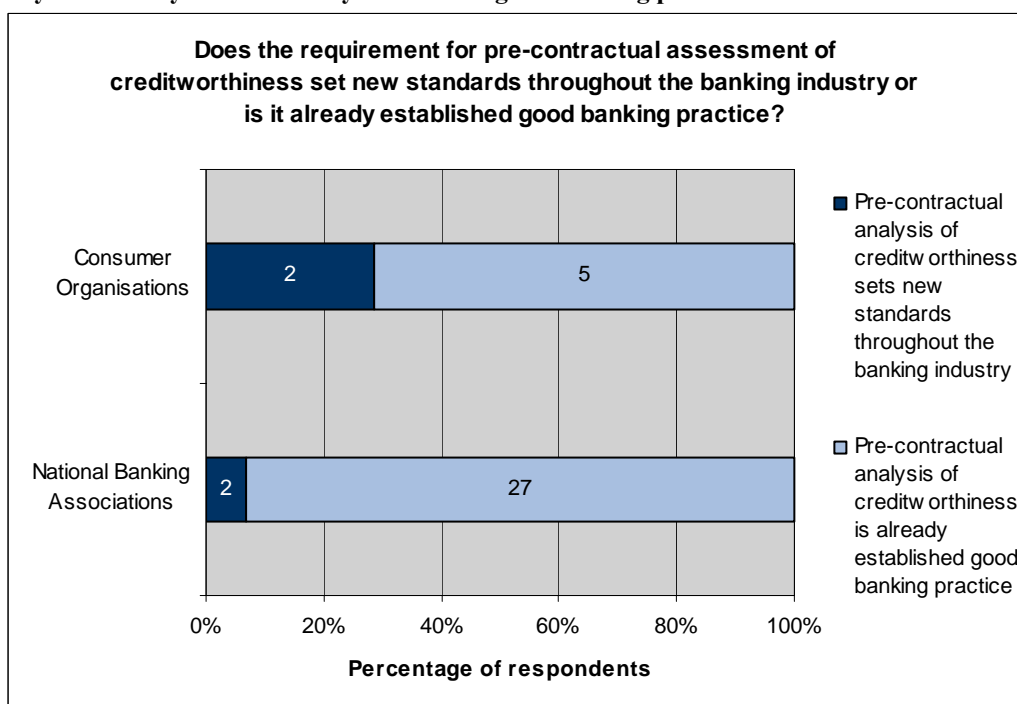
a. Acquiring new customers can be expected to be:



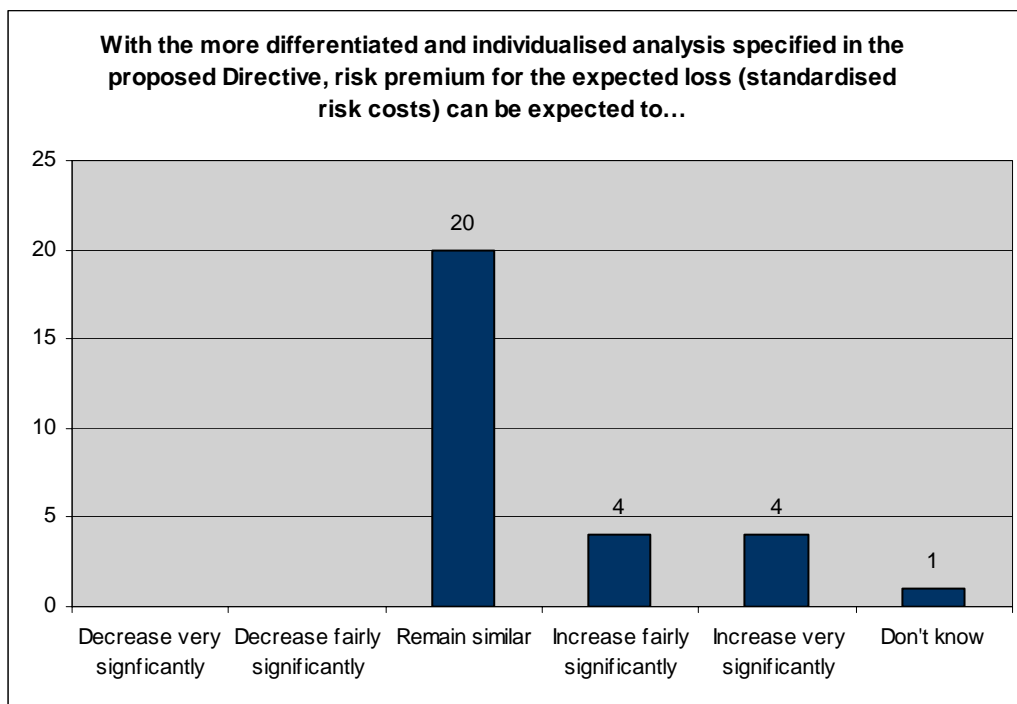
b. Front-office costs can be expected to:



12. Do you think that the requirement for pre-contractual assessment of creditworthiness specified in the modified proposal for a Consumer Credit Directive sets new standards throughout the banking industry in your country or is it already established good banking practice?

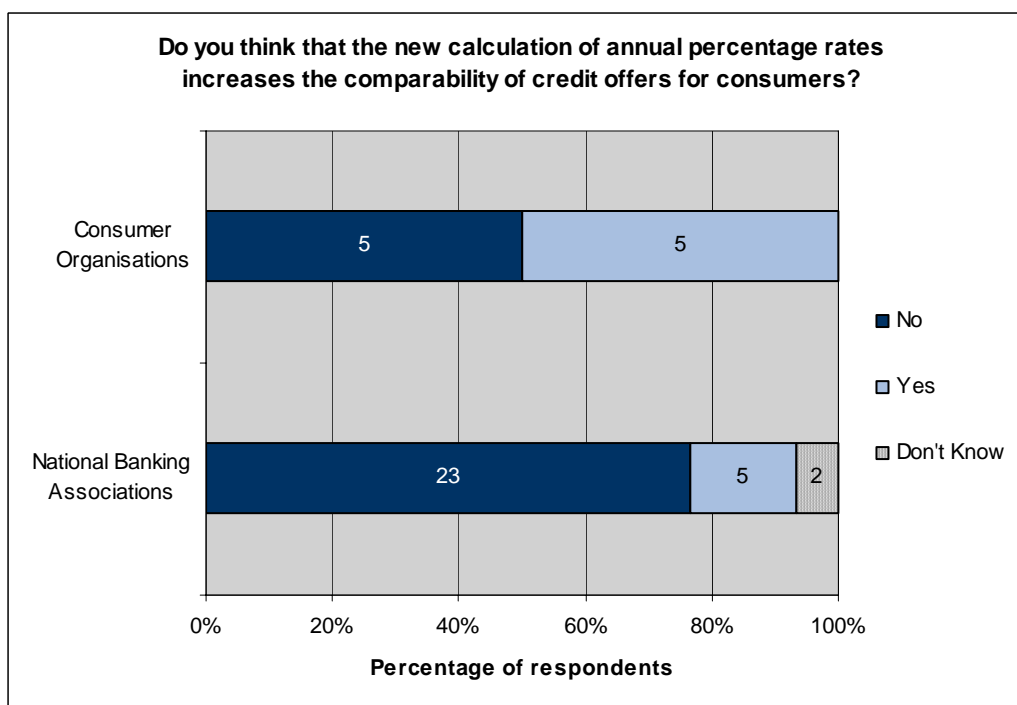


13. How do you expect that the risk premium for the expected loss (standardised risk costs) will change by the more differentiated and individualised analysis specified in the modified proposal for a Consumer Credit Directive?

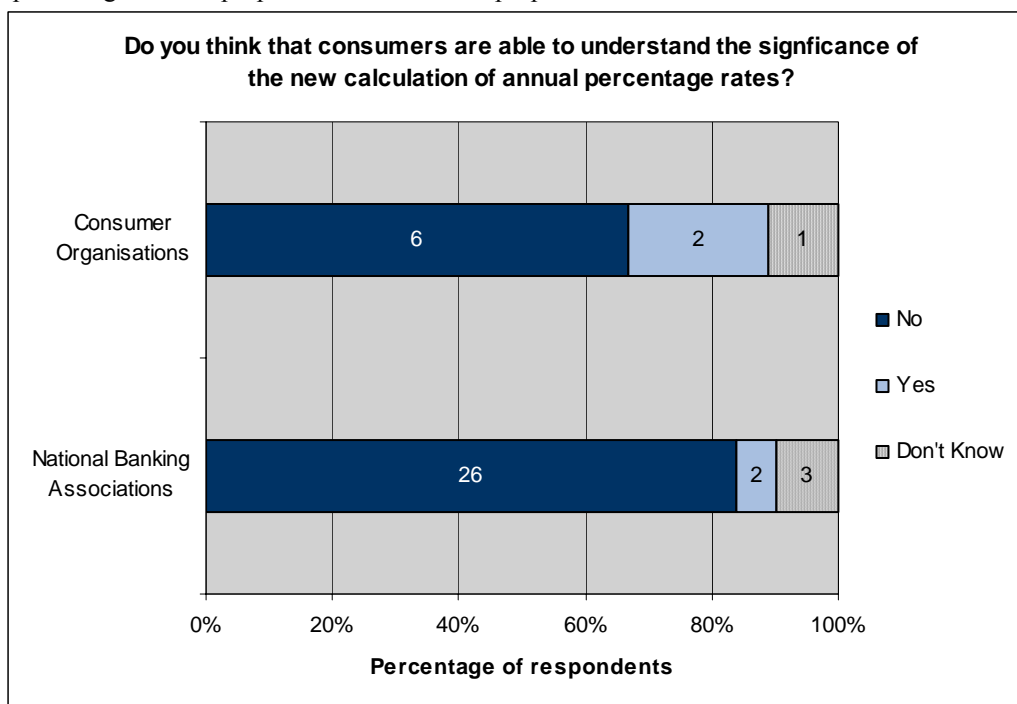


14. What do you expect are the consequences of the new calculation of annual percentage rates and other pre-contractual information requirements specified in the modified proposal for a Consumer Credit Directive?

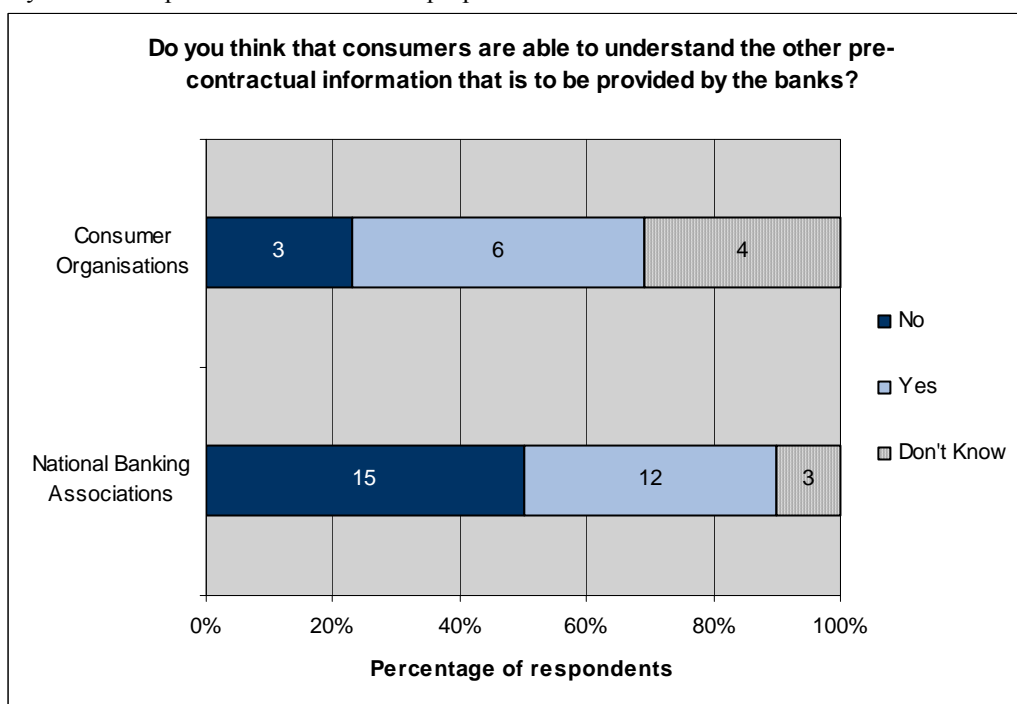
a. Do you think that the new calculation of annual percentage rates (with the inclusion of costs that have to be included under the modified proposal for a Consumer Credit Directive) increases the comparability of credit offers for consumers?



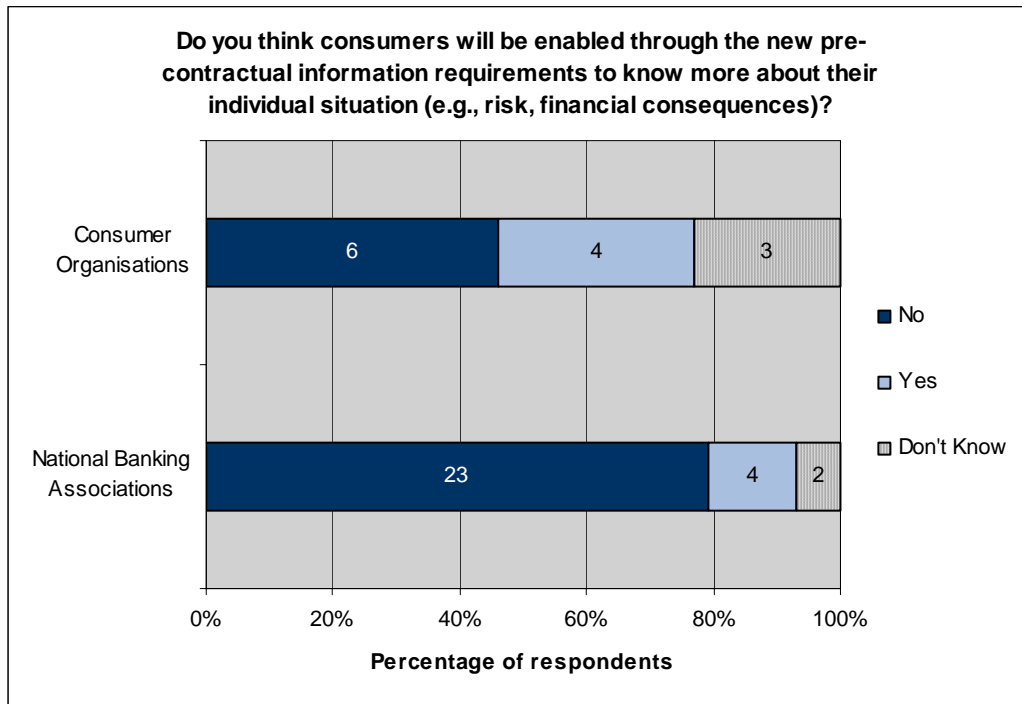
- b. Do you think that consumers are able to understand the significance of the new calculation of annual percentage rates as proposed in the modified proposal for a Consumer Credit Directive?



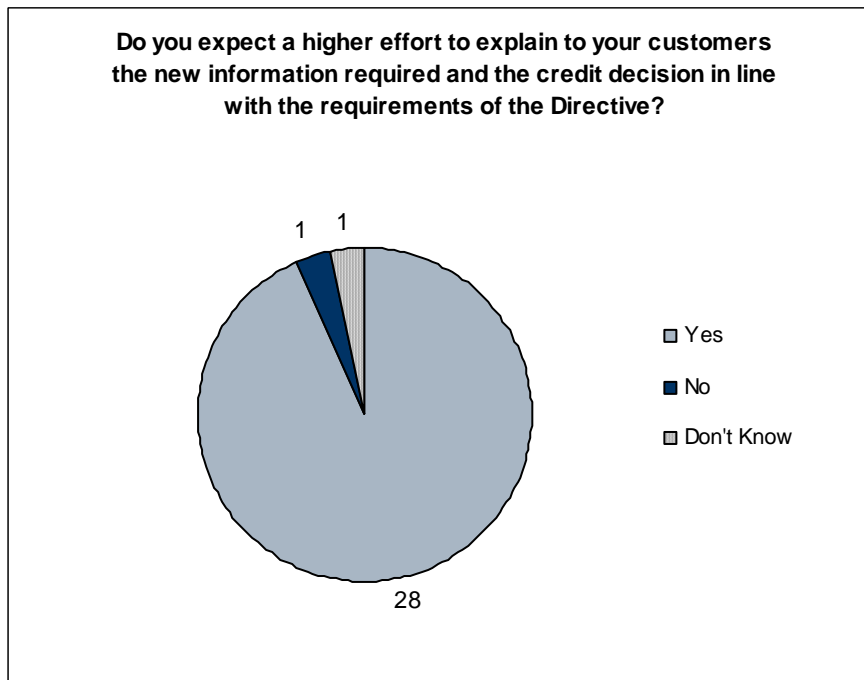
- c. Do you think that consumers are able to understand the other pre-contractual information that is to be provided by the banks specified in the modified proposal for a Consumer Credit Directive?



- d. Do you think consumers will be enabled through the new pre-contractual information requirements of the modified proposal for a Consumer Credit Directive to know more about their individual situation (e.g., risk, financial consequences)?

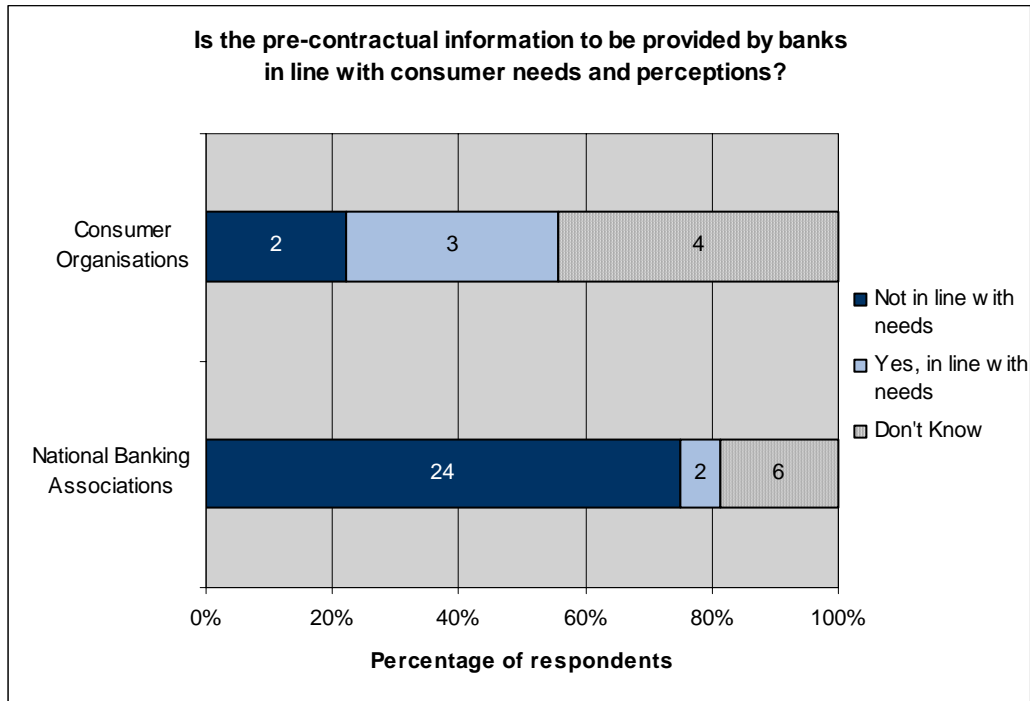


15. Do you expect a higher effort to explain to your customers the new information required and the credit decision in line with the requirements of the modified proposal for a Consumer Credit Directive?

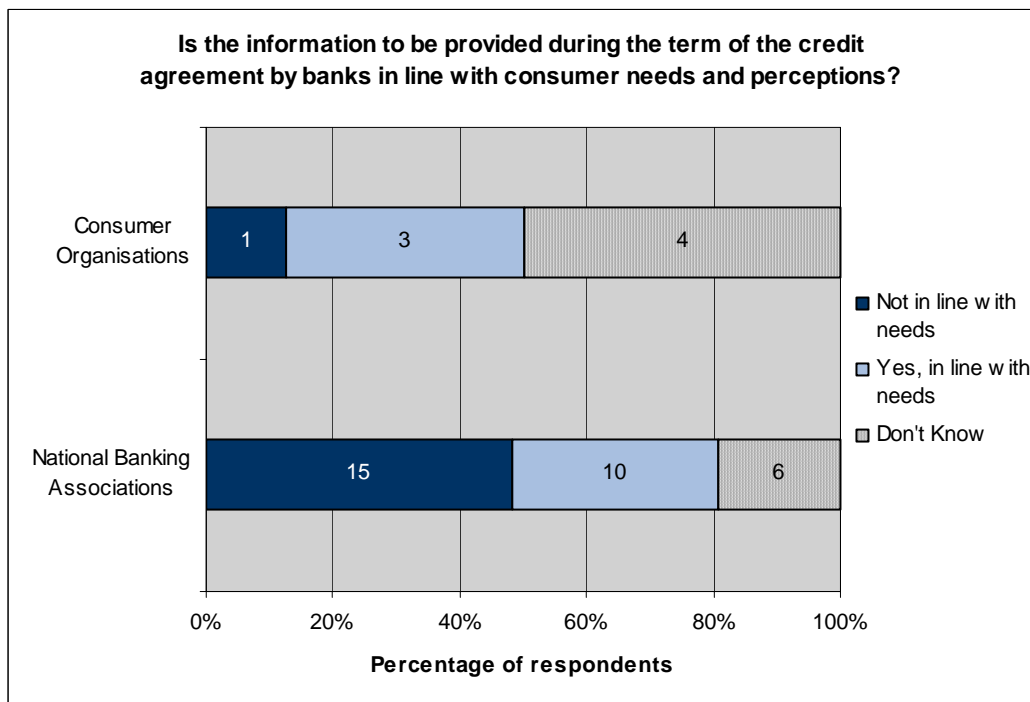


16. Is the information that is to be provided by banks on the basis of the new modified proposal for a Consumer Credit Directive in line with consumer needs and perceptions?

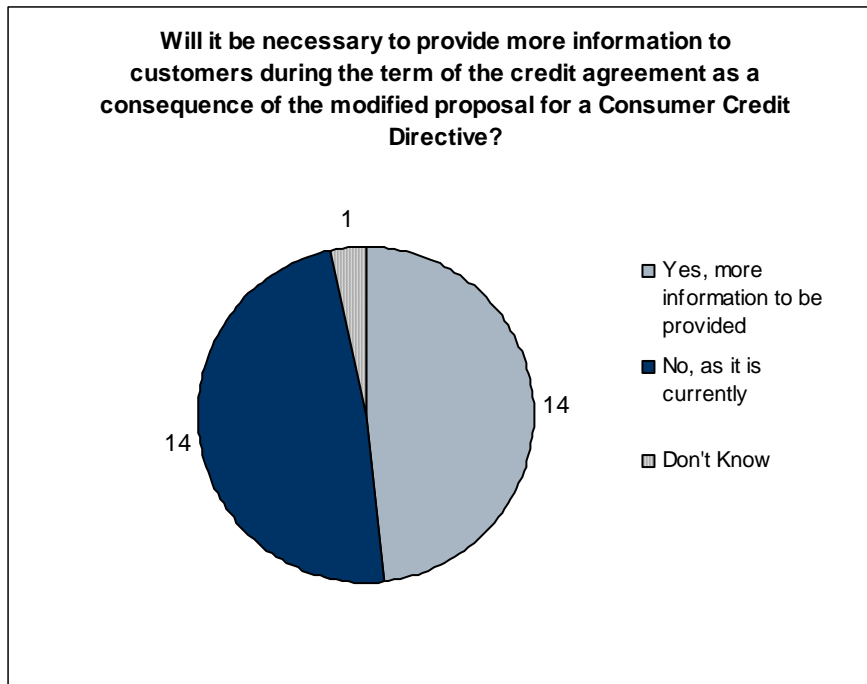
a. Pre-contractual information



b. Information to be provided during the term of the credit agreement

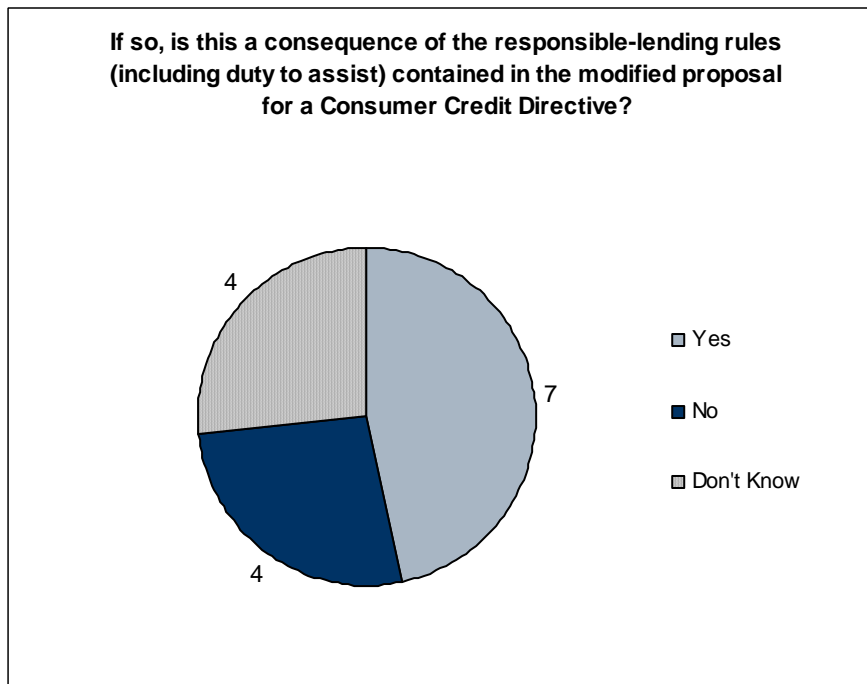


17. Will it be necessary to provide more information to customers during the term of the credit agreement as a consequence of the modified proposal for a Consumer Credit Directive?



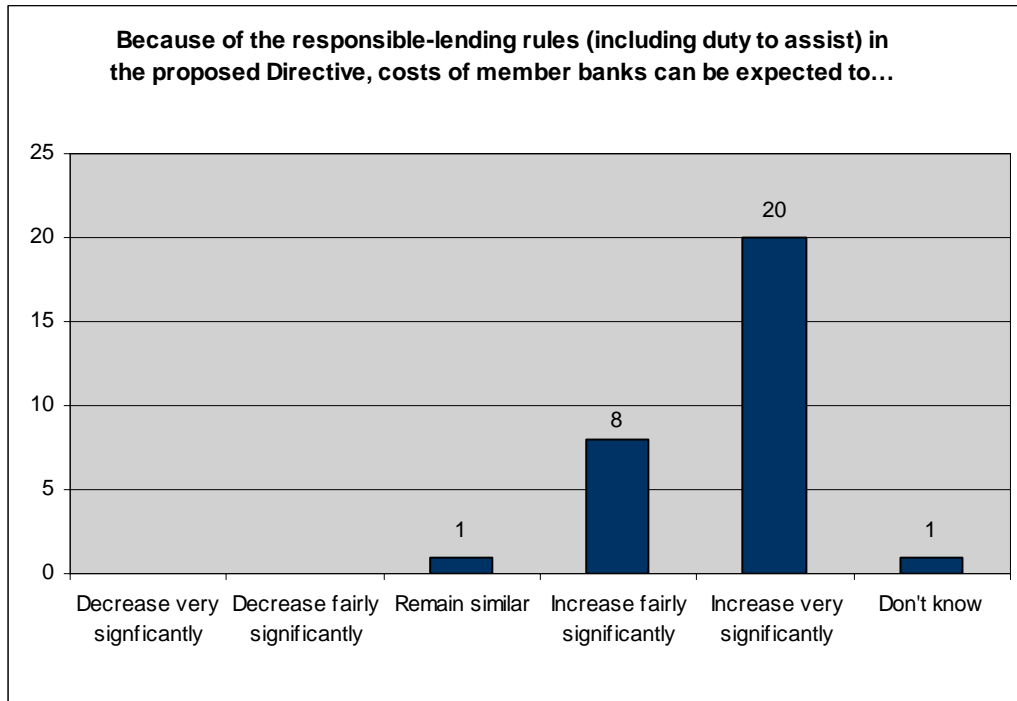
If yes,

Is this a consequence of the responsible-lending rules (including duty to assist) contained in the modified proposal for a Consumer Credit Directive?

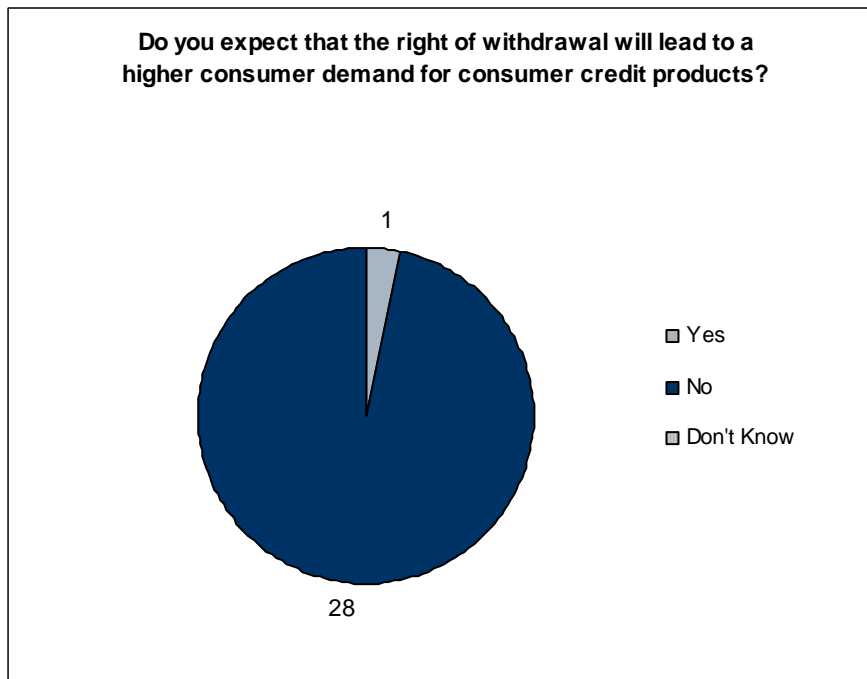


18. Which consequences do you expect from responsible-lending rules (including duty to assist) in the modified proposal for a Consumer Credit Directive for costs of your member banks?

Costs of member banks can be expected to:

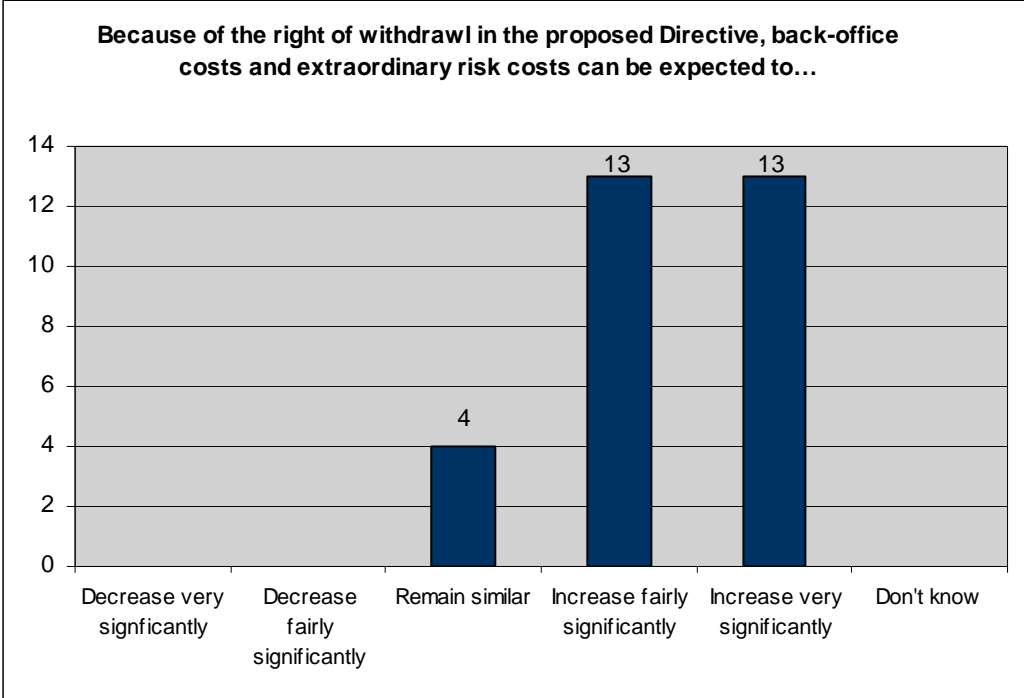


20. Do you expect that the right of withdrawal in the modified proposal for a Consumer Credit Directive will lead to a higher consumer demand for consumer credit products?

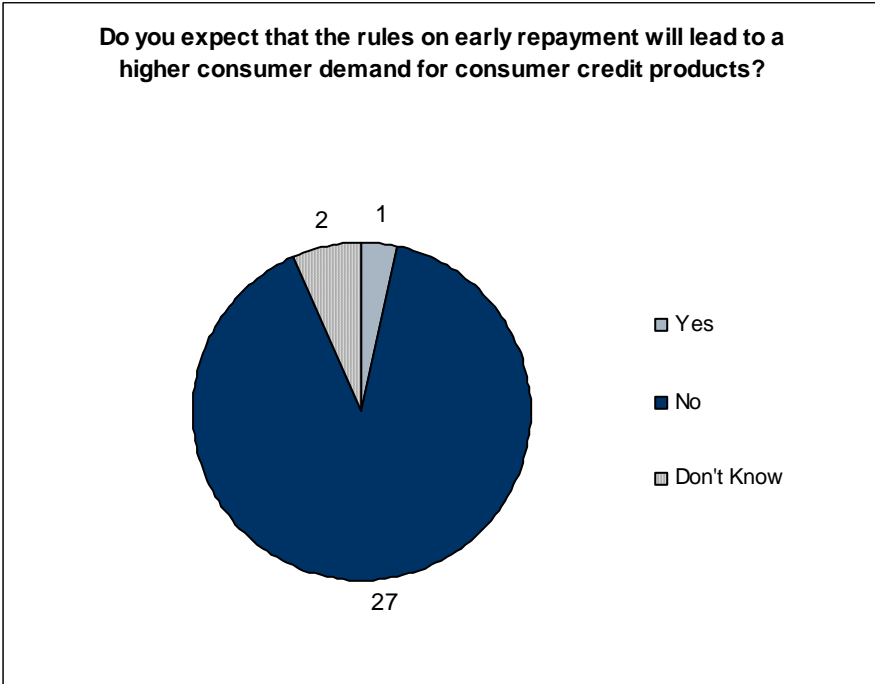


21. Which consequences do you expect from the right of withdrawal in the modified proposal for a Consumer Credit Directive for back-office costs and extraordinary risk costs (liquidity risk, interest risk)?

Back-office costs and extraordinary risk costs (liquidity risk, interest risk) can be expected to:

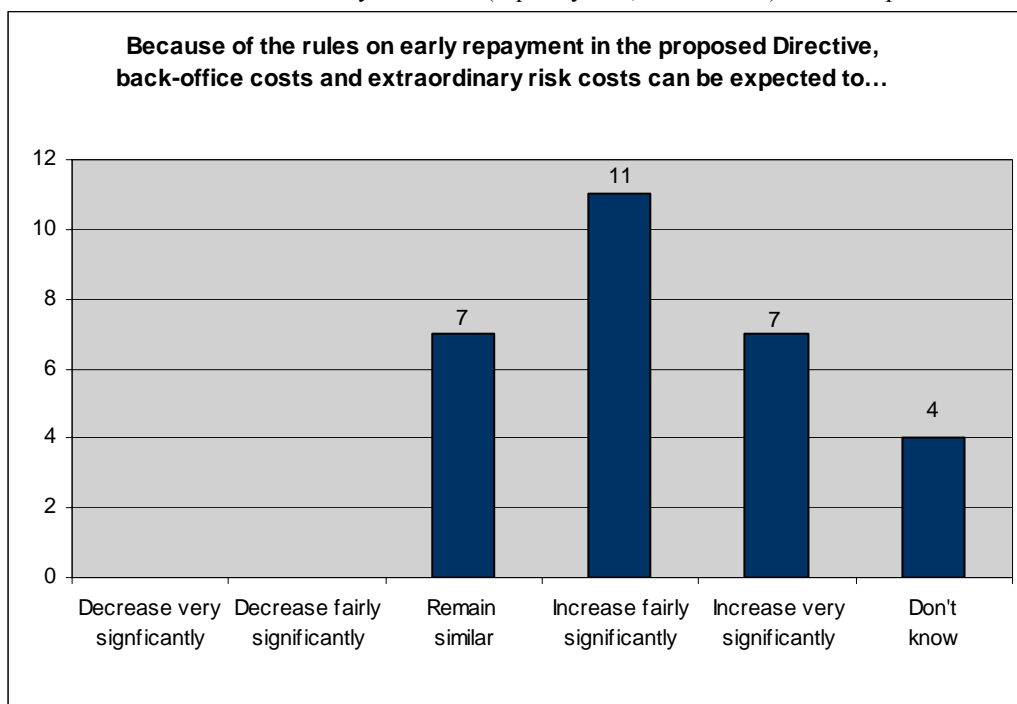


22. Do you expect that the rules on early repayment in the modified proposal for a Consumer Credit Directive lead to a higher consumer demand for consumer credit products?

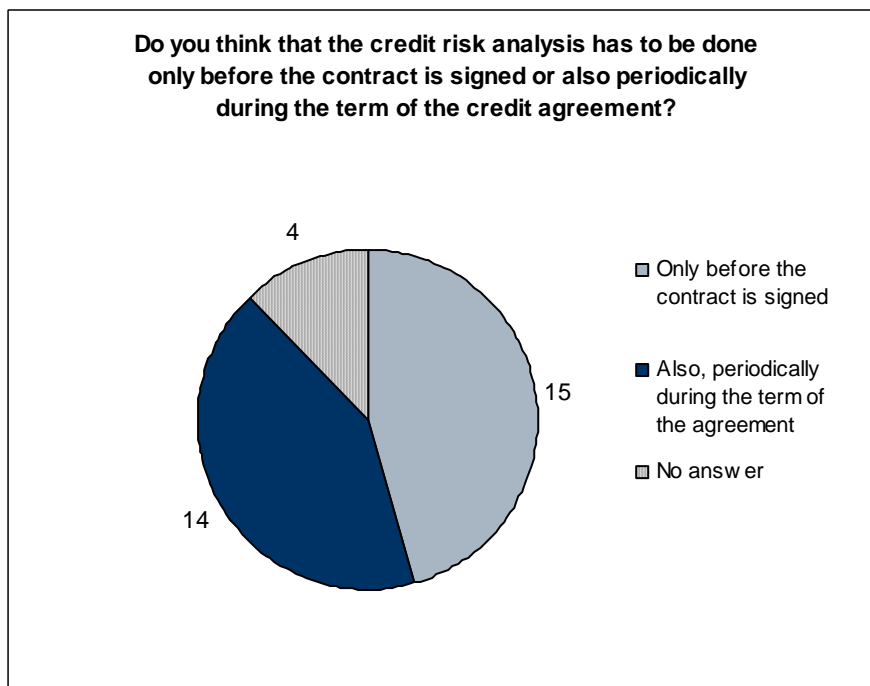


23. Which consequences do you expect from the rules on early repayment in the modified proposal for a Consumer Credit Directive for back-office costs and extraordinary risk costs?

Back-office costs and extraordinary risk costs (liquidity risk, interest risk) can be expected to:

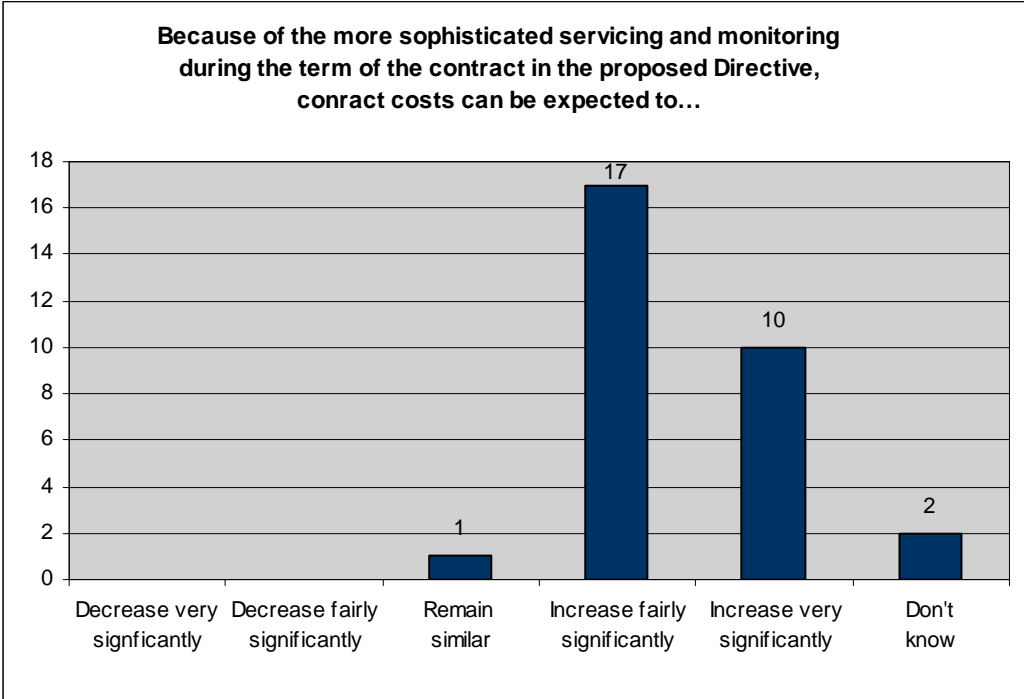


24. Do you think that with the modified proposal for a Consumer Credit Directive the credit risk analysis has to be done only before the contract is signed or also periodically during the term of the credit agreement?



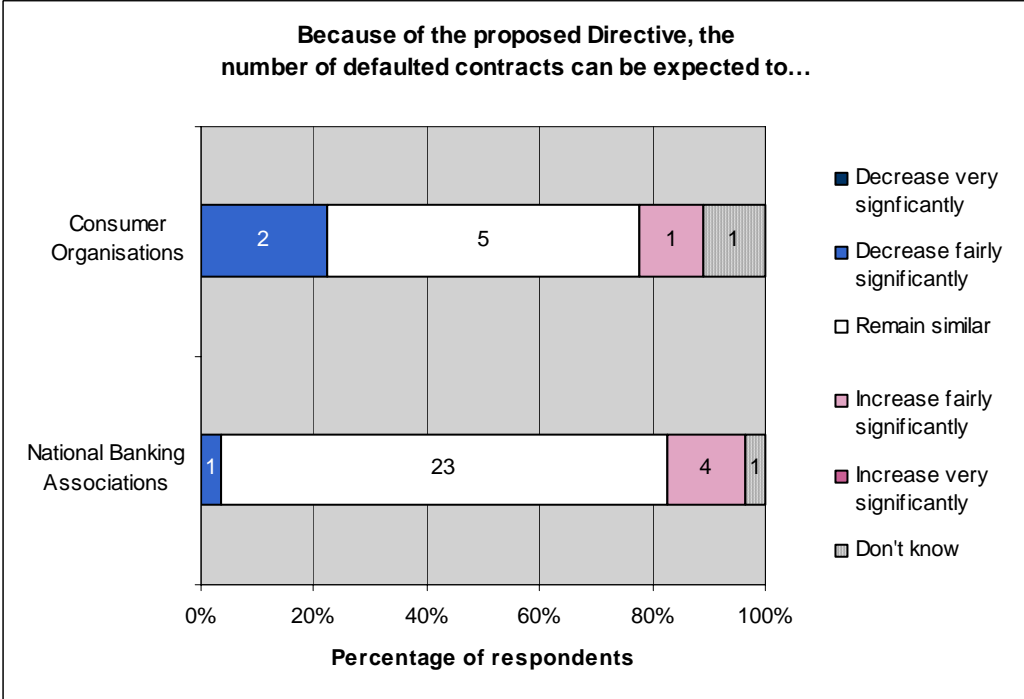
25. How are contract costs affected by a more sophisticated servicing and monitoring during the term of credit agreement?

Contract costs can be expected to:



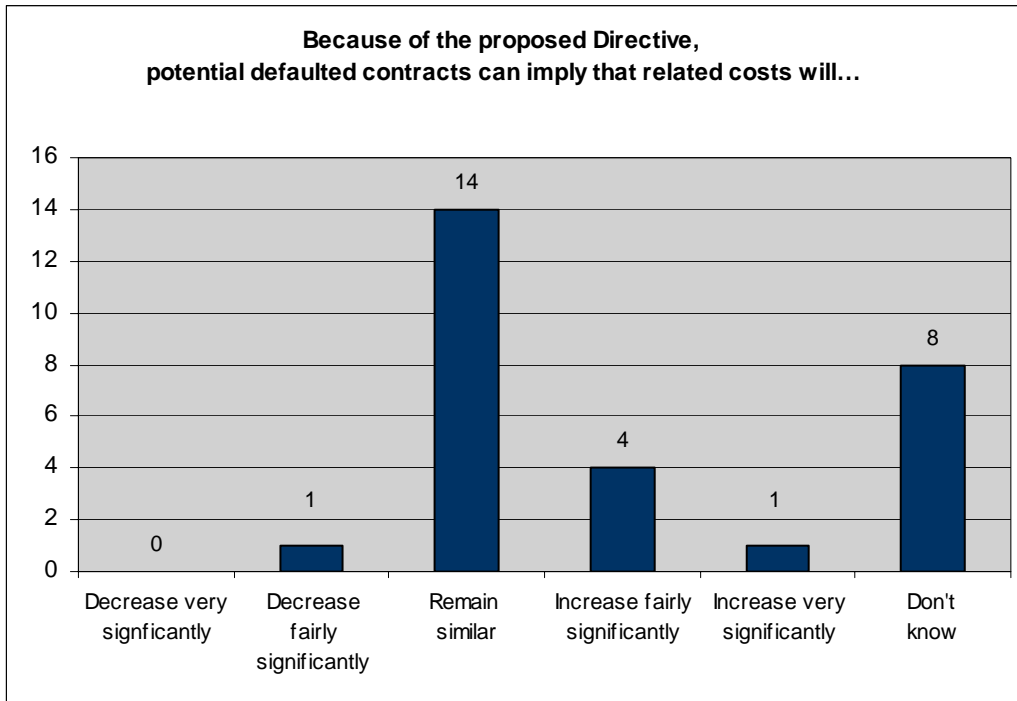
26. How do you expect the number of defaulted contracts will change because of the provisions of the modified proposal for a Consumer Credit Directive?

The number of defaulted contracts can be expected to:



27. How are costs affected by a change in the number of defaulted contracts possibly caused by the modified proposal for a Consumer Credit Directive?

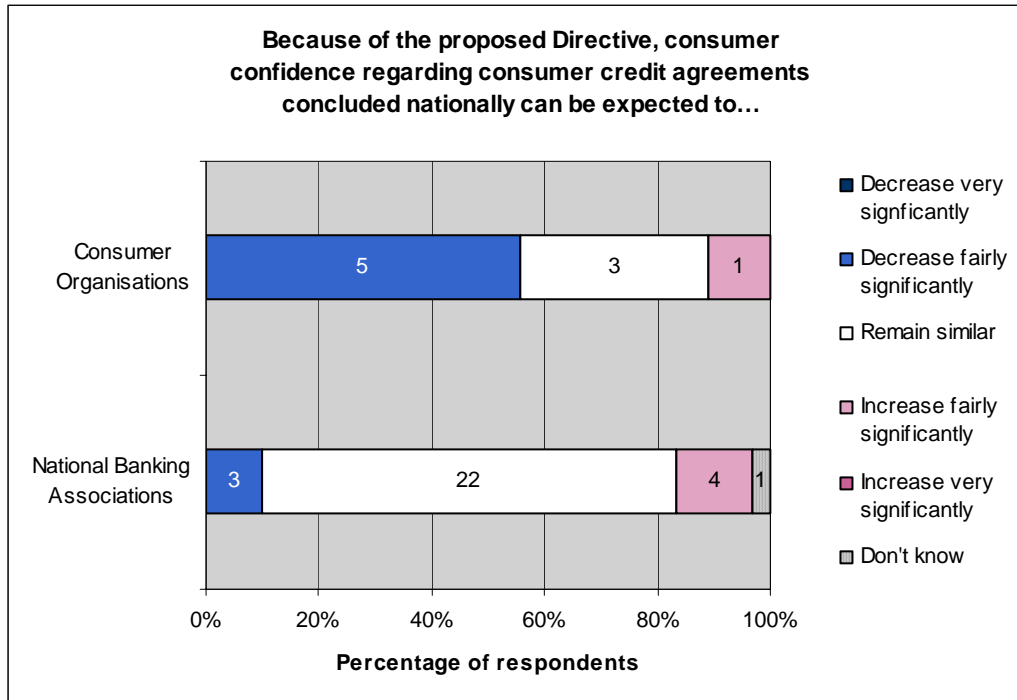
Related costs can be expected to:



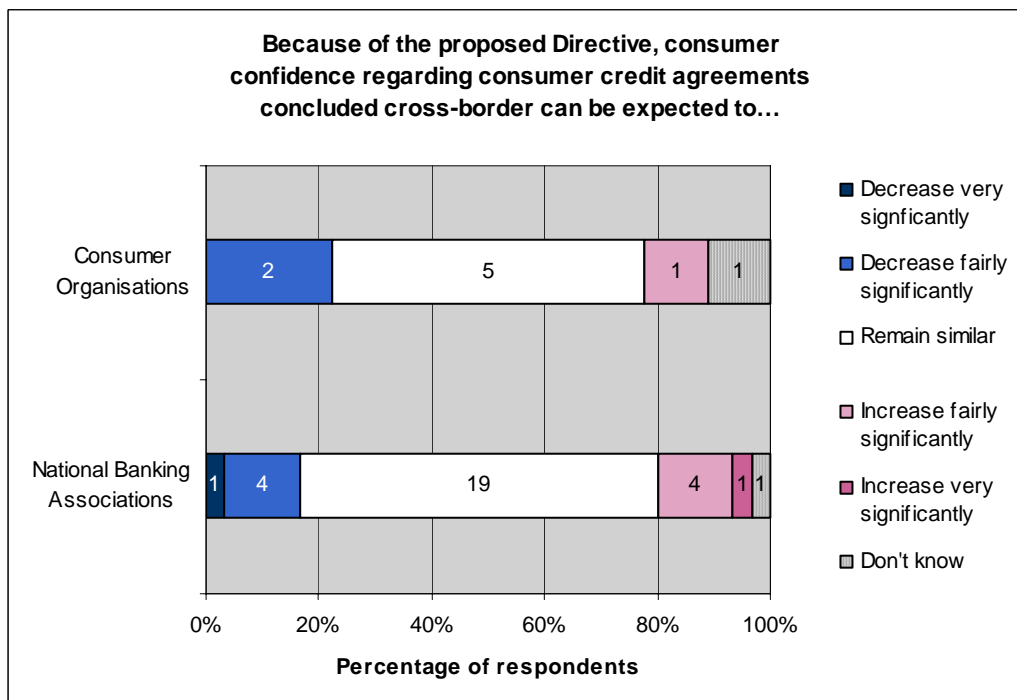
Overall impacts

28. Do you expect that consumer confidence in concluding a consumer credit agreement will increase as a consequence of the higher protection expected?

- a. Please assess the impact of the modified proposal for a Consumer Credit Directive on consumer confidence regarding consumer credit agreements concluded nationally (i.e., lender and consumer resident in MS).

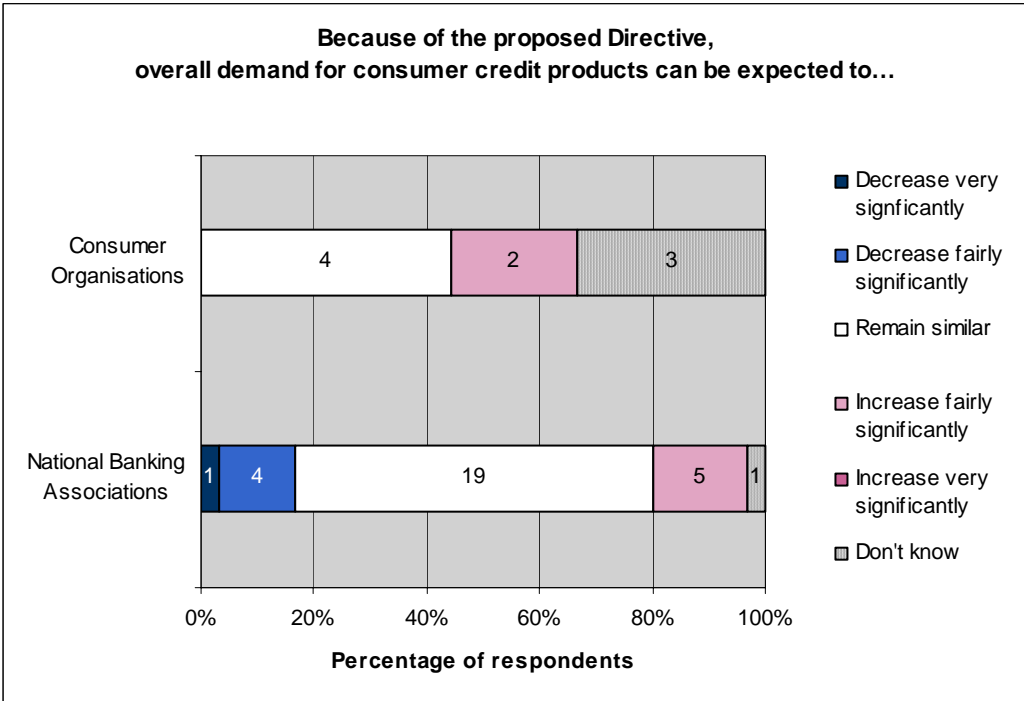


- b. Please assess the impact of the modified proposal for a Consumer Credit Directive on consumer confidence regarding consumer credit agreements directly concluded cross-border (i.e., lender from your Member State and consumer from another). Consumer confidence can be expected to:

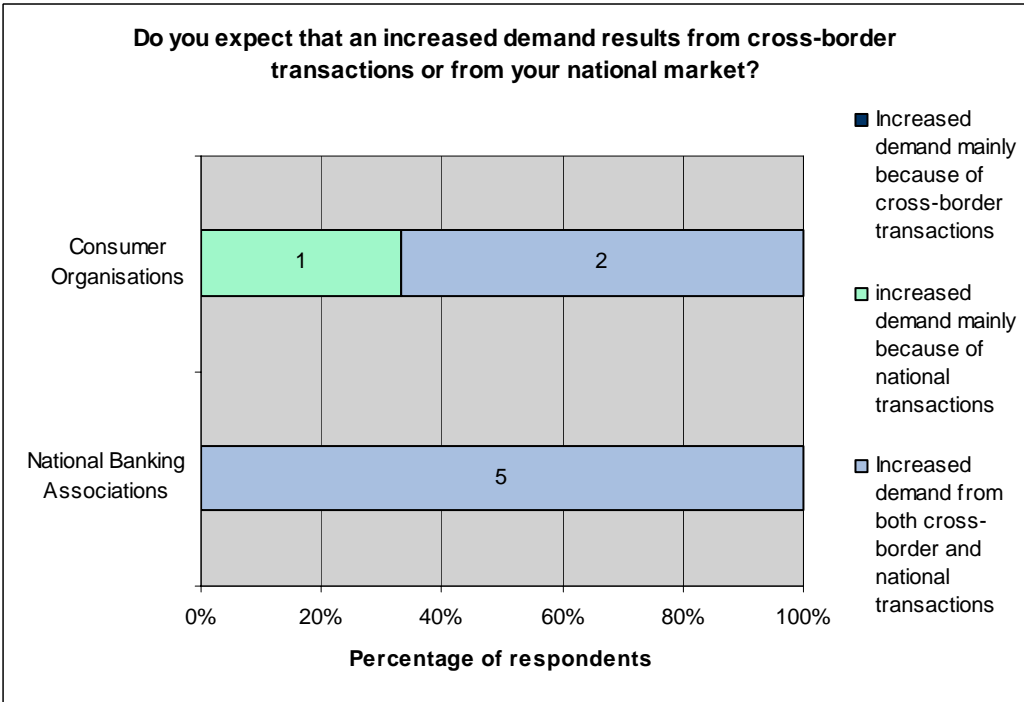


29. Would you expect an increase in the overall demand for consumer credit products with the modified proposal for a Consumer Credit Directive?

a. Demand for consumer credit products can be expected to:

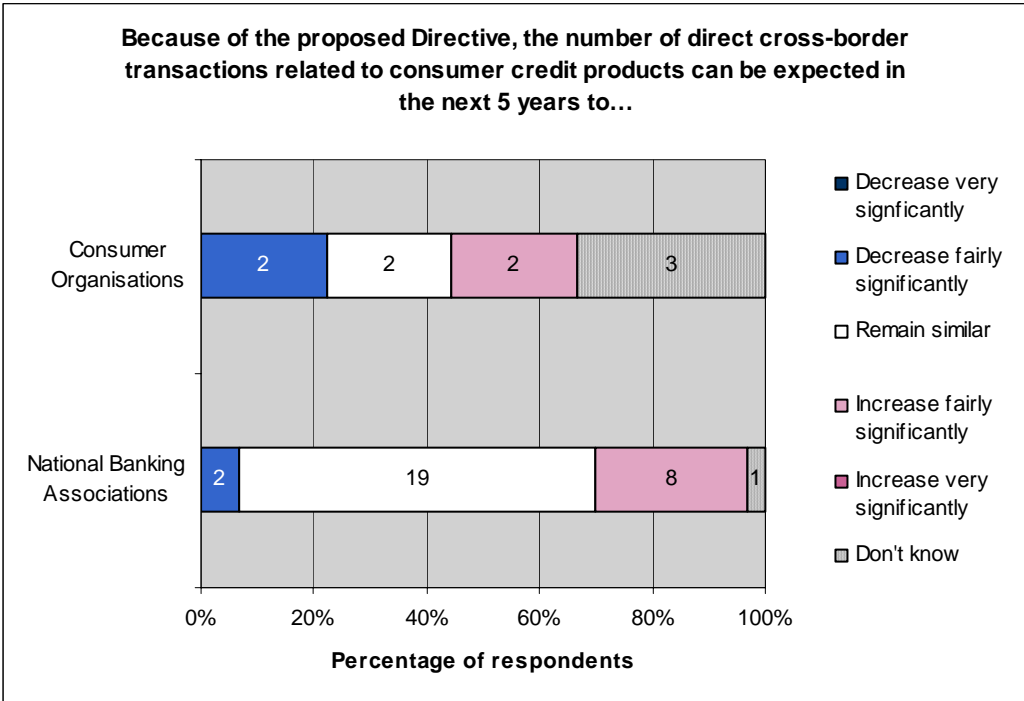


b. If you marked increase: Do you expect that an increased demand results from cross-border transactions or from your national market?



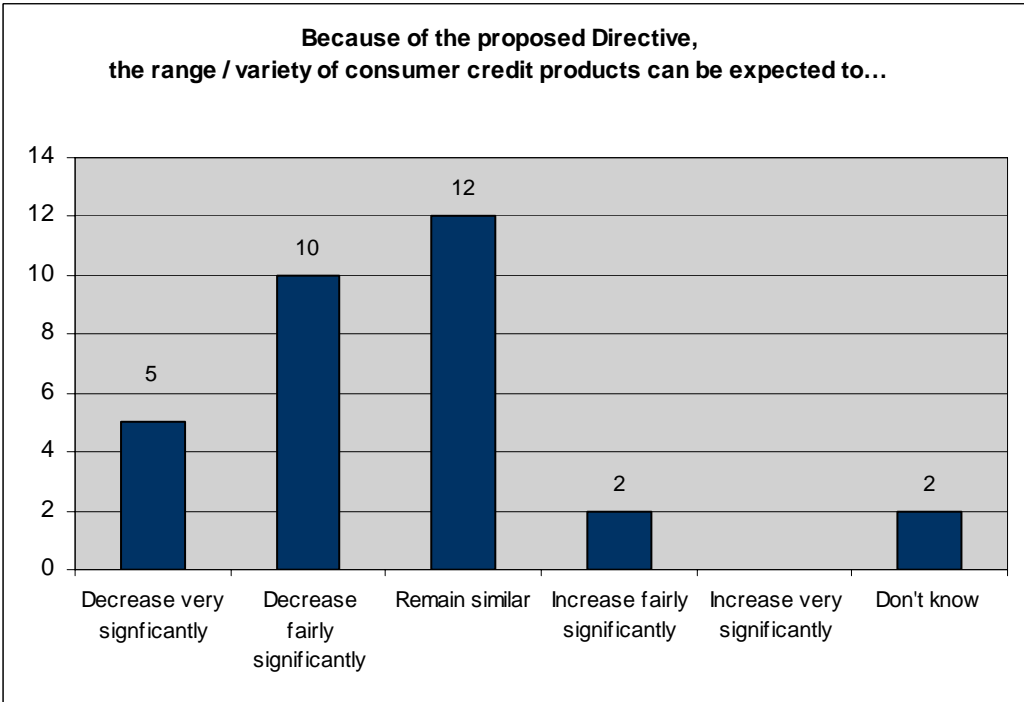
30. How do you expect the number of direct cross-border transactions related to consumer credit products to change in the next 5 years if the modified proposal for a Consumer Credit Directive is adopted?

The number of cross-border transactions can be expected to:



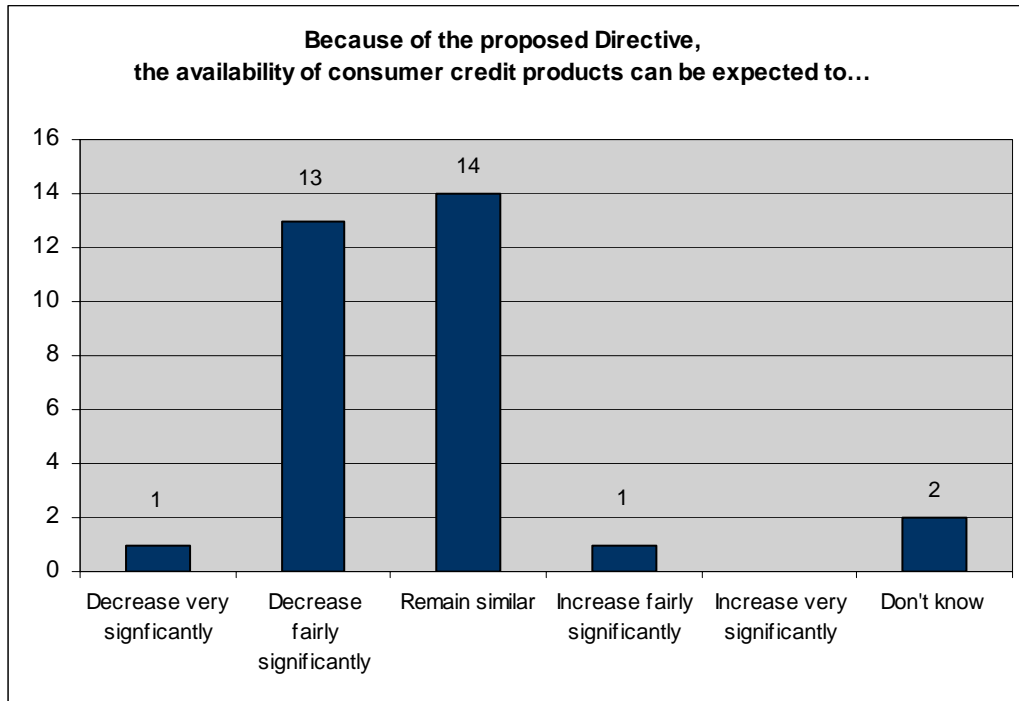
31. Which consequences of the modified proposal for a Consumer Credit Directive do you expect for the range / variety of credit products?

The range / variety of credit products can be expected to:



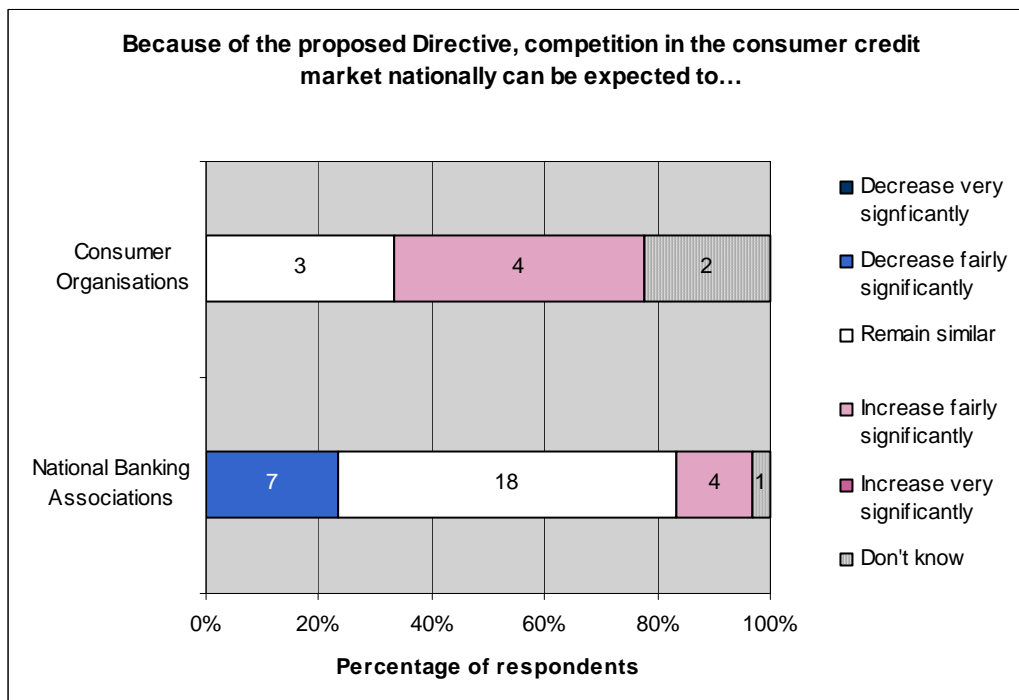
32. Which consequences of the modified proposal for a Consumer Credit Directive do you expect for the availability of credit products?

The availability of credit products can be expected to:



33. Do you expect increasing competition in the consumer credit market as a result of the modified proposal for a Consumer Credit Directive?

a. Please assess the impact of the modified proposal for a Consumer Credit Directive on competition in the consumer credit market nationally. Competition can be expected to:



b. Please assess the impact of the modified proposal for a Consumer Credit Directive on competition in the consumer credit market cross-border EU-wide. Competition can be expected to:

