Proposal for a new consumer credit directive

*by Dr. Helena Klinger**

In general, the Proposal is a welcome development. It is, however, in need of improvement in order to meet the needs of consumer protection. This paper discusses selected issues regarding the Proposal.

Extended scope of application and thus protection (Art. 2 CCD-Proposal)

Fortunately, the proposed directive takes account of consumer law related demands to the extent that platforms for peer-to-peer loans, mini-loans (net loan amount of less than € 200), short-term loans (term of less than three months) and interest-free loans will in future fall under the scope of application of the consumer credit law provisions of the directive as well. This means that essential consumer protection requirements are now being implemented, which are also formulated in the position paper "Die verbraucherorientierte Kreditbeziehung" (Consumer-oriented credit relations, p. 9) of the Federation of German Consumer Organisations, which in turn is based on the *iff* expert opinion on productive credit (both publications in German).

In addition, the Proposal includes overdraft facilities in the scope of application. This is, principally, also to be supported, although a sense of proportion is required. Overdrafts are used to bridge short-term liquidity problems, for example due to a supplementary payment of taxes or operating expenditures. The short-term credit requirement calls for the credit to be available within the existing business relationship between the customer and the bank with as little bureaucracy as possible. Bureaucratic hurdles such as excessive information requirements or time-consuming and meticulous creditworthiness checks would create obstacles to access. For a just and responsible lending

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practice, an interest rate cap should apply to overdrafts as well as to overrunning and, in the case of a longer-term usage of overdraft facilities, the creditor should be obliged to provide an offer a credit for debt restructure. An overview of the selection of legal policy measures is provided in the study by *iff* and Centre for European Economic Research on overdraft interest rates/instalment loans (pp. 208-216) (in German).

The scope of application with respect to the maximum amount of the credit is also extended. Loans of up to € 100,000 are now covered. This is likely to have a corresponding impact on the consumer right provisions that also apply to business founders as borrowers (Section 513 of the German Civil Code).

Overcoming the information asymmetry (Art. 9-12 CCD-Proposal)

In the past, both banks and consumers complained about the flood of information requirements, which led to a bureaucratic monster for providers and the classic phenomenon of "information overload" for consumers. The intention of the current Proposal to make the pre-contractual information leaner, but with emphasised focal points, has to be supported. However, the concrete design is not successful: In addition to the previous form "European Standard Information on Consumer Credit", a one-page, slimmed-down form "European Standard Overview of Consumer Credit" is now to be handed over. This means that in future more information will have to be submitted instead of less. The actual objective will probably not be achieved in this way.

A positive aspect is the idea of decelerating the conclusion of the contract. However, the proposed design for this purpose is unsuccessful as well. It is planned to send the pre-contractual information to the consumer at least one day before signing the contract. This may be diverged if the consumer is informed of the right of withdrawal no later than one day after the conclusion of the credit agreement. This creates a hurdle in the case of an urgent need for credit, which is to be compensated by a double and thus nonsensical information (reference to and reminder on the right of withdrawal). It would be more advisable for the creditor to be bound by its credit offer, for example for

five banking days. Also, the consumers should be given the draft credit agreement not just if they request it, but always as part of the pre-contractual initiation of the transaction.

It is to be welcomed that the Proposal provides an individualisation of the pre-contractual explanations on the basis of situational circumstances (e.g. debt restructure), the person of the borrower (e.g. young adult) and the specific type of credit offered (e.g. bullet loan).[1]

Quality of credit advice (Art. 16 CCD-Proposal)

Article 16 of the Proposal incorporates many provisions of the Mortgage Credit Directive. For example, the Proposal contains conduct of business rules requiring credit advisors to have appropriate skills and knowledge. In the case of '*independent advice*', a sufficient number of credit agreements available on the market should be taken as a basis. Furthermore, credit intermediaries may not receive any remuneration from the creditor in case of an '*independent advice*'.

Particularly noteworthy is the new provision that creditors must warn the consumer if a credit agreement entails a particular risk in light of the consumer's personal financial situation. Unfortunately, this approach, which is desirable in terms of consumer protection law, is unlikely to be applied in practice if credit advice in the legal sense is not obligatory and providers do not take the initiative to provide it for fear of liability, which means that in practice the provision would "come to nothing". In contrast, it would be helpful and desirable to be guided by the advisory standards from the investment sector and to require a suitable credit recommendation (cf. Section 64 (4) of the German Securities Trading Act), as envisaged in the position paper of the Federation of German Consumer Organisations on consumer-oriented credit relations (Die verbraucherorientierte Kreditbeziehung, p. 6-7).

[1] Proposals drafted for this purpose could be found in: Klinger, Ethik und Recht im Kreditgeschäft, 2016, pp. 155-164 (in German).

Provisions of creditworthiness, prevention of usury and consideration of ESG criteria (Art. 18 CCD-Proposal)

The Proposal significantly tightens the requirements that apply to the assessment of the borrower's financial and economic circumstances. The creditworthiness assessment must, thus, show that it is likely that the obligations arising from the credit agreement will be met in the prescribed manner. The scope of the assessment has also been significantly expanded and, in addition to a comparison with relevant databases, it includes an examination of supporting documents as well. This standardises the rules on creditworthiness assessment for real estate loans and other consumer loans. The same is true also for the obligation to keep documentation and records.

This harmonisation may be, on the one hand, easier to organise and monitor from the providers' and supervisors' point of view. These stricter regulations for consumer loans, serve at the same time and particularly the purpose of protecting consumers from over-indebtedness. In contrast to real estate loans, other consumer loans do not regularly have any equivalent loan security that would justify privileged treatment. Alternatively, it may also be argued that other consumer loans do not regularly reach the volume of a real estate loan with the corresponding risks.

In addition, the Proposal contains an obligation for the Member States to limit credit usury, whether through limits on interest rates, the annual percentage rate or the total cost of the loan. In any case, corresponding lending guidelines already exist within banks and are applied. From the perspective of consumer law, it is quite doubtful whether there is any further need for providing for binding upper limits or whether this would cause an access barrier for individual consumer groups. If the existing provisions of Section 138 of the German Civil Code on usury are applied consistently (cf. Reifner, BKR 2021, 409-416), further regulation is likely obsolete.

Particularly noteworthy is the exemption in the Proposal for granting credit despite a negative result of the creditworthiness assessment in specific and well justified cases (e.g. to finance exceptional health expenditure, student

loans or loans for consumers with disabilities). These social policy considerations, which take precedence over the outcome of a creditworthiness assessment carried out in the interests of the bank and the consumer, should also take account of environmental considerations. This applies, for example, to loans for financing energy-efficient building modernisation. Only in this way the ESG approach could be satisfied.

Measures to reduce and prevent over-indebtedness (Art. 34-36 CCD-Proposal)

Given the current and ongoing economic impact of the COVID 19 crisis, which has left many consumer households in financial distress, all measures envisaged by the Proposal to reduce and prevent over-indebtedness are to be welcomed.

For example, the Proposal includes an obligation for the Member States to promote financial literacy, especially for young adults taking out consumer credit for the first time, and to improve the availability of debt counselling services. Ideally, this would lead to a right to debt counselling for all debtors.

The obligation of the Member States to adopt measures to encourage creditors to be lenient in the event of a distressed credit exposure should also be emphasised. Currently, Section 498 (1)(sentence 2) of the German Civil Code provides for a dialogue offer before the creditor can claim the repayment of the total residual debt, but in practice this remains largely meaningless. In particular, it would be desirable to have adjustment options for the nonperforming credit relationship which can take the special rule of Article 240 § 3 of the Introductory Act to the German Civil Code (which is limited in time for the Covid 19 pandemic) as a point of orientation.

Effective sanctions (Art. 44 CCD-Proposal)

For sanctions to be imposed in the event of infringements of the national provisions adopted under the proposed Directive, the Proposal contains a provision on fines of at least 4 % of the creditor's annual turnover. This is also to be welcomed from the perspective of the principle of effectiveness, since regulations with the legal policy objective of compensating for damage regularly do not have sufficient deterrent effect.

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