Statement at the IMCO Committee hearing on 18 March 2021

"Consumer protection in the context of digitalisation of retail financial services (CCD and DMFSD) during the Covid-19 pandemic"

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Thank you for inviting me to this hearing on this highly important and timely topic. It will be an honour for me to share a few thoughts with you today on the challenges consumers face in light of the digitalisation of retail financial services in view of the upcoming review of the Consumer Credit Directive (CCD) and the Distance Marketing of Financial Services Directive (DMFSD).

The EU is facing worsening over-indebtedness and a non-performing loan (NPL) problem that hits vulnerable consumers the most. Consumer credit mis-selling and poor lending practices are amongst the main reasons for this, which means the CCD is falling short and requires amendments.

Permit me to present hard data from a recently published Finance Watch study on the consumer credit market in Europe. The study was based on data collected during the COVID-19 pandemic – in summer 2020 – collecting data from 89 "cases". These cases were unique moments when mystery shoppers deployed in Spain, Ireland and Romania uncovered widespread lending malpractices.

These malpractices by lenders lead to consumer credit being often mis-sold. While these malpractices happen both in online and offline consumer credit markets, the data shows something quite worrying: problems and malpractices are more prevalent in the digital consumer credit market than offline. Many consumers have been tethered to their smartphones and computers since the Covid-19 crisis. That has led to more people in the online marketplace, including vulnerable people who have been exposed recently to these malpractices. This is especially troubling considering the overhang of over-indebtedness and non-performing loans (NPL) already posing a serious problem in Europe, with vulnerable consumers being particularly at risk.

Our study shows that only 28% of consumers are able to make an informed choice when purchasing a loan online. This can be attributed to many credit providers that fail to provide pre-contractual information about a consumer credit before the conclusion of a credit contract. What is more, the pre-contractual information provided by lenders is often unclear, in particular information on borrowing costs. A serious consumer risk -- buying a consumer credit without being sufficiently informed -- leads to consumers taking up consumer credit products that may not be the right fit for their needs and financial situation.

The study also shows a troubling high degree of advertising malpractices on the online consumer credit market. This is troubling because advertising has the power to nudge consumers towards purchasing a particular product. Misleading or false information as well as aggressive unsolicited marketing tactics can have the same effect as other irresponsible lending practices. It can lead to mis-selling and, consequently, to over-indebtedness as it entices consumers to purchase a product that they may not be able to afford. Our mystery shoppers unearthed many misleading consumer credit advertisements online. For example, our study stumbled upon a case where instead of immediately and prominently disclosing an Annual Percentage Rate (APR), the advertising material prominently displayed an interest rate of 16.8%. Perhaps that seems innocent enough. But only later on, at the bottom of the webpage, an APR of 22.9% appears. This kind of practice misleads most consumers, who will take note of the interest rate *instead* of the APR.

We also looked at creditworthiness assessments (CWAs). Our research uncovered a serious problem stemming from poor CWAs, which can lead to consumers being mis-sold loans they are not able to repay. In fact, Finance Watch data collected show credit providers often use data irrelevant in determining the ability of a consumer to afford a loan. In other words, data that mismatches its intended use. Instead of looking at information on a consumer's household budget, some credit providers instead use irrelevant data such as consumers' political involvement – yes, political involvement – or opinions expressed on social media, which can lead not only to mis-selling but also to financial exclusion and discrimination. Given the easy access and availability of large amounts of online data on individuals, this is particularly worrying. The study suggests also that many credit providers fail to use sufficient and verified data for the assessment. In 40% of cases, credit providers asked for less than four pieces of information in a declarative form to perform a CWA, meaning they did not ask for supporting documents to verify the information provided.

Finance Watch data from the study also highlights high consumer protection risks linked to payday loans – new types of loans mainly sold online and currently not regulated under the CCD. These kinds of loans are "officially" intended to carry borrowers through a temporary cash deficiency to cover unexpected expenses. That means they are likely to have been purchased by large swathes of vulnerable consumers during the COVID-19 pandemic online to overcome temporary financial difficulties. The pre-contractual information provided to consumers buying these types of loans, including on their high costs, proves often inadequate. Moreover, creditworthiness assessments for these products remain poor and their costs unreasonably high and exploitative. For instance, case data from our study showed a 2,543% average APR for payday loans, with rates reaching 30,341.1%.

Lastly, our study findings show that most credit providers, regardless of the sales channel used, do not make sure that the most suitable products are sold to consumers. For instance, only 7% of consumers purchasing a loan online receive advice on the type of product sold with regards to their needs and situation.

The Finance Watch findings I have just presented confirm concerns raised in recent years by numerous stakeholders in other Member States not covered in the study. Anecdotal feedback from our members across Europe shows an urgent need for policymakers to use the upcoming Consumer Credit Directive (CCD) review to protect consumers throughout the European Union from mis-selling of loans and to prevent over-indebtedness.

Let me share amendments Finance Watch thinks are needed to the CCD to address the challenges I just outlined:

1. The CCD should *clearly* define when pre-contractual information must be provided to the consumer. This should be *at least* 24 hours before the consumer concludes a credit contract.

2. There is a need to *see* and *impact-assess* how best to present pre-contractual information provided to consumers via digital media.

3. There is also a need to introduce *detailed*, *consumer*-tested rules on the content, format and presentation of information included in advertising. In addition, ban unsolicited, personalised advertising.

4. Detailed rules are needed on *which* information should be used to perform CWAs, based only on information needed to allow for a personal budget analysis, (namely data on income and spending), including all ongoing credits and debts.

5. The CCD scope should be widened to consumer credit under €200 and an APR cap should be introduced.

6. Make *clear* in the CCD that its rules are *applicable* to all entities providing consumer credit online, including new digital players. In addition, include a requirement for *all* of these entities to be registered and supervised by a competent authority.

Finally, let me make some short remarks about the planned review of the Distance Marketing of Financial Services Directive (DMFSD). Some of the challenges and policy recommendations I present today in connection to the CCD are also applicable for the DMFSD review. The DMFSD is a “horizontal” consumer protection legislation whose aim is to ensure consumer protection for all financial services products sold online. Some of the challenges I presented today concerning the consumer credit market are also applicable to other financial services products sold online and should therefore be considered for the DMFSD review as well. For example, new non-bank entities have entered the digital retail financial services market for many financial services products, not just consumer credit. Currently legal uncertainty exists, however, about whether these new entities fall under the scope of existing EU sectoral rules. The review of both directives should tackle this issue. Likewise, the challenges I outlined today on online advertising as well as the misuse of digital data is also a problem for other financial services such as insurance. Given this, these two issues should be looked at in the upcoming review of the DMFSD as well.

The digital “new normal” of financial services can and *does* bring many pluses to consumers. Europeans enjoy easier and better access to financial services products, including across borders. However, this trend also brings with it many challenges and risks for consumers. If these issues are left unaddressed, they can lead to a serious blow to consumers, in particular vulnerable ones. Mis-selling leads to financial suffering. Financial suffering leads to not only economic hardship, but health issues and societal strain. Let us use the opportunity of these upcoming two reviews to ensure consumers are adequately protected and avoid the over-indebtedness problem from further worsening.

Thank you for your attention.