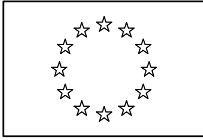

EUROPEAN COMMISSION
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FINANCIAL INSTITUTIONS
Retail issues, consumer policy and payment systems

Brussels, **30 November 2009**

SUMMARY OF RESPONSES TO THE PUBLIC CONSULTATION ON RESPONSIBLE LENDING AND BORROWING IN THE EU

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1. INTRODUCTION

On 15 June 2009, the European Commission published a public consultation document on Responsible Lending and Borrowing in the EU, and invited stakeholders to respond by 31 August 2009. This document is a summary of the contributions received.

The results of the public consultation will help the European Commission to assess the need for and scope of any policy action to ensure responsible lending and borrowing, as was mentioned in the Commission Communication *Driving European Recovery* of 4 March 2009.

2. CONSULTATION DOCUMENT

The objective of this public consultation was to collect information from all stakeholders in order to strengthen and deepen the Commission services' understanding of the remaining issued surrounding responsible lending and borrowing. The focus of the public consultation was on advertising, marketing and information practices prior to the lending transaction, and business practices in the context of lending transactions related to creditworthiness, and suitability assessments and advice. The Commission also requested stakeholders' views on how best to encourage responsible borrowing next to financial education initiatives. Finally, input was requested on the definition, role and regulatory framework of credit intermediaries.

3. RESPONSES TO THE CONSULTATION

The European Commission received 109 responses to the public consultation. This feedback summary provides an overview of the comments made by stakeholders.

The respondents can be classified in 13 categories: chambers of commerce, individual citizen, consumer advocates, consumer and user representatives, corporate, credit registers, financial sector trade unions, financial services industry federations, financial services providers, microfinance providers, Member State authorities, non-financial services industry federations, and ombudsmen.

The category 'consumer advocate' is a broad one encompassing debt advisory services, human rights groups, charities, and consumer advisory agencies, either public or not-for-profit, and certain consumer-focused think tanks and academics.

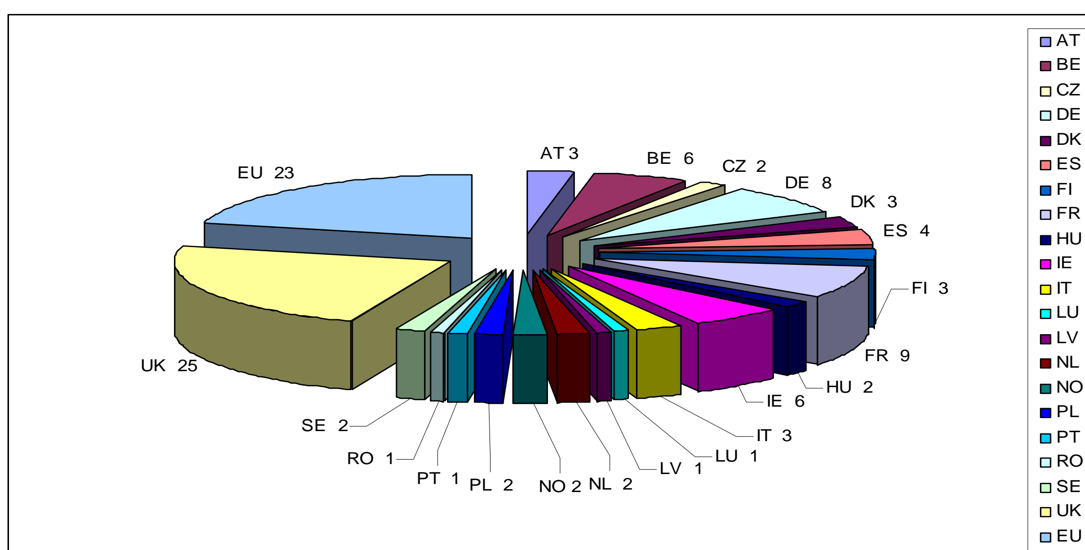
The categories 'financial services industry federation' and 'financial services provider' encompass organisations representing lenders and those representing intermediaries. Where relevant, we have identified the industry stakeholders more precisely where this difference is relevant to the issue under discussion.

Table 1: Contributions received by stakeholder category

Stakeholder category	Number of replies	Percentage
Chamber of commerce	2	2 %
Citizen	1	1 %
Consumer advocate	14	13 %
Consumer and user representative	13	12 %
Corporate	1	1 %
Credit register	3	3 %
Financial sector trade union	2	2 %
Financial services industry federation	31	27 %
Financial services provider	10	9 %
Microfinance provider	2	2 %
Member State authority	17	15 %
Non-financial services industry federation	11	10 %
Ombudsman	2	2 %
Total	109	

In total contributions were received from stakeholders in 19 EU Member States and 1 EEA Member State as well as from representative bodies at EU level.

Graph 1: Numbers of contributions received by territorial origin



3.1. General comments

The majority of the respondents welcomed the opportunity to provide input into the Commission's Responsible Lending and Borrowing initiative. It was acknowledged by stakeholders across the spectrum that lending to consumers plays a significant role in the economy. The importance of the relationship between borrowers and financial institutions was also underlined.

In general the issues identified in the consultation with regard to responsible lending and borrowing were considered to be relevant outstanding issues, although some **financial services industry representatives** and a few **Member State authorities** called for greater clarity as to the scope of the initiative, particularly with regard to the Consumer Credit Directive (CCD). These stakeholders argued that it has not yet been possible to assess the impact of CCD, which is currently being transposed in Member States, while some Member State authorities informed that they intend to extend some provisions of the CCD to mortgage lending, thereby making any further initiatives with regard to mortgage lending unnecessary. In general, Member State authorities took the opportunity offered by the consultation to inform the Commission of many national (legislative) initiatives that have been or are being undertaken to govern the sale of credit, especially mortgage credit, to consumers.

A key message **from consumer advocates** and **consumer and user representatives** was that they expect the consultation to lead to initiatives to ensure a high level of quality across credit providers, products and distribution channels.

The **financial services industry federations, providers** and some **Members State authorities** acknowledged that there are areas for improvement in relation to responsible lending and borrowing, but noted that deficiencies in the different markets are not homogeneous, and that national measures seem more appropriate. The Commission is advised to continue to apply the principle of subsidiarity in this area. Furthermore, it was mentioned both by **consumer representatives** and some **financial services providers** that the market for cross-border mortgages in the EU is very limited, and that if the Commission considers acting at EU level, it should acknowledge that credit habits vary strongly between Member States and ensure that existing national consumer protection measures would not be diluted. In this context, several contributors therefore recommended applying minimum harmonisation.

Financial services industry federations and providers presented the view that there is no compelling evidence of major market failures or abusive lending practices within the EU that could lead to the emergence of systemic risks (i.e. US-style subprime lending) or negatively affect a significant number of European customers (e.g. predatory lending), and that the Commission should not attempt to create EU solutions for a US problem.

3.2. Practice prior to the lending transaction

In **Question 1**, the Commission questioned stakeholders whether they have evidence of misleading or unfair advertising or marketing practices with regard to mortgage and consumer credit.

Consumer advocates and **consumer and user organisations** in Portugal, Ireland, United Kingdom, Netherlands, Belgium, the European **Microfinance** Network, and **Ombudsmen** of two Scandinavian countries provided examples of practices of unfair advertising and marketing specifically referring to:

- disregard for or failure to calculate APRC
- the promotion of 0 % introductory interest rates or interest free credit
- the advertising of a lower starting rate – called the 'rate of entry' – which is then employed only for the first few months
- a lack of interest rate ceiling
- floating rate mortgages
- 'buy now, pay later' advertisements that did not indicate that it concerns a credit or loan
- advertisements of easy and direct access to credit
- failure to mention administrative costs
- inadequate information on terms and conditions
- the possibility open to the lender to unilaterally change conditions
- unsolicited increases in credit limits
- predatory lending, loan sharks and payday loans
- sending direct advertising to already overindebted borrowers involved in collective debt settlement procedures
- revolving credit
- consolidated loans and equity release products
- interest-only mortgages.

These practices took place with regard to both consumer and mortgage credit and were generally performed by credit institutions. Often these practices were targeted to vulnerable people with low income, and people with damaged credit rating and financial difficulties. Consumer representatives mentioned that in these instances the EU-standardised sheets from the CCD and ESIS were not used and should be made obligatory. Other solutions for these practices according to consumer and trade union stakeholders are to allow the regulator to publish unfair advertising and marketing practices and to sanction them.

Credit registers, financial sector trade unions, financial services industry federations and **financial services providers** in general indicated that such practices do not occur, as the industry abides by the legislation. They stated that there are low levels of complaints regarding unfair practices reported to regulators. Furthermore, the Unfair Commercial Practices Directive and Consumer Credit Directive are sufficient and there is no need for further binding legislation. National law already effectively regulates misleading and unfair practices. Instead they highlighted the need to focus on the enforcement of existing rules. Nevertheless, in two Member States, measures to curb unfair advertising and marketing practices were mentioned, namely a task force to increase inspections of consumer credit advertising, and prior approval by the regulator of planned advertising.

Member State authorities' responses demonstrated differing views. UK authorities stated that there is no widespread evidence and that the existing regulation is appropriate to address these practices. The UK Treasury indicated that routine monitoring of advertising has led to some firms having to change their advertising approach. German, Latvian, French, Polish, Irish and Belgian authorities mentioned that banks still perform unfair and misleading practices such as 'bait advertising' and failure to include warning statements in a larger font size than the normal font size used in the advertisement. The German and Dutch authorities set out the regulatory responses actions that have been, and are being, undertaken to address these problems.

Question 2 asked for stakeholders' views on the development of **risk guidelines**, which could be provided to consumers before purchasing a credit product, as a complementary measure to pre-contractual information. These guidelines could alert consumers on the risk involved in a credit product. In the responses to this question, there was some degree of confusion, particularly among the consumer-side representatives as to what would constitute a risk warning and what standard information provision.

Consumer and user representatives and Irish, French, Dutch and UK **consumer advocates** were supportive of risk guidelines if these are generally available in clear, plain language and highlight the interest rate variations, all kinds of risk and not only default risk, and the consequences of changes in interest rates i.e. a 'stress test'. It was specified that consumers should receive such guidelines well in advance and be made aware of their existence independently of the financial institution. The guidelines could also be included in the pre-contractual information obligation. There were also suggestions to link such risk warnings to a household 'reference budget', an example of which is being established under the auspices of the EU PROGRESS project. Another suggestion was made to draw an analogy with the Key Investor Document for UCITS. In addition, it was suggested that risk guidelines should be included in the ESIS (e.g. in relation to foreign currency loans) with an indicator of past fluctuations and explanation by the lender. With regard to the enforcement of such guidelines, the consumer and trade union stakeholders stated that they could be controlled by consumer associations or developed and enforced by the national supervisory authority. Finally, it was mentioned that possible guidelines should be used in addition, rather than instead of, existing national legislation.

Some consumer advocates, however, warned that preventive measures in the form of guidelines are not very effective; if the products offered are not designed fairly the possible effectiveness of risk guidelines is minimised. Moreover, they stated that the addition of these guidelines could contribute to an information overload. In order to facilitate the best choice in a competitive market, consumers must have access to simple, standardised, effective information on the main criteria influencing their choice. The price, the duration, the risk, the guarantee and consequences in case of default should be presented on a common standard.

The **financial services industry federations** were sceptical about the idea of risk guidelines and the possibility to establish a set of harmonised guidelines. Generally, they stated that there is no need for additional risk warnings and noted that these are already obligatory under the CCD under the notion of 'adequate explanations'. In addition**, financial services providers** indicated that additional risk guidelines are not necessary if pre contractual information is clear and comprehensible. These industry stakeholders indicated that in most Member States there is a self-regulatory system in place to mention risks to the consumer and therefore there is no need for stringent guidelines. It

was underlined that such guidelines would lead to considerable costs, and only bring few benefits. Moreover, it is only possible to offer generic warnings as specific risks differ per market and per individual. In principle, **Member State authorities** viewed the idea of risk guidelines in a positive light but mentioned the difficulties that would be involved in imposing them on the industry. Furthermore, they questioned who should develop these guidelines. In addition, Member State authorities made reference to the Standardised Information Sheet for Consumer Credit and ESIS and considered it more useful to offer risk warnings related to the products.

Non–financial services industry representatives doubted the effectiveness of risk guidelines as they could overstate and/ or understate certain risks. Moreover, they mentioned that products could be made to fit the risk guidelines. Risks are individual and depend on the financial circumstances of the individual to each case.

3.3. Business practices in the context of lending transactions

In **Question 3** the issue of suitability of products was addressed. The Commission asked stakeholders whether in their view there are certain (categories of) credit products that are inherently unsuitable for sale to retail borrowers. Linked thereto, it was asked whether stakeholders would welcome a set of standardised or certified products to be offered to consumers.

Chambers of commerce and some **consumer advocates** indicated that there are in principle no unsuitable products. Nevertheless, the sale of some products, such as revolving credit, should be subject to better explanations, and be better monitored. They expressed support for standardised products as these could provide consumers with access to basic products that are the same in all Member States and the forces of competition could reduce their costs.

Many **consumer advocates** put forward types of practices that they deemed unsuitable for retail borrowers. Examples of high-risk products and practices are as follows:

- irresponsible mortgage products such as self-certification mortgages
- credit cards secured on borrowers’ homes
- costly revolving credit with ballooning interest charges
- cross-selling of loans and insurance products with hidden 'kick-back' provisions
- transformation of fixed-rate loans into variable rate loans prior to increases in interest rates or loans on misleadingly advantageous introductory terms
- short-term lending extended on terms that can trap the borrower into lifelong commitments and dependency
- open-ended and variable rate credit instead of instalment credit
- pyramiding of existing debt with further credit
- loans on usurious terms.

Regarding the standardisation of products, some consumer advocates argued that all products should be fair and suitable to the individual needs of the consumer, not only standardised ones. Others indicated that they would endorse standardisation with the dual aims of protecting the financially vulnerable whilst encouraging the development of innovative and creative financial solutions by the industry. They argued that these standardised products could be the credit equivalent of the principle of a basic bank account. A key view put forward was that such products would need to be accessible to low-income households or persons. In addition, some consumer advocates welcomed the

idea of certification as it could facilitate the offer of certain products to consumers without the need to obtain independent financial advice. In this regard, it was suggested by a Belgian consumer advocate group to offer a range of labelled financial products at national level. Certain products such as hire-purchase agreements, loan protection policies etc. should be excluded from this category.

Consumer and user representatives and two industry stakeholders specified that there are certain credit products that are not suitable for certain consumers, such as:

- revolving credits
- buy-to-let, interest-only and self certification mortgages
- uncapped variable rate mortgages
- teaser rate loans
- loans in excess of 100 % LTV
- payday credit at exorbitant rate
- sms loans
- usurious rate loans
- non-amortisable Point of Sale credit (only revolving credit available)
- consumer credit with moratorium (capital and interest repayable in one lump sum at the end of the contract)
- foreign currency loans.

One of the main consumer representatives at EU level supported the introduction of a set of standardised and/or certified credit products. It was mentioned that in relation thereto there should be an opt-out regime, whereby lenders offer the standard product and the borrower can opt out for more sophisticated products that meet his needs. It was stated by other consumer and user representatives that standardised products could be seen as a benchmark for consumers and an alternative to other products. Lenders should be obliged to offer certain basic products.

The **financial services industry federations, providers, and financial sector trade unions** stated that there are no inherently unsuitable products. Products differ in their suitability to different borrowers. The **credit registers** stated that prohibiting the sale of certain products to consumers would be discriminatory. They are against the definition of a list of unsuitable products for sale in the retail market. The industry is also strongly against standardised products as it is not necessary and not fit for purpose. In industry representatives' view, standardised products would stifle innovation, limit choice and diversity, and reduce competition. They plea to leave the choice to the credit institutions to design and offer a range of products in response to customer needs. A UK association underscored the ineffectiveness of standardised products with the example of the CAT standard mortgages introduced in the UK in 2000, which were not a success. Concerning certification, the financial sector **trade unions** stated that they would welcome risk classification and certification indicating suitability for different consumers but not standardisation. A recommendation was made for the creation of an appropriate regulatory framework at EU and/or national level for the possible development of simple financial products with a certificate. Nevertheless, it was highlighted that the demand for non-certified products might decline significantly due to consumer distrust if a product did not feature the certificate.

Member State authorities were largely opposed to product standardisation, and many argued that there were no inherently unsuitable products, although there was cautious support for product standardisation from a small number of Member State authorities, as long as this would not interfere with market autonomy.

Questions 4 and 5 focused further on the necessity for mortgage lenders and credit intermediaries to perform creditworthiness and/or suitability assessments before granting consumer and mortgage loans and how they should demonstrate or document the adequacy of the assessments. Moreover, a question was asked on the criteria to be used, such as loan-to-income or loan-to-value ratios.

The consumer advocates and the chambers of commerce considered that creditworthiness assessment is the basis for responsible lending. The assessment should be based on information from credit registers and from the borrower, supported by the necessary documentary proof. Elements that need to be checked include income, house expenditure and other debt obligations. It was mentioned that it is important to re-introduce a personal element to the creditworthiness assessment rather than an over-reliance on automated scoring. These stakeholders therefore supported systems that facilitate qualitative creditworthiness assessment rather than credit scoring analysis. Lenders should ask detailed questions on income and expenditure to build a 'budget frame' to assess affordability – this can be used both to guide the borrower and impose liability on the lender. Lenders must also take all necessary steps to verify the information presented by the borrower.

According to the consumer advocates, the loan-to-value ratio is not a useful criterion in the creditworthiness assessment, as house prices fluctuate over time. As creditworthiness is based on income, they preferred loan-to-(net) income ratios, as they are more reliable long-term indicators of affordability. However, the ratio should only act as a first filter for affordability. Furthermore, each case has to be taken individually as a 30 % LTI ratio in a low-income family may be unaffordable, while affordable for higher-income categories. This indicates that in some instances loan-to-income and loan-to-value ratios are not individual enough. Therefore, a call was made for guidance to be issued by the supervisor that would outline the circumstances in which a more rigorous suitability assessment should be undertaken (e.g. for social rented tenants). A number of consumer advocates supported annual random quality audits by regulatory bodies to inspect lenders' assessments of affordability or suitability of products for borrowers.

With regard to the proof of adequacy of the creditworthiness and suitability assessment, consumer advocates mentioned that lenders should keep information on the consumer and on the result of credit database consultations. For documentation, they should be able to hand over a personal profile of the consumer including proven evidence of income, credit rating information, an up-to-date financial statement, detailed assessment of the applicant's present circumstances and plans/objectives, and evidence that there has been proper consideration of the suitability of the loan for the borrower, bearing in mind known factors. Reliance on guarantees given by parents and secured on the parental family home should not be permitted. There should be a clear statement of the assessments that have been undertaken, the methodology used, and the conclusions reached, along with borrower confirmation that they understand the information presented and the potential consequences of non- or under payment.

Consumer and user representatives, a corporate, and financial sector trade unions stated that creditworthiness assessments should always and systematically be carried out, including by intermediaries. This is the assessment to seek information on the ability of the borrower to repay. The assessment should be based on loan-to-income, rather than loan-to-value. Upper limits of LTI should be considered within the range of 33–40 %, as currently apply in some national laws. If inadequate creditworthiness assessment is carried out, lenders should be deemed responsible for defaults. These stakeholders saw suitability assessment as a separate necessary exercise, to ascertain that the credit product meets the borrower's needs. Loan-to-income and loan-to-value are important criteria here but not the only ones to be considered.

These respondents were of the view that lenders should request sufficient documentation from the borrower to be able to make an informed creditworthiness assessment. Credit databases can help in creditworthiness assessment if used correctly, but borrowers should be able to see the data and correct it if necessary. They indicated that the lender could issue a document in which he verifies that an assessment has taken place and provide a written documentation of the decision to grant or refuse credit, stating the criteria on which decision was based. The assessment and advice should be saved on a durable medium. It could be documented within a standardised form filled during the negotiation of the credit contract. If credit scoring were used there would be a need for an explanatory note.

Financial services industry federations also indicated that creditworthiness should always be assessed. However, they were against the establishment of mandatory criteria or tools for the assessment of creditworthiness such as loan-to-value ratios or ratios on the monthly disposable income. They stated that lenders should have freedom to select these and/or other criteria or tools if competition is to be preserved in the banking business. Furthermore, most industry stakeholders mentioned that the Capital Requirements Directive already requires creditworthiness assessment to be carried out for prudential purposes. Community-wide harmonisation of creditworthiness assessments would not be helpful, since specific criteria have to be reviewed on a case-by-case basis and there are national specificities to take into account.

Financial services industry respondents were of the view that suitability assessments should not be harmonised, owing to the very different legal and fiscal context across the Member States. Some also stated that a suitability assessment could only be made based on a snapshot of the borrower's situation. Changes to that situation may mean that a previously suitable product is no longer suitable, but that a lender cannot be held liable for this. Illness, divorce and unemployment were cited as thee main drivers of default, not irresponsible lending. Repossession procedures are costly and cumbersome and not interesting for lenders. Moreover, as was often stated, the CCD, including its provision to carry out creditworthiness assessments, is in the process of being transposed into national law. It will be necessary to first make an assessment of the effectiveness of this provision before any other rule is suggested. The industry indicated that the Commission should consider provisions contained in the Unfair Contact Terms Directive, Consumer Credit Directive, Capital Requirements Directive, Markets in Financial Instruments Directive (MIFID) and the proposed legislative developments for Packaged Retail Investment Products, and justify any additional requirements based on analysis of costs and benefits.

Industry stakeholders noted that the use of tools such as loan-to income or loan-to-value ratios are common practice, but that besides the application of such ratios, a certain flexibility and the possibility to apply a discretionary margin in the processing of every particular file needed to be guaranteed.

A number of industry associations mentioned that implementing standard LTI or LTV criteria could be incompatible with complex lending practices, and could unnecessarily restrict lending practices without delivering improved standards to consumers. In addition, it was mentioned by a financial services provider that under Pillar 2 of the CRD, the Internal Capital Adequacy Assessment Process is laid down which means that each institution is responsible for its own business model. This issue should continue to be addressed within the scope of supervision rules.

The financial industry emphasised that credit institutions have established processes and devices to justify, document and retrace any decision taken with respect to individual loan files. There are already many requirements under Basel II and MiFID related to record keeping, and lenders maintain such records not just to satisfy regulatory requirements but to address any customer queries or complaints. The demonstration or documentation of the adequacy of the creditworthiness and the suitability assessment forms part of these documents. However, too much standardisation could be counter-productive. Lenders must be able to have their own procedures, which should be open to inspection to ensure they do not introduce consumer detriment. In general the assessment should be documented in a file containing: i) documents provided by the borrower related to his/her income (for instance his/her employer salary statement, and/or income tax declaration); ii) documents on the borrower's debt as supplied by credit registries; and iii) any other documents on the creditworthiness analysis performed by the bank. This kind of file may also be used if needed by banks' auditors and/or supervisors for their own purposes.

Member State authorities stated that creditworthiness assessments should always be performed by the lender. They considered that in cases of transactions involving credit intermediaries, whether tied (agents) or untied (brokers), the lender should also be regarded as responsible for the creditworthiness assessment. With regard to suitability, Member State authorities considered that the borrower, rather than the lender, should take on the responsibility for assessing if a product is suitable for his/her personal circumstances. Only if a credit intermediary happens to act on behalf of a prospective borrower, should he undertake a suitability assessment.

Similarly to the views put forward by the industry, Member State authorities indicated that they do not support any regulation that might compel the use of some of these ratios whilst disregarding others. Each lender should determine individually which criteria it thinks appropriate. The assessment criteria can include LTV or LTI ratios, but also other factors, such as the purpose of the loan, type and length of loan, plans for early retirement, attitude to fixed/variable interest, age, savings track record, etc. Moreover, Member States stated that the burden of proof should be on the lenders to demonstrate how they have fulfilled the creditworthiness assessment requirements, without stipulating exactly how this should be done.

The issue of **advice standards** was raised in **Question 6.** The text of the consultation recalled that the CCD and the Mortgage White Paper had called for information and adequate explanations, without a legal obligation for advice, but that the Commission wished to promote high-level mortgage advice standards to govern conduct of business in cases when advice is given. Notwithstanding this clarification, many respondents from **financial services industry federations and providers** took the opportunity to argue strongly against the introduction of an obligation to advise. Some of the arguments given included the following:

- advice is a distinct service from information provision
- the term 'adequate explanations' as set out in the CCD is sufficient
- an obligation to advise would push up the costs of borrowing for all customers, even those who do not wish for or need advice
- an obligation to advise could lead to restrictions on lending
- the quality of a provider's advice is its distinguishing feature in a competitive market
- an obligation to provide advice is ill suited to specific forms of credit distribution.

Several federations noted that the introduction of advice standards could imply to borrowers that advice is required to be given. There were also claims that the introduction of advice standards could create legal uncertainty, and open lenders up to the threat of more non-enforceable contracts. UK-based organisations also pointed to the different requirements applicable in that jurisdiction to advised and non-advised sales. Reference was made to the fact that advice as set out in the Markets in Financial Instruments Directive (MiFID) is a specific financial service, but that it was not possible to directly read across requirements from the investment to the credit market. National federations representing financial intermediaries were generally more supportive of the introduction of the suggested advice standards, with some suggesting additional standards, namely concerning the disclosure of particular risks and the identity of the intermediary. **Credit unions, microfinance providers and financial sector trade unions** were also generally in favour of such advice standards.

Consumer advocates welcomed advice standards as representing a good minimum level of service, but cautioned that they did not replace critical tools such as affordability assessment and the provision of comprehensible information. Many also underlined that such standards would only be valuable if appropriately enforced by statutory authorities, and sanctions applied in cases of breach. The adherence to such advice standards could form part of the ongoing requirements in order to be licensed to provide credit advice. However, it is feared that advice standards would be ignored unless they formed part of an approach that would make responsible lending profitable for the lender. An important EU-level **consumer representative organisation** called for greater provision of independent advice, with funding perhaps diverted from financial education initiatives for this purpose. Another consumer and user representative group advocated the involvement of consumer associations in the development of EU-level advice standards.

Member State authorities' responses to the proposed advice standards were mixed, as in some Member States similar standards are already included in statutory requirements, while others mentioned that they would welcome such standards to be included in Community-level legislation. A majority of Members State authorities indicated that harmonisation of advice standards at EU level would be difficult to achieve. The suggested standards could perhaps be better presented as best practices, and be adopted in Member States on a voluntary basis or incorporated into codes of ethics adopted by the

financial services sector. Reference was made to the debates that preceded the adoption of the CCD, and the agreement that had been finally reached to require 'adequate explanations' rather than advice, and suggested that this was sufficient. A few also mentioned that employees of lenders and tied intermediaries could not be expected to adhere to advice standards, as they would necessarily only be recommending the products of their employer. One Member State authority questioned how adherence to advice standards could be objectively assessed and given legal certainty.

3.4. Responsible borrowing

Question 7 asked if, apart from financial education, anything else could be done to encourage **responsible borrowing**.

Many respondents, particularly from industry and Member State authorities, used the opportunity afforded by this question to express their support for financial education. **Financial services industry federations** generally expressed the view that borrowers should be expected to take responsibility for their part in the credit transaction, including reading information provided to them, and providing honest, accurate and complete information on their own situation to the lender or intermediary. Some suggested specific information the borrower could be obliged to provide, including the obligation to inform the lender of changed circumstances during the course of the loan. Credit unions supported the concept of saving first before borrowing in order to encourage responsible behaviour by the borrower. One financial services industry federation mentioned the need for Member States to take stronger action against fraudulent borrowers. Others mentioned the fact that borrowers, when focused on the underlying purchase, often do not pay close attention to the information provided to them, so that behavioural psychology should be given specific attention, and that balanced and informed media and public relations campaigns could help.

Financial sector trade unions, non-financial services industry representatives and credit registers held largely the same views as the financial industry federations. **Financial sector trade unions** suggested establishing a risk classification of credit products, which would help guide the borrowing decision. **Credit registers** called for a further development and strengthening of inter-bank credit databases to be used in creditworthiness assessments. These players were also in favour of awareness-raising with borrowers of the consequence of the borrowing decision. Several **non-financial services industry representatives** called for wider access to credit registers as an aid in the creditworthiness assessment process.

Consumer advocates generally argued that the lender is in a position of strength, contrary to the borrower, and should use this power to make an adequate assessment of the borrower and the credit products before agreeing to lend. Clear and comprehensible information, and assurance of the professionalism of the advisor or intermediary, were also called for. Some supported publicising average acceptable loan-to-income ratios in order to guide the borrower, as well as average interest rates charged. Several stated that social sector lenders such as credit unions or microfinance institutions should be promoted to borrowers, as could sources of independent financial advice such as those offered by specific financial regulators. On specific product features, there were calls for mandatory 'cooling off' periods to be introduced in those Member States where this is not already the case, and for self-certification for mortgages to be disallowed.

Consumer and user representatives also expressed the view that the onus should be on providers to lend responsibly as they have the expertise and access to data to back up their lending decisions. Consumer and user representatives were not generally supportive of a focus on financial education, as they argued it cannot help consumers deal with complex products. However a few did express an interest in being involved in the preparation of education initiatives. There was a call for the standardisation of both financial products and of the (risk) information and the need for consumer bodies to be consulted when information leaflets were being compiled by providers. A reference was made to the importance of (positive) credit data registers, which can indicate in cases of default if lending has been predatory.

Member State authorities mostly pointed to the importance of accurate information provision on both sides of the borrowing transaction and for borrowers to be made to understand the consequences of their decision. Several supported the role of credit counselling services in providing independent advice on financial products, particularly to vulnerable groups. Other issues raised by Member State authorities included the importance of high-level risk warnings on the consequences of borrowing, the limitations posed by the borrower's focus on the underlying purchase transaction, and the need to inform consumers that their rights may be weakened if they provide false information.

3.5. Credit intermediaries

Questions 8 and 9 focused on the **definition of credit intermediaries** and on whether **distinctions** should be made in the treatment of such intermediaries. The consultation suggested distinctions based on degree of activity (whether the intermediaries involved offer credit intermediation services on a full-time basis or whether it is ancillary to their main occupation); product sold (mortgage credit / consumer credit / point of sale credit / other) or status vis-à-vis the lender (tied or independent status). The consultation also asked whether the definition of Credit Intermediary as used in the Consumer Credit Directive could be extended beyond the scope of that directive. Responses on these issues diverged widely.

Consumer advocates and consumer and user representatives were in favour of a definition of credit intermediary that would encompass all actors in the sector, although some argued that intermediaries have not been at the root of problems in the credit market, as they acted on behalf of lenders. These stakeholders do not support differentiating between full time intermediaries and those offering such services on an 'ancillary' basis as they argue consumers should be subject to equal protection in their dealings with all intermediaries, and that the consumer's expectations of professionalism and technical knowledge on the part of the intermediary are the same. They are generally similarly reluctant to see distinctions made on the basis of the product sold, with the possible exception of having a different (stricter) regime for mortgage brokers than for intermediaries of other credit products. There were also calls for tied intermediaries to make their status transparent to borrowers. Those involved in the provision of **microfinance** warned to be careful in defining credit intermediaries, in order to avoid damaging the microfinance sector.

Responses from the **financial services industry federations and from providers** were more divergent. While some argued for uniform regulation of all credit intermediaries and a broad application of the CCD definition of credit intermediary, others were supportive of a more tailored approach. There was broad support for a distinction between tied and independent intermediaries, given the fact that tied intermediaries come under the direct responsibility of the lender. One national federation stated that a single approach to all intermediaries could have a very detrimental impact on point of sale credit provision. Federations representing unsecured credit providers generally supported a distinction to be made between intermediaries involved in a) secured, b) unsecured and c) business lending. Differences also emerged with regard to the distinction between full-time intermediaries and those offering credit in an ancillary capacity. Such a distinction was supported by the main EU-level financial services industry federations, but not by some national federations or individual providers. **Non-financial services industry federations** generally supported a distinction between full-time and other intermediaries, with examples given from the motor industry, where the credit is provided to support the sale of the product rather than as a stand-alone activity. These actors also argued that the lender, not the intermediary, takes the lending decision. **Associations representing intermediaries** themselves supported a unified approach, including the registration with and supervision by one single authority per Member State for both mortgage and consumer credit. They argued that differentiated rules for full time and other intermediaries discriminated against those full time intermediaries offering a professional level of service. One such association pointed to the particular difficulty presented by multi-tied intermediaries, whose status is not understood by the borrower, who may believe they offer a full market search.

Member State authorities were generally supportive of using the CCD definition of credit intermediaries as a base from which to work, although a number of Member States mentioned that it is too early to assess whether it is appropriate to use this definition for Mortgage Credit, given that the CCD has yet to enter into force. One Member State also raised concerns of legal certainty surrounding the use of the term 'ancillary capacity'. A small number of Member State authorities supported taking a regulatory approach based on the risk of consumer detriment of a given activity, rather than an approach based on the role or status of the intermediary. Two supported a differentiation between tied and independent intermediaries.

In **Question 10**, the Commission sought evidence from stakeholders of **mis-selling, misconduct or other instances of consumer detriment** linked to the activities of **credit intermediaries**.

Responses to this question often did not only refer to products or services offered by intermediaries, but also by lenders. Examples from **chambers of commerce, consumer advocates and consumer and user representatives** include:

- higher interest rates being charged and unjustified guarantees demanded in economically weaker regions
- credit being offered even if it cannot be reasonably expected the borrower will be able to afford it
- disadvantageous loan consolidation transactions
- interest rate cuts not being passed on to borrowers
- disregard for APRC calculation methods
- sales objectives taking priority over appropriateness of product for a given borrower

- revolving credit being offered (especially through retailers) when instalment credit may be more appropriate for the purchase being funded
- complex loans linked to investment products
- tying of expensive insurance policies or other ancillary products with the loan, without explanation of the cost implications involved.

The most commonly mentioned problem specifically attributed to credit intermediaries was that of intermediaries in some Member States encouraging borrowers to falsify income information on their credit application, particularly for 'self-certification' mortgages, but also for other credit. Some respondents referred to the fact that evidence of poor behaviour could be seen in the sanctions imposed on credit intermediaries by regulators and the courts in response to mis-selling.

Other evidence provided concerned:

- Complaints regarding retailer-provided credit, as the intermediary is incentivised to encourage the purchaser of, for example, an electrical appliance, to purchase credit as he benefits from the sale of the appliance and from commission on the credit transaction.
- Encouragement by intermediaries to purchase sub-prime or self-certification mortgages as these earn them higher commissions.
- A failure by internet brokers to disclose credit terms and conditions in advance.
- Fees to real estate agents for loan arrangement even if the loan is not ultimately approved.
- A promise of the availability of credit even before the creditworthiness assessment has been undertaken.
- Intermediaries splitting a credit demand between different providers in order to avoid refusal of one big amount.
- Intermediaries actively seeing out vulnerable borrowers in order to earn commissions on refinancing transactions.
- Intermediaries offering higher levels of credit than was asked for.
- Evidence of lack of understanding by the intermediary of the product, e.g. with regard to motor dealers and hire-purchase agreements.
- Lack of creditworthiness assessment in intermediated transactions.

Financial services industry representatives generally either pointed to the adequacy of sanctions applied by national regulators and courts, or stated that they did not have evidence of misconduct by intermediaries. However, a few did mention certain practices with regard to product tying. Others referred to the fact that intermediaries may have incentives to encourage borrowers to switch lenders as the intermediary would earn commission on a new credit contract, although this might not be in the interests of the borrower.

Intermediaries, for their part, referred to the recent practice of a different (less attractive) interest rate being applied to loans obtained through an intermediary than if obtained directly from the lender.

One **Member State authority** stated that problems in that jurisdiction did not concern intermediaries, but rather employees of lenders.

In **Question 11**, the Commission asked whether the **patchwork of regulation** currently in place for credit intermediaries presented a problem or not. Many respondents, particularly those from **consumer advocates and financial sector trade unions** used this question to support having a legal framework in place for credit intermediaries where there is none currently, specifically with regard to licensing and conduct of business requirements, for the robust enforcement of rules and for sanctions to be imposed in the event of misconduct.

Most respondents focused on the internal market aspect of the different regulatory approaches in EU Member States. It was stated that a lack of a consistent EU framework for credit intermediaries prevents consumers from shopping around on a cross-border basis. Consumer and user representatives therefore called for a consistent approach to the regulation and supervision of credit intermediaries within Member States, for instance by having one competent authority for all credit intermediation. Several **financial services industry federations** pointed to the national, or local, nature of credit intermediation so that differing regulatory approaches in different EU Member States did not, in itself, pose a problem. It was mentioned that frequent rule changes and the lack of a high level of professionalism affecting intermediaries were more of a problem than the regulatory patchwork. Several industry stakeholders noted that an EU framework might facilitate those lenders wishing to use the services of credit intermediaries to offer credit outside their home Member State. **Representatives of intermediaries** differed in their response to this question as, on the one hand, they called for harmonised EU rules but, on the other, stated that regulation has to consider national market characteristics.

Only one Member State Authority and one Financial Services Industry Federation referred to the fact that multi-product intermediaries (i.e. those involved in the intermediation of insurance and investment products as well as credit) are subject to different regulatory regimes, and called for coherence with the Markets in Financial Instruments Directive (MiFID) and the Insurance Mediation Directive.

Member State authorities were almost evenly divided between those who did not see the current situation as presenting any major problem, those who supported a harmonised approach at EU level and those who did not comment on this question.

Question 12 invited stakeholders to suggest ways in which **conflicts of interest as a result of remuneration structures** for intermediaries (and bank branch staff) could be addressed through policy. A range of suggestions were made. Some **consumer advocates and consumer and user representatives** recommended abolishing commission structures altogether, and moving to a purely fee-based system, in which the borrower would pay a direct fee to receive advice on the credit transaction. Within lenders' organisations, this could be combined with remuneration structures that reward the employee for client satisfaction or good saving rates. A number of these stakeholders also advocate the payment of the commission over the lifetime of the loan. One group of consumer-advocate stakeholders advocated a system whereby lenders or intermediaries should be obliged to contribute to a fund to combat overindebtedness, with those making responsible lending decisions being rewarded through lower contributions to this fund. Many consumer advocates called for greater transparency in the disclosure of commissions, namely that they should be presented in percentage and real terms, and possibly in graphical form to inform the borrower. Where they responded, consumer advocates were generally supportive of extending any requirements in this vein to bank frontline staff. Only one national consumer association failed to see a problem with

commission structures, stating that creditors should be given the opportunity to recruit and remunerate as they saw fit.

Financial sector trade unions were keen for remuneration to be decoupled from the sale of individual products, but to be based on good service and the long-term interest of the firm. **Non-financial services industry representatives** argued that the disclosure rules established in the CCD were adequate for this purpose. One such association also called for lenders to have the same rules in place for tied intermediaries as for their own staff. However, **financial services industry federations** were generally against introducing requirements addressing the incentives for bank client-facing staff. Several firms and federations drew a comparison with the Insurance Mediation Directive, whereby direct employees of insurers are exempted from disclosure requirements. However, one financial services industry federation stated that bank staff should be disallowed from calling their service 'advice' as their remuneration structure means that they necessarily only recommend the products of their employer. **Associations representing credit intermediaries** called for any requirements applicable to their members to also apply to bank branch staff, to ensure a level playing field.

In general, **financial services providers** regarded adequate disclosure of commission structures as resolving the problem of incentives. Several mentioned that the existence of commission to intermediaries should be reported, but not the amount. Many federations also reported that the APRC is the only figure used by borrowers to compare offers, so as long as this figure includes all commissions, that should be sufficient, and that additional disclosure does not aid the borrower's decision-making. With regard to 'point of sale' credit, one association cited a study undertaken for the Commission that indicated that commission structures did not generate conflicts of interest.

Most **Member State authorities** who responded to this question supported the approach of increased transparency in the disclosure of commissions and fees. Some supported combining this with general rules to act in the interests of the customer. Around one third of the respondents supported applying rules in this regard to all distributors, whether bank staff or intermediaries. Several mentioned the adequacy of the CCD provisions, particularly with regard to disclosure of fees payable by borrowers to the intermediary. One authority supported the establishment of clear guidelines for remuneration structures, the implementation of which could be overseen by supervisors, while another Ministry of Finance stated governments should not get involved in fee levels or calculation methods.

Questions 13 and 14 sought views from stakeholders on the merits of **registration and supervision for credit intermediaries and on requirements that credit intermediaries would have to fulfil** in order to be able to perform their function.

Representatives of the credit intermediary sector were generally supportive of a registration and supervision regime for intermediaries. However they were split between those representing full-time credit brokers, who wished to see a level playing field, with all players being registered and supervised, and representatives of point of sale credit intermediaries, home credit providers and motor finance providers who saw registration and supervision of individual intermediaries in these sectors as being a disproportionate measure. Most **other financial services industry federations** were supportive of a registration and supervision regime for credit intermediaries. Some federations mentioned that any registration and/ or supervision requirements should apply only to independent intermediaries, as tied intermediaries operate under the

responsibility of the lender. Another service provider stressed that lenders should control intermediaries and be liable for their activities. It was suggested to the Commission to take into consideration the specific position of microfinance providers and other social lenders when looking at requirements for intermediaries.

With regard to the qualification requirements to be authorised as a credit intermediary, responses from the industry were mixed. Most **financial services industry federations** and some **intermediary representatives** supported a requirement for professional indemnity insurance, although some argued this was unnecessary for home credit agents and point of sale intermediaries. Many also argued that indemnity insurance was not necessary for tied intermediaries. A capital requirement is seen as a disproportionate tool, which would establish excessively high barriers to entry to the profession. Some large EU-level financial services industry federations argued that independent intermediaries should be required to adhere to the same (self-regulatory) selling practices rules lenders have in place for their own staff and tied intermediaries. Many of the industry representatives, especially those representing intermediaries themselves, were supportive of minimum competency or professional training requirements, although views were divided over whether or not a self-regulatory programme would suffice to deliver the desired outcome. Finally, it was mentioned that, as credit intermediation is mainly a locally-offered service, it should be up to Member States to decide on the level of requirements that would be appropriate to their individual markets.

Consumer and user representatives were unanimously supportive of a registration and supervision regime for intermediaries, with professional competency requirements and professional indemnity insurance being strongly endorsed. **Consumer advocates**, too, were strongly supportive of registration and supervision regimes and professional requirements for credit intermediaries, although one respondent recalled that such measures would still not address the incentive bias problem. A national consumer advisory service advocated the extension of professional competency requirements to bank client-facing staff.

Member State authorities also gave positive feedback on a registration and supervision framework for intermediaries, with several giving evidence of the legal frameworks already in place on their territories. Some stated that intermediaries should be able to prove their competency according to the products they distribute and the activities they perform. A few also mentioned the need for not only initial competency proof, but for continuing professional development of the intermediary. A small number of Member States where credit intermediaries do not have a large market share noted that self-regulatory initiatives to ensure the probity and professional competency of intermediaries would be sufficient and cost-effective.

Question 15 asked stakeholders how they thought the activities of **credit intermediaries could be brought within existing complaints and out-of-court redress systems**. This question was not answered by around one third of contributors. Of those that did answer, there was general support for dealings with intermediaries to be addressed by existing complaints or redress channels, but few concrete suggestions on how to achieve this.

With regard to complaints against tied intermediaries, most **industry stakeholders** expressed the opinion that these should be dealt with by the lenders' own complaints and redress structures in the same way as complaints against their own services. Two large EU-level financial services industry federations stated that intermediaries' representative bodies should establish their own complaints/ redress mechanisms. It was mentioned that

if complaints are brought directly against lenders, and the complaint concerns an intermediary's role in the transaction, ombudsmen's services should be able to hold the intermediary to account. Furthermore, it was stated that complaints and redress issues are best dealt with at Member State level, and that the benefits of EU-wide harmonisation here would be outweighed by the costs. There were also individual calls for ADR mechanisms to be better publicised with customers, for the decisions of ombudsmen to be open to appeal, for a system of mediation involving both industry and consumer representatives, and for assurances that borrowers would still be able to achieve legal redress through the courts.

Consumer advocates and **consumer and user representatives** also pointed to the importance of consumer access to the courts, but that ADR mechanisms could be a useful complement. The use of such structures should be free of charge for consumers. A large EU-level consumer organisation argued that it was not relevant to discuss out-of-court redress in isolation and was in favour of the possibility of collective redress.

Member State authorities were also generally supportive of including complaints against intermediaries in the existing mechanisms, and provided evidence of this being the case in several Member States. One authority expressed scepticism as to the effectiveness of such structures, and another stated that it would be inefficient to establish a redress system only for credit intermediation. Member State authorities, like industry stakeholders, expressed the opinion that tied intermediaries are the direct responsibility of the lender.