The revision of the Consumer Credit Directive: Does it go far enough?

Meryem Gökten and Willem Pieter De Groen*

Commentary

Following the rise in digital lenders and increasing online distribution of consumer credit, the European Commission proposed a revision of the Consumer Credit Directive (CCD) in June 2021[1]. The first European Consumer Credit Directive was implemented in 1987 and was replaced in 2008 with the current directive, which was designed to strengthen consumer rights, harmonise the set of rules on financial institutions, and allow consumers to make informed choices when signing a credit agreement.

The existing CCD has introduced a number of benefits for consumers, however it is now somewhat outdated due to various technological and market developments since its adoption. The Commission's proposal aims to address these developments and improve the regulatory framework for consumer credit by expanding its scope, introducing pricing rules, clarifying information requirements, and revising the creditworthiness assessment. Nevertheless, it remains a question as to whether the revisions are enough to create a well-functioning single market for consumer credit. This commentary assesses the proposed revisions.

* The opinions and conclusions expressed in this commentary are those of the authors and do not necessarily reflect those of ECRI and its members.

[1] EC (2021b), 'The Proposal for a Directive of the European Parliament and of the Council on Consumer Credits', European Commission Brussels COM(2021) 347 final.

Scope

Starting with the proposed revisions in scope, both the existing and the proposed CCD determine the consumer loans covered by the directive based on their value in combination with the type of consumer loan.

In terms of value, the scope of the existing CCD is limited and can create fragmentation and limit the protection of consumers obtaining loans out of scope. The existing directive covers the vast majority of consumer loans, covering loans ranging in value between EUR 200 and EUR 75 000. The proposed directive expands the scope, also covering loans below EUR 200 and loans between EUR 75 000 and EUR 100 000. The coverage of loans below EUR 200 is logical as it can also concern loans with relatively high costs provided to vulnerable households. Moreover, in the absence of EU legislation, several Member States have already taken their own measures to protect consumers obtaining loans below EUR 200, including mostly payday loans, pawnshop loans and revolving credit agreements (e.g. credit cards[2]) and bank consumer loans. Their inclusion in the directive provides some minimum harmonisation across Member States. In turn, determining the appropriate upper threshold is more difficult[3]. Looking at the current market practice, consumer loans in most countries do not exceed EUR 100 000, though there are already some exceptions for those of significantly higher values and this might increase in the future. It is unclear why consumer loans above EUR 100 000 should not be covered by the CCD, as a high value loan does not necessarily need less protection[4] and consumer loans are in general riskier than, for example, housing loans which are covered up to an unlimited amount under the Mortgage Credit Directive.

The existing CCD covers most, but not all consumer loans[5], which is addressed in the proposed CCD by including additional types of loans: buy-now-pay-later schemes[6], payday loans[7], short-term overdrafts facilities[8], interest-free credits[9] and loans offered through crowd-lending

[2] Reifner et al. (2010).

[3] Consumer loans over EUR 75 000 are often offered as housing loans/mortgages to households in the EU and they are regulated by the EU Mortgage Credit Directive, which is also currently under revision. The Mortgage Credit Directive also covers unsecured credit agreements whose purpose is the renovation of a residential immovable property involving a total amount of credit above EUR 75 000. However, other types of loans with purposes other than housing or renovation are not covered by either of the directives.

[4] For example, the high value loan can correspond with a relatively low and unstable income, causing the borrower to still be financially vulnerable.

[5] According to a survey conducted by Deloitte in 2018, personal loans granted by banks are the most common type of consumer credit. Their share out of the total amount of consumer credit ranges from between 30 % in Italyto 52 % in Poland (Deloitte 2019).

[6] Buy-now-pay-later schemes allow consumers to purchase goods and services by paying off the price at a later date.

[7] Payday loans, also called instant loans, provide a short-term borrowing option where a borrower is expected to repay the loan's principal from their next monthly salary.

[8] An overdraft facility allows consumers to continue withdrawing money even when the account has no or has insufficient funds to cover the amount of the withdrawal. The option is tied to interest payments and typically has additional costs attached.

[9] Interest-free credit is defined as credit agreements without interest and without any other charges. The credit must be repaid within a certain period and charges are only applicable if the repayment doesn't occur in the specified period.

platforms[10]. The proposal requires the providers of these loans (including those that are not credit institutions) to be subject to adequate supervision. Nevertheless, pawnshop and doorstep loans are left out of the proposed scope. Pawnshop loans are secured loans whereby the borrower gives a personal good as collateral to the pawnshop. If the loan is not repaid on time, the pawnshop gets to keep the personal good. Doorstep loans, also called 'home credit', are unsecured loans which are delivered to and collected at the residence of the borrower. What both types of loans have in common is that they are provided on location and thus can't be provided across borders[11], which is the main reason for the Commission not to include these loans in the proposal[12]. Nevertheless, in the interest of the European Single Market, these types of loans should not compete under less stringent consumer protection. For example, according to the UK's Financial Ombudsman Service (2021), a lack of regulation and enforcement leaves room for malpractices, such as disputes over the amount owed or interest, as well as rude and intimidating practices by debt collectors.

Clarifying information requirements

Since its adoption, the CCD has faced criticism that it would insufficiently ensure the quality of information provided to consumers (EBA, 2021). The information provided to borrowers is not always clear and often complex, especially the information regarding the costs of credit and the consequences of missing payments. The lack of clarity and complexity often result in higher than expected costs, and makes it difficult for consumers to compare different loan offers and subsequently make informed choices[13]. To increase consumer awareness and to promote responsible lending practices, the proposal aims to streamline and reflect the growing importance of digital services in the pre-contractual phase. The proposal aims to improve the provisions of pre-contractual information by requiring lenders to focus more on the key information, such as borrowing rates and costs, the annual percentage rate of charge (APR), and the total amount of credit. This information would be summarised in a Standard European Consumer Credit Information overview and form, of which the latter fits on a mobile phone screen. Additionally, the proposal also envisages the introduction of a reflection period, with a duration of one day, before the conclusion of the credit agreement or a reminder on the right of withdrawal.

[10] Peer-to-peer platforms connects individuals or businesses looking for loans and individuals and businesses willing to lend money.

[11] Both types of loans have relatively high costs and are provided to vulnerable households.

[12] According to the Commission, their inclusion in the CCD cannot be justified under the principle of subsidiarity (Article 5 of the Treaty on European Union).

[13] In addition, according to an online mystery shopping exercise conducted by Finance Watch (2021), more than 37 % of participants declared the pre-contractual information as unclear, and 60 % of participants stated that theywere unable to make informed choices based on the information, as the pre-contractual information mostly lacksfull disclosure of all the costs and fees associated with the credit agreement, and the consequences in case of overdue payments.

Revising the creditworthiness assessment

The quality of creditworthiness assessments currently varies across Member States and poor assessment practices have resulted in misselling. The Commission aims to tighten the rules on creditworthiness assessments by requiring lenders for all loans within the scope of the proposal to perform creditworthiness assessments and by banning lending practices if the result of the assessment is negative. In specific circumstances lenders can still provide loans even if the assessment is negative. This includes situations in which the lenders have a long-lasting relationship with a consumer and can assess the likelihood of the consumer meeting his/her obligations[14]. These exceptions imply a risk to both the borrower and lender, which would have to be monitored by the supervisors.

The cross-selling of consumer credit with other financial products, either as a mandatory (tying)[15] or as an optional (bundling)[16] element, has been a common practice in the EU. These cross-sold financial products are in some instances excessively expensive, abundant and/or resist competition. For example, the cross-selling of payment protection insurance (PPI) to ensure the repayment of loans in specific circumstances[17] has been the most common malpractice, with cases in various Member States such as Germany, Spain and Ireland. Hence, the PPIs were sold to consumers who either did not need the insurance or were completely unaware about what they were actually buying. Several Member States have already adopted their own regulatory approaches, which the Commission aims to harmonise. The proposed CCD bans tying practices, unsolicited sales of credit without the consumer's explicit agreement, and sales of ancillary services as default options (including pre-ticked boxes).

[14] Specific provisions regarding the outcome of the assessments are not favoured by industry representatives based on two key arguments. First, industry representatives argue against such strict provisions since it would put credit intermediaries under increasing legal labilities. Second, they state that credit worthiness assessments are based on consumers' current repayment capabilities and does not say anything about consumers' future income,and as a result future repayment capability (EMF-ECBC, 2020).

[15] Product tying refers to the selling of a credit agreement in a package with other distinct financial services, whichmay not have the same terms or conditions. In the case of tying, credit agreements are not made available to the consumer separately.

[16] Product bundling refers to the selling of a credit agreement with other distinct financial services, which may nothave the same terms or conditions. In the case of bundling, the credit agreement can be made separately. The provision of ancillary services is an example for bundling practices. Such services are sold to consumers mostly in the form of pre-ticked boxes in the credit agreements.

[17] PPI is an insurance policy to guarantee the repayment of loans if the borrower dies, becomes ill or disabled, orfaces other circumstances preventing them from meeting the obligations under the credit agreement.

Introducing pricing rules

In the absence of EU-wide regulation, most Member States have regulated consumer loans outside of the scope of the existing directive. Most Member States have introduced interest rate or APR caps at different levels to avoid excessively costly consumer loans[18]. The importance of consumer loans outside the scope of the CCD is growing in Member States without price caps, and loans outside of the scope are the main reason for complaints in Member States such as Bulgaria and Malta. In the latest draft CCD amendments, caps on interest rates, APRs, and/or total cost of the credit agreements are introduced. The proposal leaves the decision on the level of these caps to Member States. Capping has proved to be beneficial for consumers in some of the Member States. However, it can also push consumers to even more damaging types of credit (Bouyon and Oliinyk, 2019). To avoid this, it is important that vulnerable consumers are referred to independent debt advice channels, which according to the proposal should be made readily available. Nevertheless, it is still not guaranteed that all individuals that need debt advice would be able to receive it, although previous research has shown that this is beneficial for both debtors and society at large.

Conclusion

Overall, the Commission proposal to revise the CCD is an important step forward in covering nearly all consumer loans, strengthening the Single Market and improving consumer protection and debt advice for those in need of it. Nevertheless, there are still some areas where it could have gone further to strengthen the Single Market.

Indeed, the larger and remaining types of consumer loans (pawnshop and doorstep loans) could also be covered, and the credit worthiness assessment, as well as pricing caps could be defined as such that they allow for cross-border offering.

[18] The exclusion of certain types of credit, such as payday loans, led to an increasing supply of high-cost loans. In the Netherlands, APR for payday loans (also called 'flash credit') goes up to several hundred percent, and in Finlandannual interest rate for payday loans can be as high as 1 000% (Cherednychenko 2018).

References

Bouyon, S. and Oliinyk, I (2019), 'Price rules in consumer credit: should the EU act?', European Credit Research Institute, available at http://ecri.eu/publications/research-reports/price-rules-consumer-credit-should-eu-act.

Cherednychenko, O.O. (2018), 'Consumer credit: Mis-selling of financial products: study requested by the ECON Committee', European Parliament, Brussels.

Deloitte (2019), 'The future of credit: a European perspective', available at https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/financial-services/deloitte-uk-mastercard-the-future-of-credit-a-european-perspective-2019-report-digital-updated.pdf.

EBA (2021), 'EBA Consumer Trends Report 2020/21', European Banking Authority, available at https://www.eba.europa.eu/eba-assesses-consumer-trends-20202021

EMF-ECBC (2020),'EC Public Consultation on New Consumer Agenda EMF-ECBC Response', European Mortgage Federation - European Covered Bond Council, available at https://hypo.org/app/uploads/sites/2/2021/03/EMF-ECBC-Final-Response-to-New-Consumer-Agenda-CCD-02.10.20.pdf.

EP (2008), 'Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on Credit Agreements for Consumers and Repealing Council Directive 87/102/EEC.', *Official Journal of the European Union*, Vol. 133(66), pp. 12–25.

EP (2014), 'Directive 2014/17/EU of the European Parliament and of the Council of 4 February2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010', *OfficialJournal of the European Union*.

EC (2021a), 'Commission Staff Working Document Impact Assessment Report Accompanying the Proposal for a Directive of the European Parliament and of the Council on Consumer Credits', SWD(2021) 170 final, European Commission, Brussels.

EC (2021b), 'The Proposal for a Directive of the European Parliament and of the Council on Consumer Credits', COM(2021) 347 final, Brussels

ECB (2021), 'Domestic and cross-border positions of euro area MFIs (excluding the Eurosystem)', ECB Statistical Warehouse, MFI balance sheets.

Finance Watch (2021), 'Consumer credit market malpractices uncovered', available at www.finance-watch.org/wp-content/uploads/2021/04/Consumer-credit-market- study-V13.pdf.

The New York Times (2020), 'Virus Revives Italy's Age-Old Shadow Safety Net: The Pawnshop 'available at https://www.nytimes.com/2020/07/06/world/europe/italy-coronavirus-pawnshops.html.

Reifner U., Clerc-Renaud, S. and Knobloch M. (2010), 'Study on interest rate restrictions in the EU: Final Report for the EU Commission DG Internal Market and Services', p. 124, Brussels/Hamburg/Mannheim.

UK Financial Ombudsman Service (2021), 'Consumers' Complaints - Home Credit', available at www.financial-ombudsman.org.uk/businesses/complaints-deal/consumer- credit/home-credit

Ziegler, T., Shneor R., Wenzlaff, K., Wang, B., Kim, J., Odorovic, A., Paes, F., Suresh, K., Zhang, B., Johanson, D., López-Closs, C., Mammadova, L., Adams, N. and Luo, D. (2020), 'The Global Alternative Finance Market Benchmarking Report.', Centre for Alternative Finance at the University of Cambridge.

Annex. Main proposed changes under the CCD

Table 1. Comparison of the 2008/48/EC with the new proposal – Main Changes

2008/48/EC	2021 Proposal
Article 2. Scope	
Credit agreements involving a total amountof credit more than EUR 200 or less than EUR 75 000	Credit agreements involving a total amount of credit of less than EUR 100 000 (includingthose under EUR 200)
N/A	Crowdfunding/peer-to-peer credit agreements
N/A	Interest free credit agreements withoutcharges or credit agreements to be repaid within three months with only insignificant charges
N/A	All overdraft facilities
N/A	All leasing agreements (with an option to purchase goods or services)
N/A	Payday loans
N/A	Buy-now-pay-later schemes
Article 3. Definitions	
N/A	Additional definitions of - ‘crowdfunding credit services’, - ‘crowdfunding platform’ - ‘pre-contractual information’ - ‘profiling’ - ‘pre-contractual information’ - ‘tying practice’ - ‘bundling practice’ - ‘advisory services’ - ‘tying practice’ - ‘revolving credit facility’ - ‘debt advisory services’
N/A	Indication that the price was personalised onthe basis of automated processing
N/A	Possibility for the client to have recourse toan out-of-court complaint and redress mechanism and the methods for havingaccess to it
N/A	Possibility that the credit agreement or crowdfunding credit references an independent benchmark. In this case, the name of that benchmark, the name of its administrator and its potential implications on the consumer must be provided to the consumer.

2008/48/EC	2021 Proposal
N/A	(3.h) An indication that other drawdown mechanisms for the relevant type of credit agreement or crowdfunding credit services may result in higher annual percentage rates of charge.
N/A	(3.t) where applicable, an indication that the price was personalised on the basis of automated processing, including profiling.
N/A	(3.v.) the possibility of having recourse to an out-of-court complaint and redress mechanism for the consumer and themethods for having access to it.
Article 13. Personalised offers on the basis of automated processing	
N/A	Obligation to inform consumers when they are presented with a personalised offer thatis based on profiling or other types of automated processing of personal data
Article 14. Tying and bundling practices	
N/A	Prohibits tying practices, unless it can be demonstrated that they result in a clear benefit for consumers taking due account of the availability and prices of the kinds of products in question, while allowing bundling practices.
Article 15. Inferred agreement for the purchase of ancillary services	
Member states are free to regulate, in the case of the provision of ancillary services, consumers must be informed.	Prohibits inferring a consumer agreement through default options, such as pre-ticked boxes.
Article 16. Advisory services	
N/A	Establishes standards to ensure that, where advice is given by the creditor, the credit intermediary or the provider of crowdfunding credit services, consumers are made aware of this, without introducing any obligation to provide advice.
Article 17. Ban on unsolicited credit sales	
N/A	Prohibits any unsolicited sale of credit,including non-requested pre-approvedcredit cards sent to consumers or consumers' overdraft/credit card spending limit being raised unilaterally by the creditor, without their prior request or explicit agreement.

<table>
<tr><th>2008/48/EC</th><th>2021 Proposal</th></tr>
<tr><td colspan="2">Article 18. Obligation to assess the creditworthiness of the consumer</td></tr>
<tr><td>N/A</td><td>The requirement that the provider may only make the credit available to the consumer ifthe result of the assessment is positive.
Specific circumstances, in which credit intermediaries can grant a credit even if the assessment outcome is negative:
- long-standing relationship with the consumer
- student loans
- loans for healthcare expenses
- loans for consumers with disabilities</td></tr>
<tr><td>N/A</td><td>Obligation when the creditworthiness assessment involves the use of profiling or other automated processing of personal data, that member states must ensure that the consumer has the right to:
- request and obtain humanintervention on the part of the creditor to review the decision
- request and obtain from the creditora clear explanation of the assessmentof creditworthiness, including on thelogic and risks involved in the automated processing of personal data, as well as its significance and effects on the decision contest the assessment of thecreditworthiness and the decision</td></tr>
<tr><td colspan="2">Article 24. Overdraft facilities</td></tr>
<tr><td>N/A</td><td>Provisions to ensure that consumers are kept regularly informed of certain particulars of their overdraft facility</td></tr>
<tr><td colspan="2">Article 31. Caps on interest rates, annual percentage rate of charge and the total cost ofcredit to the consumer</td></tr>
<tr><td>N/A</td><td>Caps introduced on:
- interest rates applicable to credit agreements or to crowdfundingcredit services
- the annual percentage rate of charge
- the total cost of credit to the consumer
And any additional caps introduced by the Member States may apply to revolving credit facilities</td></tr>
</table>

2008/48/EC	2021 Proposal
Article 35. Arrears and forbearance measures	
N/A	Introduces measures to encourage reasonable forbearance before enforcementproceedings are initiated, such as: - a total or partial refinancing of a credit agreement - a modification of the existing terms and conditions of a credit agreement,including extending the term of the credit agreement - changing the type of the credit agreement - deferring payment of all or part of the installment repayment for a period - changing the interest rate - offering a payment holiday - partial repayments; - currency conversions - partial forgiveness and debt consolidation Moreover, Member States may require that, if the creditor has defined charges due to default, those charges do not exceed what isnecessary to compensate the creditor forcosts it has incurred as a result of the default.Creditors can, if allowed by Member States, impose additional charges on the consumer in the event of default. In such a case, Member States must introduce a cap on those charges.
Article 36. Debt advisory services	
N/A	Requires Member States to ensure debt advisory services are made available to consumers.
Article 37. Admission, registration and supervision of non-credit institutions	
N/A	Requires creditors, credit intermediaries and providers of crowdfunding credit services that are not credit institutions to be subject to an adequate admission process and to registration and supervision arrangements.
Article 44. Penalties	
N/A	Inclusion of the possibility either to impose fines through administrative procedures or to initiate legal proceedings for the imposition of fines, or both, the maximum amount of such fines being at least 4 % to thecreditor.

European Credit Research Institute

The European Credit Research Institute (ECRI) is an independent, non-profit research institute that develops its expertise from an interdisciplinary team and networks of academic cooperation partners. It was founded in 1999 by a consortium of European banking and financial institutions. ECRI's operations and staff are managed by the Centre for European Policy Studies. ECRI provides in-depth analysis and insight into the structure, evolution and regulation of retail financial services markets in Europe. Through its research activities, publications and conferences, ECRI keeps its members up to date on a variety of topics in the area of retail financial services at the European level, such as consumer credit and housing loans, credit reporting, consumer protection and electronic payments. ECRI also provides a venue for its members to participate in the EU level policy discussion.

For further information, visit the website: www.ecri.eu.

Centre for European Policy Studies

CEPS is one of Europe's leading think tanks and forums for debate on EU affairs, with an exceptionally strong in-house research capacity and an extensive network of partner institutes throughout the world. As an organisation, CEPS is committed to carrying out state-of-the-art policy research and maintaining high standards of academic excellence and unqualified independence and impartiality. It provides a forum for discussion among all stakeholders in the European policy process and works to build collaborative networks of researchers, policymakers and business representatives across Europe

For further information, visit the website: www.ceps.eu.

European Credit Research Institute (ECRI) at the Centre for European Policy Studies (CEPS)
1 Place du Congrès, 1000 Brussels, Belgium
Tel: +32 (0) 2 229 39 87, e-mail: ecri@ceps.eu, web: www.ecri.eu