



Finance Watch

Making finance serve society

Consumer credit market malpractices uncovered

An in-depth study of consumer credit markets in Spain, Romania and Ireland and what it means for the Consumer Credit Directive review



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I. Executive Summary

Urgent regulatory action is needed to address the causes of over-indebtedness in the European Union. Over-indebtedness has not only dire financial implications for individual consumers, in particular vulnerable ones, but also far-reaching negative implications for the economy, the social benefits system of a country as well as financial stability. The European Union has been facing a serious situation of over-indebtedness for several years and in light of this, and against the background of the corona crisis, addressing over-indebtedness has become as important as ever.

Key triggers for over-indebtedness are irresponsible lending and mis-selling of consumer credits. If consumers are sold a credit that they are unable to afford, they can quickly find themselves not only in a situation of financial distress but also in a spiral of over-indebtedness. This stems from many indebted consumers driven to purchase additional credit to pay back outstanding credit and to make essential purchases needed to survive.

Therefore, it is crucial that the triggers for mis-selling of consumer credit are identified and addressed. For these purposes, Finance Watch conducted a mystery shopping exercise to identify what could be the reasons for the mis-selling of consumer credit and irresponsible lending. Our main findings show that:

- Many credit providers do not provide pre-contractual information about a consumer credit before the conclusion of a credit contract. As a result, only 40% of consumers find themselves able to make an informed choice when purchasing a credit.
- The pre-contractual information provided by credit providers is unclear for the consumer in 37% of cases.
- Often, in 25% of the cases, information is unclear about costs in the pre-contractual information provided to consumers.
- Only 29% of consumers receive clear information about the consequences in the case of arrears and defaults.
- Only 13% of consumers receive advice on the type of product sold with regards to their needs and situation.
- There are serious advertising malpractices in the consumer credit market.
- Many creditworthiness assessments (CWAs) are not adequate as they do not use the right set of data to assess a borrower's ability to afford a loan, do not use a sufficient amount of information, and are based on unverified declarations made by the consumer.
- Costs are unreasonably high in terms of annual percentage rates (APRs) for payday loans and revolving credits.
- The pre-contractual information provided to consumers, including on their high costs, is often inadequate with regards to payday loans and revolving credit.

- Creditworthiness assessments are often poor for payday loan sales.
- The causes for mis-selling of consumer credit identified in this study are more prevalent in the online credit market and in cases where loans are sold by non-bank entities.

These findings confirm other studies as well as feedback from public authorities, consumer groups and other sources during the past years regarding the need for regulatory and supervisory action to ensure consumers are protected and existing high level of over-indebtedness is properly addressed in the European Union.

The central piece of legislation regulating the EU consumer credit market, the Consumer Credit Directive (CCD), proved an important step forward when introduced in 2008. This study confirms a need for numerous revisions of the CCD, however, to ensure that mis-selling of credits and irresponsible lending are properly addressed.

This report provides several recommendations on the key amendments needed to the CCD to tackle the causes for mis-selling and irresponsible lending in the consumer credit market, including recommendations on the Directive's scope, pre-contractual information and advertising rules, rules concerning the online market, and CCD rules on creditworthiness assessments. In addition, based on our findings, we make the case that rules should be introduced on pricing of credit (price caps) and specific rules aiming to make sure that suitability is considered by the credit provider when credit is sold to a consumer.

II. Introduction

State of the consumer credit market in the EU and recent developments

The consumer credit market plays an important role in Europe as evidenced by its significant growth in the last two decades. Between 1997 and 2017, household debt in Europe increased from 39.3% to 50% of nominal gross domestic product and in 2017 the outstanding amount of consumer credit in the EU-28 was around €1,800 billion¹. In September 2019, EU banks' exposure to consumer loans stood at €1.14 trillion, up by 14% compared with September 2015 (€1 trillion). This has outpaced overall credit growth (+10%) over the same period². In terms of market size, the biggest EU consumer credit markets are Germany, France, Italy, Spain and Poland. The upward trend in consumer credit sales has been driven, at least in part, by the historically low interest rates which Europe has been experiencing for years.

The consumer credit market has significantly changed in the last decade. The market is being increasingly digitalized and more and more consumers are purchasing their credits online without any physical interaction with credit providers. Across 10 EU countries, 20% of consumers in 2015 completed the entire consumer credit sales process (searching and purchasing the loan) online.³ This trend has led many traditional credit providers and intermediaries to adapt their business models and to distribute their consumer credit products through digital channels, including by partnering up with new Fintech companies. Moreover, new non-bank players such as peer-to-peer lenders have entered the market.

In addition, the market has seen the emergence and growing use of new credit products and services in the last 10 years. For example, peer-to-peer lending has emerged as part of the digitalisation trend described above. These products are sold via peer-to-peer lending platforms that enable people to borrow loans directly from other private individuals online. In addition, payday loans (short-term loans with usuriously high costs to consumers) and revolving credit have become increasingly popular.

Despite the rising digital trend of the market, the cross-border sales of consumer credits have remained very low in the European Union. The European Commission study on the role of digitalisation and innovation in creating a true single market for retail financial services and insurance shows, for example, that only 0.8% of household loans granted in the euro area are sold on a cross-border basis and that consumers' lack of trust in cross-border products presents a key barrier to the development of a single market⁴.

1 https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/fsug-opinions-190408-responsible-consumer-credit-lending_en.pdf and <https://www.ceicdata.com/en/indicator/european-union/household-debt-of-nominal-gdp>

2 EBA, thematic note on Consumer Lending in the EU banking sector https://eba.europa.eu/sites/default/documents/files/document_library/Risk%20Analysis%20and%20Data/Risk%20Assessment%20Reports/2020/Thematic%20notes/881264/Thematic%20note%20on%20Consumer%20Lending%20in%20the%20EU%20banking%20sector.pdf

3 BEUC, review of consumer credit directive https://www.beuc.eu/publications/beuc-x-2019-019_review_of_the_consumer_credit_directive.pdf

4 Study on the role of digitalisation and innovation in creating a true single market for retail financial services and insurance https://ec.europa.eu/info/sites/info/files/study-digitalisation-01072016_en.pdf

Risks of irresponsible lending and mis-selling of credit

Consumer credit can bring benefits to consumers and stimulate economic growth as long as it is affordable, tailor-made to consumer need and financial situation, and sold responsibly. For example, many big-ticket items such as cars or technological products prove too expensive for most people to pay for in total at once. With credit, it is possible to pay for these items over time. Moreover, the provision of consumer credit, provided that suitable and affordable credit is sold, can help consumers meet their financial commitments during periods of temporary financial difficulties.

While the credit market can bring benefits for consumers and the economy, mis-selling of consumer credit and irresponsible and exploitative selling practices of lenders lead, however, to over-indebtedness which brings huge negative impacts for consumers, the economy, and financial stability.

If consumers sign for a loan they are unable to repay, they often find themselves in a situation where they feel forced to take out another loan to repay the loan they are unable to repay. This leads to a spiral of over-indebtedness from which the borrower, in particular vulnerable ones, are unable to escape. Furthermore, over-indebtedness leads to borrowers' fundamental rights to lead a life worthy of human dignity being negatively impacted since these over-indebted borrowers may be pressured to use even their minimum social protection income (income needed to provide for basic needs such as food and medicine) to repay the high interest due for their loans.

In addition, it has been well documented in various research that over-indebtedness can lead to social exclusion or psychological and health problems for a consumer. A recent cross-sectional health survey measuring mental and physical health amongst heavily over-indebted Swedes showed that over-indebted individuals suffer from an attenuated level of mental and physical health compared to the general population. For example, the study showed a nine-fold jump in specific medical diagnoses (e.g. clinical depression, diabetes and heart attacks) amongst over-indebted persons compared to the general population as a whole.⁵

The mental and physical health consequences of over-indebtedness also have a negative impact on economic growth and on the social benefit system of a country. Due to its impacts on the mental and physical health of consumers, over-indebtedness brings with it high costs for medical care services, loss of production and costs for the social insurance / unemployment benefit systems.

In addition, as shown by a 2017 working paper from the Bank for International Settlements (BIS), a rise in household debt levels boosts consumption and GDP growth in the short run but tends to hamper GDP growth in the long run. The negative long-run effects on consumption tend to intensify as the household debt-to-GDP ratio exceeds a threshold of 60%⁶. In 2018, the Asian Banker, a financial industry publication, showed a 5 percent increase in the household-debt-to-GDP ratio over a three-year period most likely lead to a 1.25 percent drop in real GDP growth three years down the road⁷.

In addition, over-indebtedness has negative impacts on financial stability as high volumes of non-performing loans (NPLs) may endanger the stability of financial institutions, especially in times of crises such as the current Covid-19 pandemic. The latest data shows that the level of NPLs for all EU banks has experi-

5 Ahlström, R., & Edström, S., Savemark M., The Swedish Consumer Agency, Report 2014:15 <https://www.finance-watch.org/wp-content/uploads/2018/12/Is-debt-relief-rehabilitative-R-Alstrom.pdf>

6 BIS, "The real effects of household debt in the short and long run" <https://www.bis.org/publ/work607.pdf>

7 <https://www.theasianbanker.com/updates-and-articles/heavy-household-debt-burden-poses-risks-in-some-asia-pacific-countries>

enced a first uptick, rising to 2.9% in Q1 2020, up from 2.6% in Q4 2019.⁸ This percentage is foreseen to further rise in the coming months once crisis relief measures such as loan moratoria come to an end.⁹

Importance of regulation of the consumer credit market

In light of the above, it is crucial that the consumer credit market is regulated in a way that prevents mis-selling of consumer credit and irresponsible lending and thereby prevents excessive debt levels and over-indebtedness.

The key piece of EU legislation governing the provision of consumer credit is the Consumer Credit Directive (CCD) that became applicable in 2008.¹⁰ As stated in the recitals of the directive, one of the main aims of the CCD is to enhance consumer confidence and trust of every EU consumer to use credit, to grow the size of the market and to ensure a single, efficient and competitive single credit market. To this end, it contains important consumer protection rules. The directive specifies:

- The information that needs to be mentioned in consumer credit advertising;
- The pre-contractual information to be provided to the consumer prior to the conclusion of a credit agreement;
- The information to be included in the credit agreement;
- The information to be provided during the contractual relationship between the creditor and the consumer;
- The right to withdraw from the agreement within 14 days of signing, and
- A general requirement for lenders to perform a creditworthiness assessment before concluding a credit contract.

While the introduction of the CCD was an important step forward at the time, numerous feedback and statistics from the market over the past years indicate that the CCD, in its current form, has seemingly not been able to sufficiently address and prevent mis-selling of consumer credit and irresponsible lending. According to the latest EU consumer scoreboard, the percentage of people who reported medium to high detriment when purchasing credit was 68.6%.¹¹ Furthermore, indicators from public authorities over recent years show irresponsible lending in the European Union leading to negative impacts on households' economic security. For example, the European Banking Authority (EBA) Consumer Trends report from 2018/19 shows that some regulators in the European Union expressed high concern by the levels of personal loans in arrears.¹² Moreover, the report shows that of the total number of consumer complaints

⁸ https://ec.europa.eu/finance/docs/law/201216-communication-non-performing-loans_en.pdf

⁹ https://eba.europa.eu/sites/default/documents/files/document_library/Risk%20Analysis%20and%20Data/Risk%20Assessment%20Reports/2020/December%202020/961060/Risk%20Assessment_Report_December_2020.pdf

¹⁰ Directive 2008/48/EC on consumer credit agreements: <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:133:0066:0092:EN:PDF> <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:133:0066:0092:EN:PDF>

¹¹ The European Consumer Scoreboard <http://34.250.91.50/QvAJAXZfc/opendoc.htm?document=just%20docs%5Cscoreboard%5Cconsumerscoreboard.qvw&host=QVS%40win-bhithhttpf&anonymous=true>

¹² EBA, consumer trend report 2018-2019 <https://eba.europa.eu/sites/default/documents/files/documents/10180/2551996/75e73a19-d313-44c9-8430-fc6eca025e8b/Consumer%20Trends%20Report%202018-19.pdf> <https://eba.europa.eu/sites/default/documents/files/documents/10180/2551996/75e73a19-d313-44c9-8430-fc6eca025e8b/Consumer%20Trends%20Report%202018-19.pdf>

reported by national competent authorities in 2017, on average 17% relate to consumer credit. The top reasons for consumer complaints as identified by competent authorities are the level of fees, debts and debt collection, levels of interest rates and management issues.

If left unaddressed, the above-mentioned situation and its negative consequences will become worse during the coming years. The economic consequences of the Covid-19 crisis are harming people's incomes and employment situations, thereby exacerbating the already negative impacts of mis-sold loans and irresponsible lending, in particular for vulnerable households. As evidenced by a recent survey of the European Parliament, 39% of Europeans say that the Covid-19 crisis has already impacted their personal income, while a further 27% expect such an impact in the future¹³. The coronavirus crisis, and the economic and social challenges that it entails, come at a time when many vulnerable groups in Europe have already been exposed to debt and arrears, according to Eurofound's new research on household indebtedness.¹⁴

In light of the above, it is timely to investigate the current causes in the consumer credit market that are leading to irresponsible lending and mis-selling of consumer credit and identify what revisions to the CCD are needed to adequately address this. To this end, Finance Watch conducted a study to look into some of the causes for mis-selling and irresponsible lending and identify where there may be gaps and shortcomings in the CCD to address this.

The study findings are detailed in this report and have focused on the following areas: the provision of pre-contractual information and the Standard European Consumer Credit Information, or SECCI (chapter 4), advice and suitability of the consumer credit product offered (chapter 5), costs and fees (chapter 6), advertising practices (chapter 8), creditworthiness assessment practices (chapter 9), bank vs. non-bank entities comparison (chapter 10), online vs. offline credit market comparison (chapter 11), loans currently not in scope of the CCD (chapter 4) and leasing agreements (chapter 12).

After highlighting the flaws in the market identified by the study, the report draws a number of conclusions and provides a number of evidence-based recommendations regarding which revisions are needed to the CCD.

¹³ European Parliament Barometer, public opinion in time of Coronavirus <https://www.europarl.europa.eu/at-your-service/en/heard/eurobarometer/public-opinion-in-the-eu-in-time-of-coronavirus-crisis-3>

¹⁴ Eurofound, Europe's pre-existing household debt condition likely to be exacerbated by virus crisis <https://www.eurofound.europa.eu/news/news-articles/europes-pre-existing-household-debt-condition-likely-to-be-exacerbated-by-virus-crisis>

III. Methodology

For the purposes of analysing some of the main factors leading to the mis-selling of consumer credit and to help identify areas where amendments are needed to the Consumer Credit Directive (CCD), Finance Watch commissioned a study of the consumer credit market based on a mystery shopping exercise.

As part of this exercise, Finance Watch collected 89 different real case studies from three different EU Member States, representing three different geographical areas (North, South and East) of the European Union: Ireland, Spain, and Romania. The data was collected by three consultants respectively for each country, i.e. the University College Cork, Asufin and Credere. The mystery shopping exercise was complemented by discussions with experts who are in close contact with consumers in the field to refine the main findings of the dataset analysis.

The data used in this study was collected from June to September 2020. The consultants were tasked by Finance Watch to provide information about the lending practices and consumer experiences for the following consumer credit products: payday loans \leq €180; car loans \leq €20,000; personal loans: \leq €2,500, and revolving credits \leq €1,500. This study examined two different sales channels, i.e. the online and offline markets and two types of loan providers, i.e. banks and non-banks.

For the study, a questionnaire provided by Finance Watch was used. For each loan, our consultants collected information on the following aspects of the sales process and practices of the consumer credit market:

- The type of pre-contractual information provided by the credit provider.
- The quality of the pre-contractual information (whether or not the information allowed for an informed choice, possibility to compare products, easiness of access to information, clarity of the information, clarity of the information on costs, clarity of the information on reimbursements, clarity of the information on consequences of arrears or default, clarity of the information on possible changes to the terms and conditions, and the clarity of the information on the cancellation period).
- Information about the costs of the credit offered by the provider.
- Information about the creditworthiness assessment process of the credit provider (the quantity and type of data collected to perform the creditworthiness assessment).
- The quality of the creditworthiness assessment.
- The existence of illegal or unfair lending practices.
- Whether advice was provided during the pre-contractual phase and in how far suitability of the product was considered by the provider during the sales process.
- Compliance of the provider with the current version of the CCD.

The mystery shopping exercise offered both qualitative and quantitative information on the overall consumer experience in the consumer credit market. Our study provides evidence of the real-life experience on the consumer credit market and sales practices in three EU Member States. Within the limits of this focus, the study provides reliable insights into the current state of the consumer credit market in the European Union and the reasons for mis-selling of consumer credit.

Using the large dataset that we received, this paper aims at using our study findings to answer several questions related to the effectiveness of the CCD and to put forward recommendations for evidence-based amendments to the legislative text.

IV. Main findings

1. Provision of pre-contractual information

The disclosure of the key information of a consumer credit product (known as the Standard European Consumer Credit Information or its abbreviation SECCI in the CCD) prior to the conclusion of a credit agreement is crucial to protect consumers and avoid mis-selling. It ensures that consumers can understand what they are buying, the consequences of their purchase and risks that they could be facing. This allows consumers to compare the different products on the market and to make an informed choice about whether to purchase a product based on its suitability to the consumer's needs and financial situation.

The case studies that Finance Watch collected, however, suggest important shortcomings on the market that concern the provision of pre-contractual information, which could give rise to mis-selling of consumer credit.

Compliance and enforcement of existing rules

For one, our study findings indicate a general problem of compliance and enforcement of the existing pre-contractual rules as stipulated in Article 5 of the CCD. In the study, pre-contractual information was compliant with the CCD in barely more than half (55%) of the cases examined. Our consultants reported a lack of oversight and little resources at the disposal of competent authorities as key reasons for this.

Timing of provision of pre-contractual information (SECCI)

Moreover, our study shows that the existing rules on pre-contractual information in the CCD contain various flaws which prevent consumers from being able to make an informed choice and compare products. According to Article 5 of the CCD, the pre-contractual information on consumer credits is to be provided to a consumer “in good time before the consumer is bound by any credit agreement”.¹⁵ This requirement is in place to ensure that the consumer has the ability to make an informed choice on whether to purchase a product as well as compare offers before concluding a credit agreement. Only 46% of the people participating in our study reported, however, that they could compare consumer credit products before making a decision to purchase a loan. A key reason given for this was that many credit providers only provided the pre-contractual information at the time of the signing of the consumer credit contract (i.e. not prior to the time when the credit contract was signed).

Article 5 of the CCD lacks a definition of what “in good time” means with regards to the timing of when the pre-contractual information is to be provided to the consumer. The fact that our study shows that many consumers only receive the SECCI at the time of the conclusion of the contract indicates that this lack of a clear interpretation of what “in good time” means according to the Directive is a problem. To allow consumers enough time to read and understand the pre-contractual information and actively research and compare different product offers, we would argue that “in good time” should be defined in the CCD as being at least 48 hours prior to the conclusion of a credit agreement.

¹⁵ CCD legislative text: <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32008L0048>

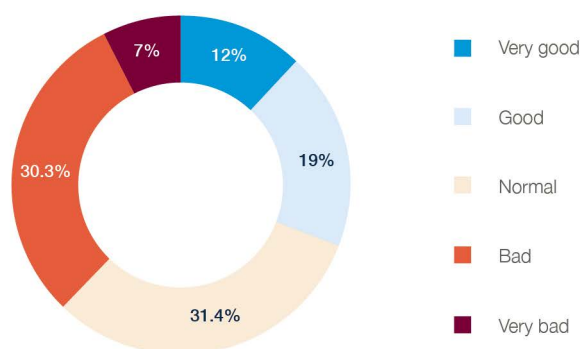
The quality of information

In addition to issues of timing, our study also shows issues around the clarity of the pre-contractual information provided. In order for the pre-contractual information to be effective, consumers must be able to understand the pre-contractual information provided to them. However, in our study, in more than 37% of the cases, the information provided was reported to be unclear for the consumer and 60% of the study participants reported that they were unable to make an informed choice.

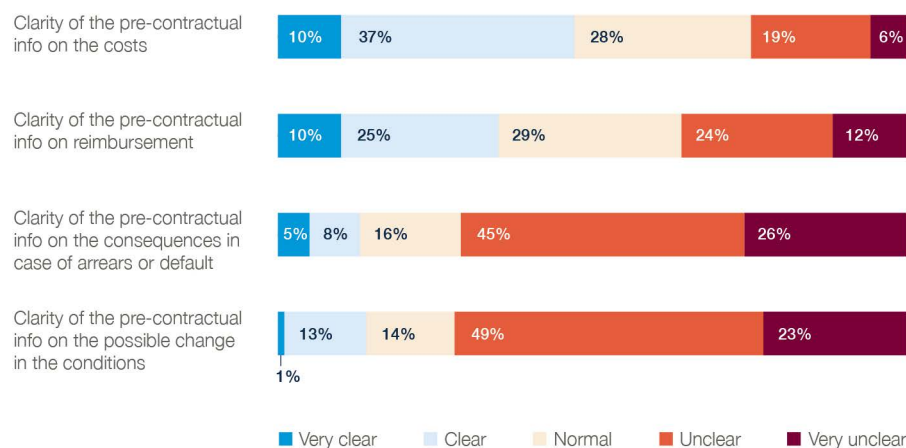
Most concerning, our study reveals customers being unclear about pre-contractual information on costs, in particular the consequences in case of missing payments. The disclosure of all costs and fees associated with a loan and making sure that the consumer understands these costs proves crucial to allow consumers to assess whether they can afford a loan offered. The costs and fees associated with a loan are quite complex. Interest payments are not the only costs that consumers have to consider when buying a credit, since sellers often charge additional fees for a consumer credit. These additional fees take different forms. For example, many providers charge an application review fee, and a monthly administration fee. In 25% of the cases in our study, the information about costs provided in the pre-contractual information (SECCI) was rated unclear by participants while reimbursement information was unclear in 36% of cases. Most alarmingly, in 71% of cases, study participants did not receive clear information about the consequences in case of arrears or default. Often the information was less clear and more difficult to access when our consultants were trying to purchase a loan online than offline. Furthermore, our study shows that information on possible changes in the terms and conditions was reported as being unclear in 72% of cases. Graphs 1 and 2 shown below illustrates how credit providers fail to enable consumers to make an informed choice.

Graph 1: Overall clarity of pre-contractual information received by the consumer

Question: "How do you rate the clarity of the pre-contractual information received?"



Graph 2: Specific aspects of pre-contractual information received



This indicates several possible shortcomings of the SECCI which have been highlighted by other sources recently. It could indicate, for example, that the information provided in the SECCI is too lengthy and complex for consumers who do not have a high level of financial literacy.¹⁶ Behavioural studies show, for example, that consumers may have difficulties understanding key credit information such as interest rates or the APR.¹⁷

Moreover, it may indicate flawed presentation and format of the key information in the SECCI. Behavioural economic studies show that the way in which information is presented to consumers as well as its format can have a big impact on the understandability of the information provided.¹⁸ As evidenced by behavioural research, the format and presentation of pre-contractual information, in particular in the online environment, can have flaws such as information being placed where it can be overlooked or certain information being presented prominently to the detriment of other important elements.¹⁹ An indication of this was confirmed also by our study participants who indicated that online pre-contractual information was the clearest when it contained examples and simulations, and when loan calculators and a FAQ section were present.

Shortcomings of the explanations provided along with the pre-contractual information

Furthermore, the fact that pre-contractual information was rated as unclear suggests that the explanations that creditors are supposed to provide along with the SECCI may not be adequate and/or sufficient. According to Article 5, paragraph 6 of the CCD, “Member States shall ensure that creditors and, where applicable, credit intermediaries provide adequate explanations to the consumer, in order to place the consumer in a position enabling him to assess whether the proposed credit agreement is adapted to his needs and to his financial situation, where appropriate by explaining the pre-contractual information...”. In fact, signs that the explanations provided by credit providers are flawed are confirmed by several pieces of feedback from our study. For in-person sales of consumer credit, our study consultants often had to insist on getting answers to their questions on pre-contractual information. Moreover, the explanations provided along with the SECCI were often reported to be limited. For example, many providers excluded fees or consequences of defaults when explaining the pre-contractual information. In addition, some cases reported that the loan calculator used to explain the pre-contractual information on costs excluded nominal costs and showed only monthly instalments and not interest rates.

The evidence presented in our study on pre-contractual information suggests therefore the need for changes to the presentation, format and content of the SECCI. Given the behavioural research considerations discussed earlier, these new provisions should be fully impact assessed and tested with consumers. Moreover, our study findings suggest that the CCD rules on explanations of the pre-contractual information should be modified in a way that guarantees sufficient and clear explanations are provided along with the SECCI, in particular with regards to costs.

¹⁶ CCD Evaluation Study of the EC, page 32.

¹⁷ London Economics, 2013.

¹⁸ Nibud, “Een persoonlijke lening” https://www.nibud.nl/wp-content/uploads/181030-Een-persoonlijke-lening_keuzes-en-ervaring-van-consumenten.pdf https://www.nibud.nl/wp-content/uploads/181030-Een-persoonlijke-lening_keuzes-en-ervaring-van-consumenten.pdf

¹⁹ See London Economics Europe, VVA Europe, Ipsos NV, ConPolicy, Timelex, 2019; EBA, 2019; ECRI, 2015.

2. Advice and suitability of the consumer credit product offered

For a consumer credit product to be suitable for a specific consumer, it must meet the consumers' needs and objectives and be affordable. For example, choosing between instalment credit and revolving credit to finance a new good may have different implications for the borrower in terms of costs and repayment conditions. Therefore, it is important that the consumer chooses the most suitable option. Besides, the consumer credit must be affordable, i.e. the consumer should be able to repay the loan without incurring financial distress potentially leading to over-indebtedness.

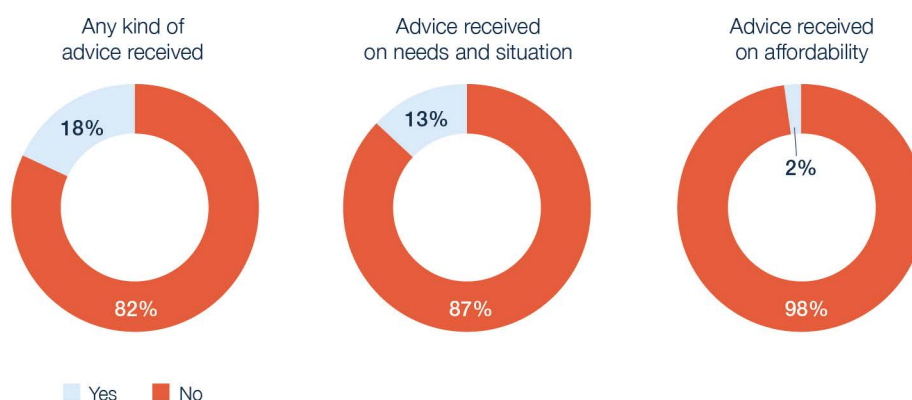
The CCD currently lacks rules requiring credit providers to consider suitability when selling credit to a consumer. For example, it does not require Member States to provide for a general obligation on creditors to offer consumers the most suitable credit, but only an obligation for Member States to ensure that creditors and intermediaries provide adequate explanations to consumers on the pre-contractual information provided. Moreover, it does not include standards on advisory services.

Our study suggests that the lack of rules on suitability leads to creditors not making sure, on their own volition, that the most suitable products are sold to consumers (See Graph 3 below). In 87% of the cases looked at in our study, consumers did not receive any advice about credit with regards to their needs and budget situation. Moreover, only 2% of clients received advice regarding the affordability of the credit offered, as shown by the graphs below.

This indicates that new rules may be needed within the CCD to make sure that creditors consider the suitability of credit products and make sure that their products are distributed to those consumers for whom the product is suitable.

An effective new rule to ensure this would be to introduce product governance requirements in the CCD in line with the product governance requirements already in place for most other consumer financial services products (e.g. retail investment products under MiFID, retail insurance products under the Insurance Distribution Directive, etc.). This would ensure that a product manufacturer has to identify a target market for each credit product at its stage of inception, that all relevant risks to such identified target market are assessed and that the intended distribution strategy is consistent with the identified target market.

Graph 3: Advice received



Another effective way to ensure that suitability is considered in the sales process would be to introduce remuneration rules in the CCD for staff selling consumer credit products to ensure that their selling

practices are driven by the consumers' interests and not by remuneration. There is evidence that in some countries the sales commissions for insurance linked to credit contracts are as high as 50% of the insurance premium.²⁰

In addition, the CCD should, as is the case in the Mortgage Credit Directive (MCD), include rules on advisory services to guarantee that consumers receive adequate, quality advice. This advice should, as a minimum, include an assessment of the suitability of a credit product offered based on consumers' personal and financial situation as well as their preferences and objectives so as to enable the recommendation of suitable credit agreements. By doing this, mis-selling of consumer credits would be reduced as well as over-indebtedness.

3. Advertising practices

Advertising has the power to nudge consumers towards purchasing a particular product. Therefore, it is crucial that advertising material provides consumers with complete and truthful information about the key features of the credit product. Misleading or false information as well as aggressive unsolicited marketing tactics can have the same effect as other irresponsible lending practices in that 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 study confirms serious advertising malpractices in the consumer credit market that can lead to mis-selling and irresponsible lending. In almost 20% of the cases examined in the study, problems arose with advertising materials. For example, our study identified a case where a credit provider in Romania advertised that the fixed interest rate for the personal loan they were selling started at 8%, without informing the consumer about the maximum level of the interest rate or the necessary conditions to be fulfilled in order to benefit from this offer. After investigating this specific offer further and asking the loan officer for more explanations, our consultant found out that the real fixed interest rate was 10.75%. In another case, instead of immediately and prominently disclosing an APR, the advertising material provided an interest rate of 16.8%. Only later on the page, an APR of 22.9% was presented. This confusing practice proves confusing for consumers as the interest rate shown is considerably lower than the APR and most consumers do not understand the difference between these two cost figures. Moreover, it is misleading as most consumers will take note of the interest rate instead of the APR as the interest rate is presented in a prominent way.

Also noteworthy and concerning given the high costs of these products (please see chapter 7.2 of this report), our study finds many cases of misleading advertising on revolving credits online. It identifies that advertising for revolving credit often contains misleading information and malpractices in the way certain information in the advertisement is presented on the product page of the lender's website. For example, in one case, an advertisement used the misleading headline "Limitless purchases", suggesting that the credit allowed limitless borrowing of any amount the consumer wished for. The real information, however, was presented in a less prominent way in the middle of the page: the maximum limit is in fact €3,000 for 24 months with automatic renewal.

These malpractices clearly show a need to regulate advertising practices in the consumer credit market. Similarly to the situation prevailing for pre-contractual information, more detailed rules may be needed on

²⁰ https://www.finanzwende.de/fileadmin/user_upload/Kampagnen/Achtung_Kreditfalle/Faire_Kreditvergabe_Layout_final.pdf, p.31 and <https://www.fsma.be/fr/news/enquete-sur-les-assurances-de-solde-restant-du-proposees-dans-le-cadre-de-credits-la>

the format, content and presentation of the information in advertising to make sure that the information provided does not mislead and includes all of the essential elements. By omitting certain information or presenting certain information in a prominent or non-prominent way, the advertising message can become misleading.

Moreover, since many consumers are not able to fully understand the information on costs of a consumer credit, it would be worth introducing in the CCD a requirement to include in every advertising a warning about the financial consequences of taking out a loan. Such a warning would be a nudging measure (behavioural finance) to stimulate consumers' reflection and to counter overconfidence and the optimism bias, reducing the planning fallacy in which people tend to focus on the best possible case. In the Netherlands and in Belgium, an obligatory standardized warning to this effect already exists: "Watch out, borrowing money costs money" in picture form.²¹

Let op! Geld lenen kost geld

In addition, personalised, unsolicited advertising activity in the consumer credit market should be banned. Research shows that personalised offers take advantage of consumers by nudging them to borrow and spend beyond their financial capabilities.²² Malpractices in personalised advertising are likely to increase due to the digital transformation as it is becoming increasingly easier for creditors to obtain information about consumers and their behaviours online.

21 <https://www.denederlandsekredietmaatschappij.nl/geld-lenen-kost-geld/> Add source <https://www.finance-watch.org/wp-content/uploads/2019/04/Finance-Watch-CCD-consultation-response.pdf>

22 For example: FSUG, 2019, https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/fsug-opinions-190408-responsible-consumer-credit-lending_en.pdf

4. Creditworthiness Assessment practices

Adequate creditworthiness assessments (CWA) are one of the key tools to avoid mis-selling of consumer credit and thereby avoid over-indebtedness. An adequate CWA is one which assesses whether a consumer is able to afford a credit and to allow the credit provider to adjust its credit offer in amount, duration and cost in order for the credit to be affordable for the customer.

As pointed out in Finance Watch's paper "Responsible lending and privacy protection: A consumer perspective"²³, assessing consumers' income and expenditures as well as data on their ability to manage their budget, which should include credit and debt instalments, is the most appropriate way to assess their ability to repay a loan and to propose an adjusted offer (in amount and in duration) to match the needs of the borrower. Moreover, it is crucial that CWAs respect consumers' data protection rights in line with the GDPR principles.

However, our study confirms that there are many poor creditworthiness assessments in the consumer credit market which, as a result, can lead to credit being mis-sold to consumers not able to repay them.

In 31% of the cases investigated in our study, information about the borrower's budget balance (level of income/level of expenditures) was not even asked as part of the CWA process. Moreover, our consultants in Romania reported that CWAs there are often solely based on the income of the debtor and not on specific expenditures.

Moreover, in 40% of the cases in our study, credit providers asked for less than four pieces of information in a declarative form to perform a CWA. While it is the type of data that matters and not the number of data used per se to ensure a good CWA, it is questionable whether less than four pieces of information are sufficient to make a full assessment of a household budget.

Furthermore, our study has shown that many credit providers do not ensure that the CWA is accurate, as they do not collect supporting evidence to verify declarations made by consumers. A recent judgment of the Court of Justice of the European Union of 18 December 2014 stated that the current CCD rules on CWA "...must be interpreted to the effect that, it does not preclude the consumer's creditworthiness assessment from being carried out solely on the basis of information supplied by the consumer, provided that that information is sufficient and that mere declarations by the consumer are also accompanied by supporting evidence".²⁴ However, 48% of our study participants were not asked to provide any documents/copies/hard data to support the declarations they made as part of the creditworthiness assessment process in the pre-contractual phase. It could be that at least some of these providers collect the supporting evidence from alternative sources than the customer. However, this would be in contravention to the GDPR principles that state that lenders should only obtain personal data with the data owners' informed consent.²⁵

Moreover, our study provides evidence that in fact not always the right/appropriate type of data is collected to perform a CWA. Our investigation showed that some creditors collect information that has no relevance

23 https://www.finance-watch.org/wp-content/uploads/2020/10/FW-paper_Responsible-lending-and-privacy-protection_Oct2020.pdf

24 Judgment of the Court (Fourth Chamber), 18 December 2014 CA Consumer Finance SA v Ingrid Bakkaus and Others <http://curia.europa.eu/juris/liste.jsf?num=C-449/13> Add source

25 Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) <https://eur-lex.europa.eu/eli/reg/2016/679/oj>

at all in determining whether a consumer is able to repay a loan. This irrelevant data includes data such as information on whether the consumer is politically involved or not, their type of housing and previous address. Not only is this type of data irrelevant in determining a consumer's ability to afford a loan but it can also lead to a refusal of credit (and thereby to financial exclusion) based on discrimination, i.e. in this case, the refusal of a credit based on someone's political beliefs or the neighbourhood they live in.

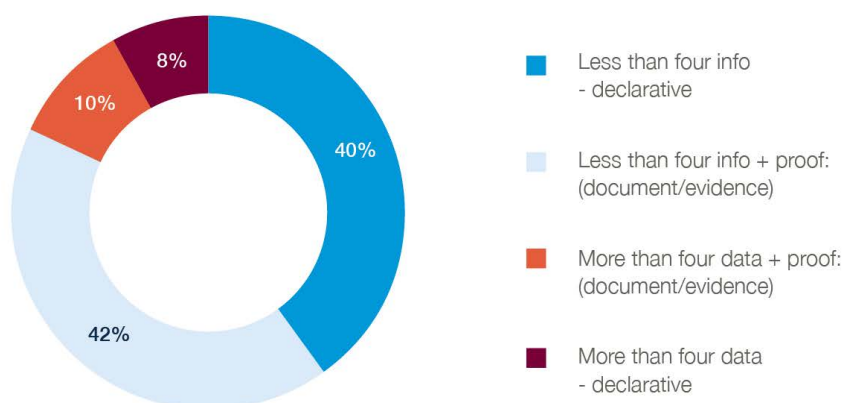
Another powerful example worth pointing out which shows that there is a problem on the market concerning the use of the wrong type of data for CWA is the particular case of a big creditor in Ireland offering credit online. In this particular case, consumers are asked to provide video selfies confirming their identity. Interestingly, the creditor explicitly mentions on its website that the provider uses the data to research consumers' social media to help the provider conduct "behavioural analysis" and credit decision-making. This is problematic as it suggests that the creditor could be using social media data that are totally irrelevant and inappropriate for a CWA such as public comments made by a consumer on their social media page for CWA purposes. Moreover, it is problematic from the point of view of data privacy. A screenshot of the creditor's website can be found below:

We will undertake this processing under a legitimate business interest. As part of our ongoing commitment to understanding our customers better, we sometimes research comments and opinions made public on social media sites. We sometimes also match information on these sites with the data we hold to undertake behavioural analysis and assist with credit decisioning. The information we collect may also assist use with looking at targeted advertising using Social media.

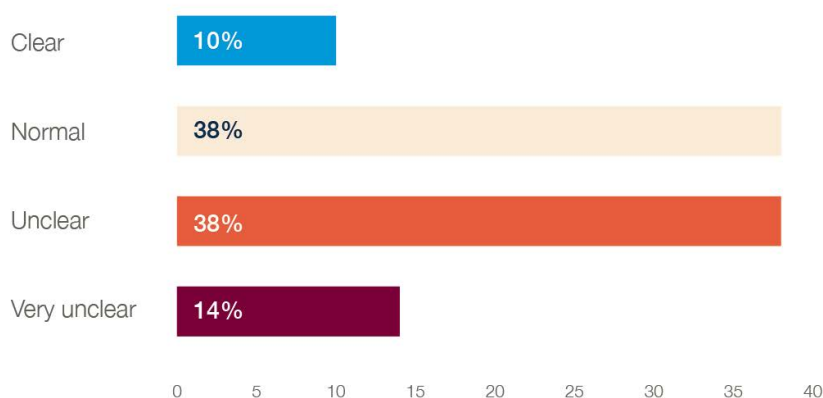
Graph 4 below shows the type of data collected about the customers budget.

Graph 4: Type of data collected on consumer's budget

Question: "What type of data regarding the consumer was collected?"



In addition, our study shows that in most cases, credit providers do not provide a satisfactory explanation to the consumer in cases where the credit application is rejected (See Graph 5 that follows on next page). In our study, 52% of the participants rated the explanation as shown by the graph below for a refusal of a credit application as being "unclear" or "very unclear". Also, most providers do not communicate the credit scoring process to consumers.

Graph 5: Clarity of explanation by credit provider on credit refusal

While the CCD requires a creditworthiness assessment to be performed²⁶, it does not include any requirements on which information should be used as part of the assessment to ensure that it is accurate. As our study findings show, given that there are many cases of inadequate creditworthiness assessments, some of them based on wrong and insufficient amounts of data, there is a need for the legislative text to specify how the assessment should be done. More specifically, what specific information should be used for the assessment.

In addition, the Directive does not include any rules on what a creditor is supposed to do based on the outcome of the assessment, i.e. whether to grant or reject the credit, depending on whether the CWA outcome was positive or negative. To prevent the mis-selling of loans, however, there should also be going forward a requirement in the Directive that a credit should only be sold to the consumer where the result of the CWA indicates that the obligations resulting from the credit agreement are likely to be met. This is particularly important given that for certain loans, in particular payday loans sold to vulnerable consumers, poor performance in repayment is considered to be part of the creditor's business model as the failure to repay is compensated by extremely high interest rates.²⁷

5. Bank vs. non-bank entities

Banks are not the only entities selling consumer credit. Non-bank entities such as insurance corporations and pension funds, financial auxiliaries, and other financial intermediaries also offer credit.²⁸ Moreover, thanks to technological innovation (digitalisation), many new digital non-bank entities, such as peer-to-peer lenders, have also entered the credit market.

Even though, in theory, these entities are not exempted under the CCD, our study shows that the problems giving rise to mis-selling and irresponsible lending are significantly higher amongst non-bank loan providers than amongst banks. As illustrated in Graph 6 below, our data shows that:

²⁶ See note 11

²⁷ Monika Attaité, Pay-day lenders: why can we consider them as being bad players on the credit market? When credit use difficulties of the clients are a good business for lenders <https://www.finance-watch.org/wp-content/uploads/2018/12/Pay-day-lenders-M-Attait%C3%A9.pdf>

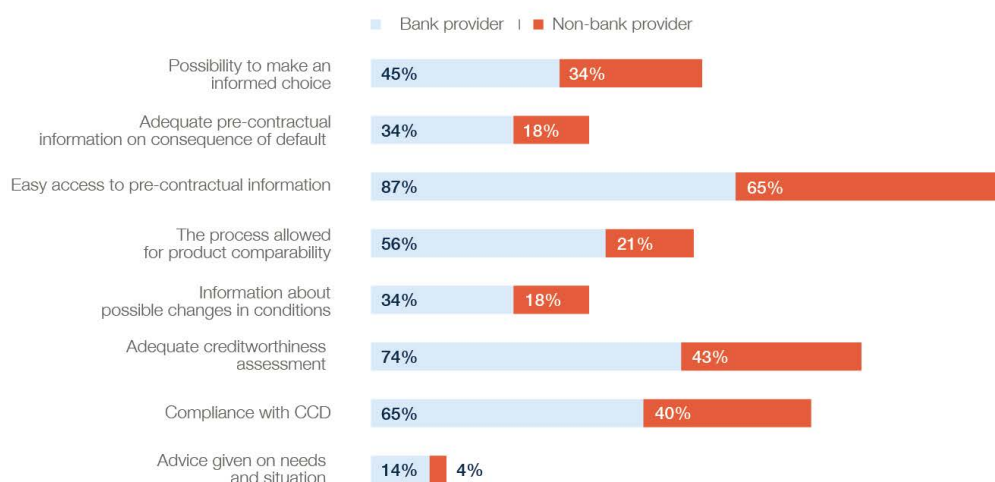
²⁸ European Central Bank, 2016, Bank lending survey for the euro area, Glossary

Consumers purchasing consumer credit from them are less likely to be able to make informed choices and compare products.

- These entities are less likely to verify the suitability of credit products they sell.
- Non-banks usually charge more than bank providers for a consumer credit as the average APR is higher for credits offered by non-banks.
- On average, non-bank entities are less compliant with the existing rules of the CCD overall.
- The quality of non-banks' creditworthiness assessments are poorer than those of bank providers.

Graph 6 below shows the differences in the consumer experience of the consumer credit sales process by type of provider (the percentages are relative to the number of positive/affirmative answers on the total).

Graph 6: Comparison of consumer experience with different types of credit providers



This suggests that clarifications and modifications to the CCD are necessary to make explicitly clear that the activities of non-credit institutions on the credit market are in the scope of the Directive. Moreover, it is important that the CCD includes a requirement that non-credit institutions are subject to an adequate admission process including entering the non-credit institution in a register and supervision arrangements by a competent authority in each Member State. This would ensure that the activities of non-credit institutions are supervised and the CCD rules are enforced with regards to these non-bank institutions. The Mortgage Credit Directive already contains rules for this and this could be replicated in the CCD.

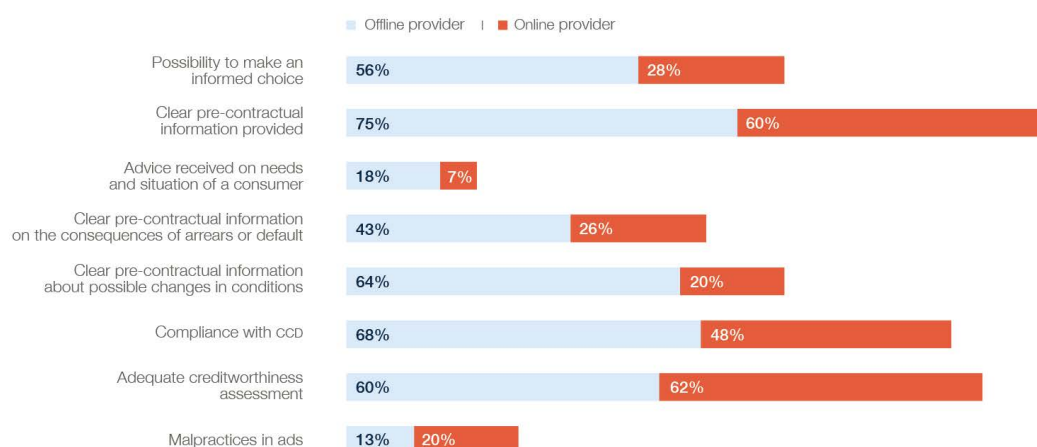
6. Comparison online vs. offline market

The financial services market, including the consumer credit market, has increasingly become digital in recent years and this trend is set to continue in the years to come. In light of this development, it is important to look at the situation on the online consumer credit market with regards to malpractices that can lead to irresponsible lending and mis-selling of consumer credit. Moreover, it is important to investigate whether any modifications to the CCD are needed to make sure that the online market is regulated in an appropriate way.

Against this background, our study investigates the state of play of the online consumer credit market. It suggests that while digitalisation brings opportunities, it also brings new consumer protection risks. The data we collected shows that the problems and malpractices that can lead to irresponsible lending and over-indebtedness are higher in the digital consumer credit market than offline.

As shown below in Graph 7, only 28% of our study participants said they were able to make an informed choice when purchasing a loan online, which suggests that the pre-contractual information and explanations of the pre-contractual information provided by creditors selling loans online are poor. This is particularly worrying as our data shows that the pre-contractual information on the consequences of arrears and default provided to consumers online is only clear in 26% of the cases.

Graph 7: Comparison of consumer experience with offline and online providers



Moreover, our study shows that providers of consumer credit on the online market are much less compliant with the existing CCD rules. Furthermore, our data shows that creditworthiness assessments for loans purchased online are poor and malpractices in advertising are worse online than offline.

This indicates a need for changes to the CCD that ensure it is fit for purpose as digital transformation sweeps the consumer credit market. This includes clarifying that the CCD rules are applicable to all entities providing consumer credit online, including new digital players such as peer-to-peer lenders or other types of Fintech companies, and making sure that the rules are properly enforced on the online market. For example, there is legal uncertainty currently whether peer-to-peer lenders are in scope of the CCD²⁹, as lenders on such platforms are usually private individuals. It is somewhat unclear, in such a case, whether they fall strictly within the definition of “creditor”.

In addition, a need exists for modifications in the CCD to make sure that pre-contractual information is also provided by digital means and before the conclusion of a credit agreement when a consumer credit is marketed online. The current version of the CCD allows the pre-contractual information to be provided after the sale of a consumer credit product in cases where distance communication channels have been used and this needs to be revised.³⁰

²⁹ EC Evaluation of the CCD

³⁰ Article 5 of the CCD

Finally, the CCD currently does not contain rules on how pre-contractual information should be presented to consumers in a digital environment where different dynamics (in terms of speed of information and consumer experience) apply. Therefore, there is a need to see and impact assess how best to present pre-contractual information provided to consumers via digital media.

Non-banks providing credit online

Technological innovation (digitalisation) has led to the emergence of many new non-bank entities entering the consumer credit market. These new market players have the potential to disrupt the traditional banking system, cutting costs, fees and offering cheap and reliable credit to individuals. For example, in the EU-27, consumer lending-based crowdfunding has a higher share than business lending-based crowdfunding and makes up around 35% of the total crowdfunding market.³¹ However, as mentioned in this study, there is currently legal uncertainty about whether and which specific peer-to-peer lenders fall within the scope of the CCD.

Including all new digital players in the scope of the CCD will not only reduce mis-selling and over-indebtedness but also create a regulatory level playing field between traditional providers and these new entities and will allow for fair market competition.

7. Concerns with regards to specific types of loans

7.1. Payday loans (under €200) not in scope of the CCD

The Consumer Credit Directive (CCD) currently applies only to credit above the value of €200 (Art. 2.2.c). However, credit providers are offering credit below that threshold and their use is widespread across the Union.

Amongst these loans under €200 are often so-called payday loans. These loans are officially intended to carry the borrower through a temporary cash deficiency to cover unexpected expenses such as sudden medical costs.³² They are supposed to be repaid over a short term (before the borrower's next payday), however such loans are often extended over time at extremely high costs.³³ A recent OECD report shows that since 2008, the provision of payday loans has expanded across the European Union and is now available in many Member States.³⁴ Payday loans are often offered through digital channels and therefore also easily sold cross-border in the European Union.³⁵ These loans have attracted a lot of attention by regulators in recent years as a source of over-indebtedness and have gained the reputation of being exploitative, in particular for vulnerable groups.³⁶

31 European Commission, Impact Assessment, Proposal for a Regulation on European Crowdfunding Service Providers (ECSP) for Business: https://ec.europa.eu/info/sites/info/files/180308-proposal-crowdfunding-impact-assessment_en.pdf

32 Pay-day lenders: why can we consider them as being bad players on the credit market?, https://www.financite.be/sites/default/files/references/files/payday_lenders_-_vf.pdf
https://www.financite.be/sites/default/files/references/files/payday_lenders_-_vf.pdf

33 EC evaluation of the CCD

34 16 EU Member States were captured in a recent OECD report examining the provision of payday loans in a selection of countries, of which 9 reported presence of this type of credit product (AT, CZ, DE, DK, EE, LV, NL, RO, SK), while 6 did not (EL, ES, FR, PT, SE, SI); OECD, 2019.

35 European Commission, <https://eur-lex.europa.eu/legal-content/EN/TEXT/PDF/?uri=CELEX:52020SC0254&rid=5>

36 Pay-day lenders: why can we consider them as being bad players on the credit market?, https://www.financite.be/sites/default/files/references/files/payday_lenders_-_vf.pdf
https://www.financite.be/sites/default/files/references/files/payday_lenders_-_vf.pdf

Research conducted by the Office of Fair Trading (OFT) in the United Kingdom found approximately a third of payday borrowers roll over their loans and more than half take multiple loans in a year³⁷. Together they make up more than 80% of payday lenders' revenue in the United Kingdom, meaning that only a fifth of payday lenders' revenue actually comes from one-time borrowers for whom the product is supposedly created. Moreover, around a third of borrowers default on their loans. To make matters even worse, payday lenders' revenue is often heavily dependent on such misfortune of their consumers³⁸.

In light of the above, the Finance Watch study included mystery shopping of payday loans to see if the fact that these products are currently not in scope of the CCD has negative implications for consumers. Our evidence suggests that there are many malpractices on the payday loan market which can give rise to mis-selling of payday loans.

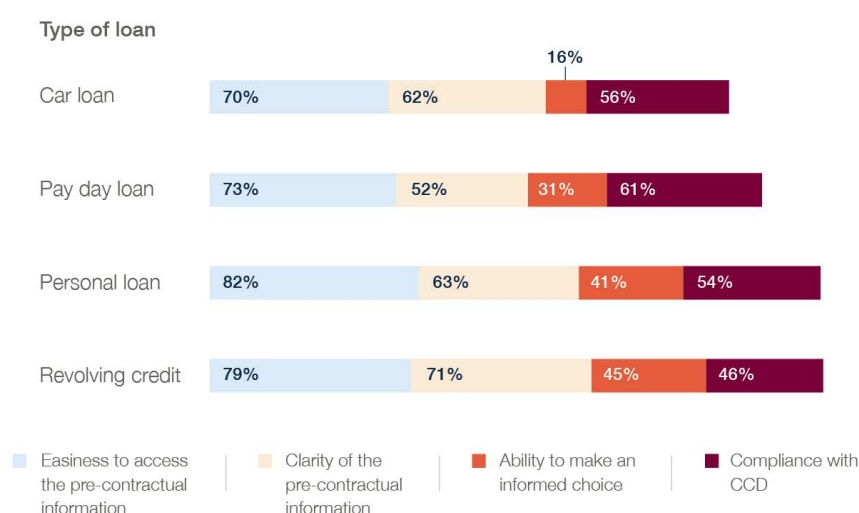
For one, our study suggests that consumers of payday loans are not sufficiently informed about the key features (costs, etc.) of these loans before purchasing them.

Moreover, our study suggests that payday loan consumers often encounter difficulties in even accessing and finding the pre-contractual information. The easiness, in fact, was rated "clear" only by 73% of the participants, in comparison to 82% for a personal loan or 79% for revolving credit. Since, as mentioned previously, payday loans are often sold via digital channels, this is particularly problematic.

As a result of the lack of clarity of the pre-contractual information and the difficulty in accessing it in the first place, only 42% of our study participants reported that they were able to compare different offers when purchasing a payday loan and only 31% said they were able to make an informed choice. This proves highly problematic as it raises the risk that consumers of payday loans purchase products that are not suitable to their needs and financial situation.

Graph 8 below shows the differences in the consumer experience of the consumer credit sales process by loan type.

Graph 8: Differences in consumer experience of the credit sales process by loan type



https://www.financite.be/sites/default/files/references/files/payday_lenders_-_vf.pdf this reference is not working

³⁷ Office of Fair Trading. Payday Lending. OFT1481. March 2013

³⁸ See note 33

In addition, our study confirmed that these products are not sold responsibly. Amongst our study participants, the quality of the creditworthiness assessments of payday loans was graded as being adequate in just slightly more than half of the cases.

Finally, our study has shown unreasonably high APRs for payday loans (See Table 1 below), thus confirming other research throughout the years that these products are exploitative.³⁹ Our research showed a 2.543% average APR for high-cost short-term credit. Also, the case studies show some loan providers charge costs significantly higher than the average on the mainstream market. The minimum APR value found for payday loans in our study was 7.43% while the maximum was a stunning 30,341.1%.

Table 1: Annual percentage rates by loan type

Type of loan	Average APR	Minimum value	Maximum value	Range
Car loan	8.64%	6.30%	45.36%	39.16%
Personal loan	33.33%	7.57%	219.00%	211.43%
Revolving credit	164.92%	12.00%	361.00%	349.11%
Payday loan	2,543.00%	7.43%	30,341.10%	30,333.67%

These findings discussed above clearly show that the scope of the CCD should be extended to loans under €200 as the non-regulation of many payday loans bears serious risks for consumers. Furthermore, the findings show a need to introduce an APR cap to protect vulnerable consumers in particular from huge and unreasonable costs that can easily lead to over-indebtedness. Simply disclosing these costs and expecting consumers to understand their implications is not enough given that the APR, let alone its implications, are not easily understood by consumers, as evidenced by behavioural research.⁴⁰

7.2. Revolving Credit

The study results also confirm concerns raised in recent times by various other sources that there are reasons to be concerned about the sales of revolving credit.⁴¹ Revolving credit is credit which is automatically renewed as debts are paid off.⁴² Credit cards are the most prominent product included within this product category. The terms of a credit card may require that the consumer repays a certain percentage of the outstanding amount of the credit on a regular basis (e.g. each month) or only pays interest throughout the duration of the contract and repays the total amount borrowed upon expiration of the contract.⁴³ Revolving credit is in scope of the CCD only in cases where the credit amount is less than €200. As a consequence, not all revolving credit are currently in the scope of the Directive.

39 BEUC, 2019: https://www.beuc.eu/publications/beuc-x-2019-019_review_of_the_consumer_credit_directive.pdf

40 London Economics, Study on The Functioning of the Consumer Credit Market in the EU, 2013

41 E.g. Evaluation Study of the CCD, European Commission, 2019

42 Oxford Dictionary of English, Oxford University Press, 2018

43 https://www.beuc.eu/publications/beuc-x-2019-019_review_of_the_consumer_credit_directive.pdf

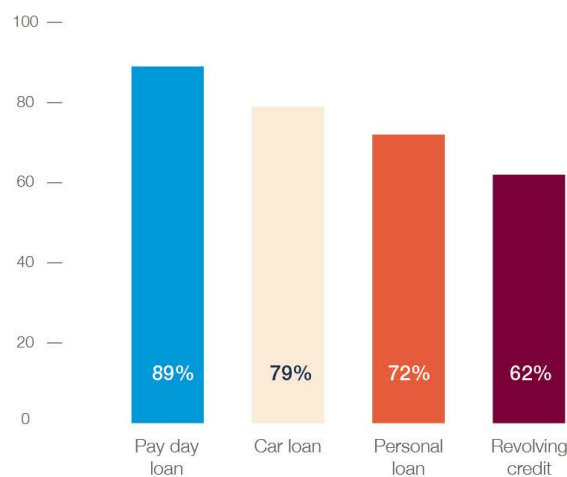
Customers often value revolving credit such as credit cards because it is flexible, allowing consumers to defer payment and spread its costs over a number of months. However, as shown in various research over the past years, credit cards may work to the disadvantage of consumers since these products operate on several behavioural biases likely to lead consumers to accumulate debt over a long period of time.⁴⁴ These behavioural biases are, for example, over-optimism (overestimating one's ability to maintain a zero balance), myopia (overvaluing the short-term benefits of a credit transaction and neglecting the future impact), and cumulative cost neglect (dismissing the cumulative effect of a large number of small credit options).⁴⁵ As a consequence, consumers can easily end up in situations where they are making minimum repayments that simply cover the interest and fees, without ever reducing the debt (i.e. persistent debt).⁴⁶ In addition, concern has been raised for years about the high costs of these products as well as a lack of sufficient and good quality pre-contractual information about the revolving credit products on offer.⁴⁷ These concerns are especially worrying as revolving credit is typically used by vulnerable consumers with limited access to other types of consumer credit, often leading to over-indebtedness.

Our study findings confirm the concern discussed above that revolving credit is highly expensive and therefore, coupled with the fact that it exploits consumer biases, presents a potential risk and source for over-indebtedness. In our study, the average APR for revolving credit was 164.92%. The maximum APR identified was 361%.

The graph below shows the results to the question: *How do you rate the clarity of the pre-contractual information on costs?*

Graph 9: Clarity of the pre-contractual information on costs by loan type

Question: "How do you rate the clarity of the pre-contractual information on costs?"



44 E.g. C.R. Sunstein, 'Boundedly Rational Borrowing' (2006) 73 University of Chicago Law Review, p. 249; O. Bar-Gill, 'The Behavioural Economics of Consumer Contracts' (2008) 92 Minnesota Law Review, p. 749; O. Bar-Gill, 'Seduction by Plastic' (2008) 98 Northwestern University Law Review, p. 1373; Y.M. Atamer, 'Duty of Responsible Lending: Should the European Union Take Action?', in S. Grundmann & Y.M. Atamer (eds), Financial Services, Financial Crisis and General European Contract Law: Failure and Challenges of Contracting (Alphen aan den Rijn: Kluwer Law International, 2011), p. 179, 183 et seq. See also U. Reifner et al., Study on interest rate restrictions in the EU: Final Report for the EU Commission DG Internal Market and Services, Brussels/Hamburg/Mannheim, 2010, p. 119.

45 EC evaluation study of the CCD, 2020.

46 EC evaluation of the CCD, 2020.

47 BEUC, 2019 and EC evaluation of the CCD, 2020.

In addition, our study shows serious flaws within the pre-contractual information provided to consumers on revolving credit, in particular with regards to information about the costs. According to our study findings, the pre-contractual information provided to consumers on revolving credit is not clear in 29% of the cases. Particularly alarming given the high costs associated with these products (as discussed earlier), is that only 37% of the study participants thought the pre-contractual information on the consequences of arrears or default was clear and only 62% reported the information about overall costs being clear. As a consequence of this, only 45% of our study participants felt they could make an informed choice when purchasing a revolving credit and only 29% felt they were in a position to compare different revolving credit offers.

Moreover, our study shows that many revolving credits may not be sold responsibly. The creditworthiness assessments of revolving credits was graded adequate in only 66% of the cases.

The overall findings mentioned above show therefore that special attention must be given to ensure properly regulated revolving credit. These are products that, based on their design and costs, can easily lead to over-indebtedness for vulnerable consumers. Therefore, making sure that consumers receive adequate pre-contractual information about these products prior to a sale is key, and conducting proper CWAs is paramount. Furthermore, as in the case of payday loans, the fact that high costs are associated with these loans shows the need to introduce an APR cap to protect consumers from becoming overly indebted.

V. Implications & recommendations for the Consumer Credit Directive revision

1. Implications

The Consumer Credit Directive (CCD) has been applicable in the European Union since 2008. As stated in the recitals of the Directive, one of its main aims is to enhance consumer confidence and trust of every EU consumer to use credit, to grow the size of the market and to ensure a single, efficient and competitive single credit market. This report shows, however, how this is not happening and that, instead, serious malpractices by lenders in the consumer credit market give rise to mis-selling of consumer credit which, as a consequence, promotes an already troublesome situation of over-indebtedness in the European Union, hitting vulnerable consumers the most.

These malpractices are largely due to gaps and a number of shortcomings of the CCD. Given that the Directive is currently undergoing a review, it is important that this occasion be used to make the necessary modifications to the Directive to address the rising problem of over-indebtedness which has not only strongly negative impacts for the financial, mental and physical well-being of consumers, but also negative implications for the economy and society as a whole.

As evidenced in this report, the scope of the Directive needs to be widened to products under €200, as many products within that category of loans have the potential, if unregulated, to cause serious harm to vulnerable consumers and exacerbate over-indebtedness.

In addition, our report shows that the pre-contractual information requirements of the CCD need revisions, in particular concerning information about the costs of the credit, both in the SECCI and with regards to the explanations provided by credit providers. Moreover, as our report shows, robust regulation of advertising practices is needed. Advertising can play a powerful role in the pre-contractual phase as it can have an influence on consumers' decision-making process on whether to purchase a loan. Therefore, it is not only important that the key information about the product is provided in the advertising material but also that this information is presented in a way that does not make it misleading. As our study shows, there are too many misleading advertising materials in the consumer credit market.

The CCD currently lacks any rules on making sure that the most suitable credit is sold to a consumer. Our study findings show that a lack of any rules in this area has led to suitability not being a factor for most credit providers when selling a consumer credit. As argued in this report, a number of tools, such as product governance requirements and advisory standards, should be introduced in the CCD to address this issue.

Our report shows also that the CCD rules on creditworthiness assessment need to be strengthened. An adequate creditworthiness assessment determines whether a prospective borrower is able to repay a consumer credit and is, as such, an essential element of responsible lending. As our study findings have shown, however, adequate creditworthiness assessments in the EU are lacking. The only way to address this is for the CCD to include rules stipulating the exact information and data that creditors should use when performing a CWA. As importantly, in order to ensure that the CWA is based on correct information, there is a need to ensure that any declarative information provided by the consumer is complemented by the provision of supporting documents.

Lastly, our report shows that there is a need for the CCD to make clear that non-bank entities are in scope of the Directive. Banks are not the only players on the consumer credit market, and the rising digitalisation of the consumer credit market is likely to increase this trend even further in the years to come. As our study shows, malpractices in the lending market giving rise to irresponsible lending and over-indebtedness are stronger amongst non-banks than amongst banks. It is therefore essential for the scope of the revised CCD to include all entities selling consumer credits without exceptions. There is also a need to ensure that the CCD is adjusted in certain areas to ensure that it is fit for purpose for the digital market. This includes, for example, making clear that the pre-contractual information must be provided before the conclusion of the contract in instances where consumer credit is distributed online.

A well-functioning consumer credit market benefits households, manufacturers and sellers of goods and services, and stimulates economic growth. But if credit is misused and the debt burden becomes unsustainable, the resulting detriment for borrowers, lenders and economic stability is very high. With the right regulation in place we can reduce over-indebtedness and its far-reaching detrimental consequences. The current revision of the CCD is the opportunity to do this.

2. Recommendations

As argued throughout this report, a number of revisions are needed to the Consumer Credit Directive (CCD) to prevent mis-selling of consumer credit and irresponsible lending practices.

Based on the findings of our mystery shopping exercise, we have identified recommendations for key amendments to the CCD to address key malpractices on the consumer credit market that lead to over-indebtedness.

The findings of our study highlight the need for the following amendments to the CCD:

Rules on pre-contractual information:

- Introduce new consumer-tested rules on the content, format and presentation of the pre-contractual information provided to consumers. These new rules would make sure consumers receive all key information about a credit, and ensure that none of the information presented is misleading or missed during read through.
- Define in the CCD when the pre-contractual information must be provided to the consumer. This should happen at least 48 hours before the consumer concludes a credit contract to ensure that the consumer has enough time to assess whether the loan on offer is suitable and to compare different credit products.
- Introduce detailed consumer-tested requirements in the CCD regarding the provision of adequate explanations of the pre-contractual information document (SECCI) to guarantee that sufficient and clear explanations are provided along with the SECCI, in particular with regards to costs.

Rules on advice and suitability of the consumer credit product offered:

- Introduce product governance requirements in the CCD, obliging manufacturers of consumer credit products to define a target market when designing a consumer credit product and requiring the product manufacturer to take the necessary steps to make sure that the products they manufacture are sold only to that target market.

- Introduce standards on the provision of advisory services to consumers, in line with the Mortgage Credit Directive.
- Introduce in the CCD a set of conduct of business rules on the remuneration policy of credit providers and intermediaries to ensure they thwart irresponsible lending practices.

Advertising practices:

- Introduce detailed, consumer-tested rules on the content, format and presentation of the information included in advertising to make sure that advertisements are not misleading and include all of the essential information about a credit which a consumer needs to be informed about the key features of a credit.
- Ban unsolicited advertising.
- Introduce a requirement for credit providers to include in all consumer credit advertising material consumer-tested warnings that credit costs money.

Creditworthiness Assessment practices (CWA):

- Introduce detailed rules in the CCD concerning which specific information that should be used to perform a creditworthiness assessment. The assessment should be based only on information needed to allow for an adequate personal budget analysis (data on income and expenditures), including all on-going credit and debts.
- Introduce a rule in the CCD stating that the sale of consumer credit should be refused if the result of the CWA shows that the consumer is not able to afford the loan.
- Introduce in the CCD a requirement establishing the right of consumers to receive an explanation on how and on what basis a decision on their creditworthiness was reached.

Rules on non-bank entities:

- Make explicit in the CCD that all non-bank entities, including all online players engaged in the selling of consumer credit, are in the scope of the Directive.
- Introduce a requirement in the CCD that all non-bank entities – both online and offline – must be registered and supervised by a competent authority to enforce these players' compliance with the Directive.

Specific rules for the online credit market:

- Make explicit in the CCD that rules in the legislative text are applicable to all entities providing consumer credit online, including new digital players such as peer-to-peer lenders or other types of Fintech companies providing online credit.
- Introduce an explicit requirement that the pre-contractual information must be provided by digital means before the conclusion of a credit agreement when a consumer credit is marketed online.

- Introduce consumer-tested rules on how the pre-contractual information should be presented to consumers in a digital environment (format and presentation of the information) to ensure that the rules are adapted to the specifics of the digital world.
- Introduce a requirement that all non-credit institutions selling consumer credit online, regardless of their business model, be regulated and supervised.

Rules to address concerns about specific loan types (payday loans under €200 and revolving credit):

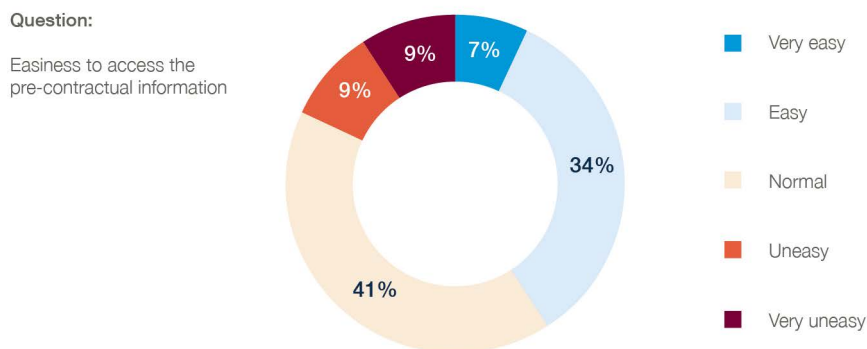
- Widen the scope of the CCD to consumer credit under €200.
- Introduce in the CCD a cap for the annual percentage rate (APR).

It is important to point out that the recommendations above are solely based on the evidence of the study conducted for this report. Our study had limitations with regards to its scope: for example, not all selling practices, products and credit providers were examined and therefore not all malpractices in the consumer credit market were unearthed. Other data, information and feedback from other sources than our report show that there are additional malpractices beyond the ones identified in our study that require addressing in the CCD.

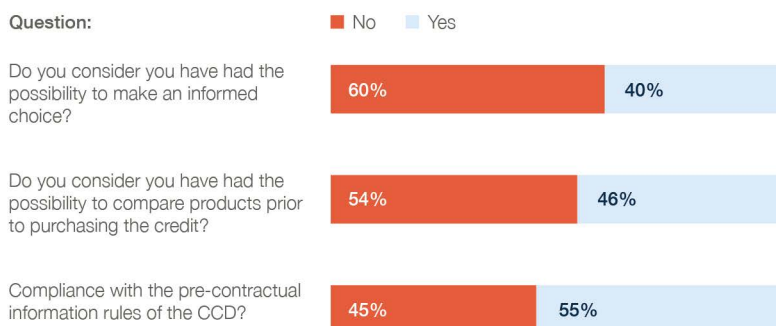
Therefore, the recommendations in this report should not be read as an exhaustive list of the changes Finance Watch recommends necessary to the CCD to ensure that the consumer credit market protects consumers, and prevent mis-selling and irresponsible lending and thereby over-indebtedness. Nevertheless, they do highlight some of the key improvements needed to the CCD and should be used by policymakers on the occasion of the current review of the CCD.

Annex - Key statistics/findings of the study commissioned by Finance Watch

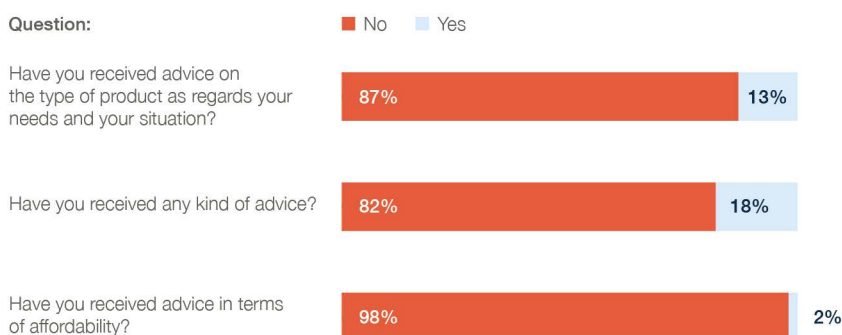
Graph 10a: Provision of pre-contractual information — Ease of access



Graph 10b: Provision of pre-contractual information — Clarity



Graph 11: Advice and suitability of the consumer credit product offered



Graph 12: Advertising practices

Question:

■ No ■ Yes

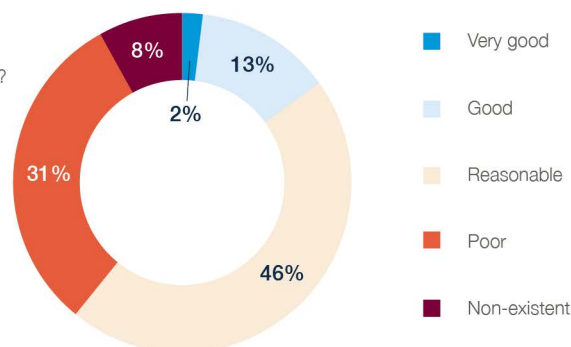
Have you experienced malpractices in advertising material?



Graph 13a: Creditworthiness Assessment practices (CWA) — Quality of assessment

Question:

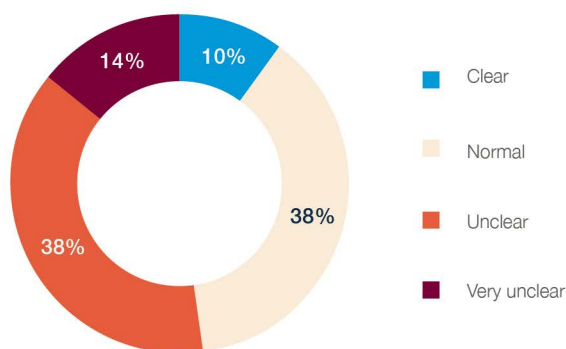
How was the quality of the creditworthiness assessment?



Graph 13b: Creditworthiness Assessment practices (CWA) — Refusal of credit feedback

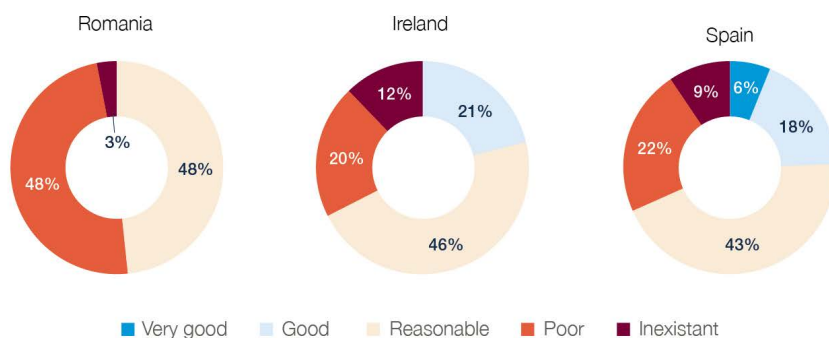
Question:

Refusal of a credit: how clear was the explanation for the refusal?



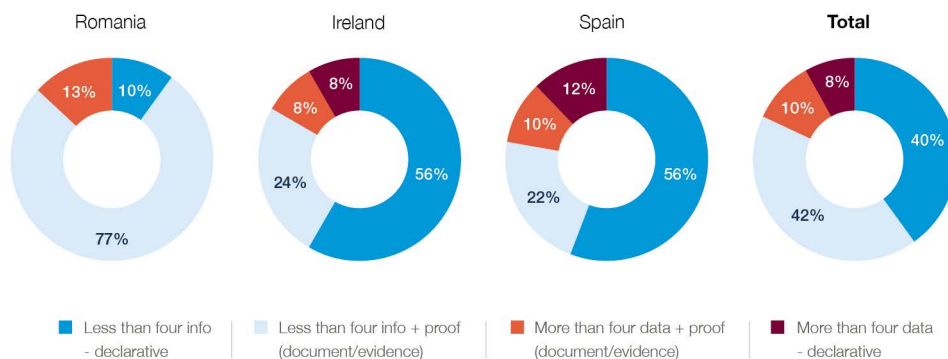
Graph 13c: Creditworthiness Assessment practices (CWA) — Quality

Quality of CWA by Member State:



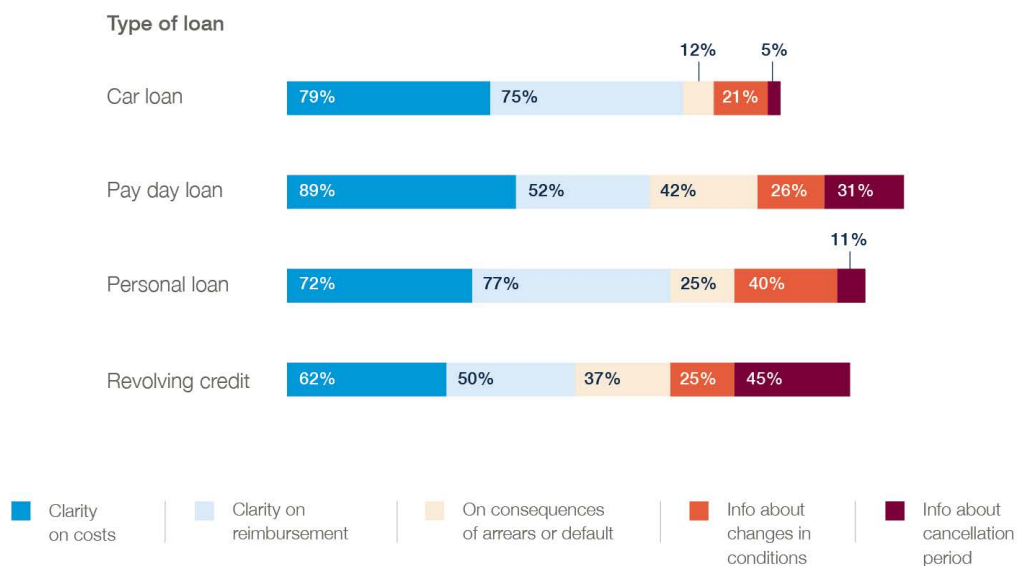
Graph 13d: Creditworthiness Assessment practices (CWA) — Budget data collected

The data collected on consumers' budget by Member State:



Graph 14: Concerns on specific loan types — Clarity of pre-contractual information

The graph below indicates whether the pre-contractual information for the different loan types was clear with regards to costs, reimbursements, the consequences of arrears or default, changes in the conditions, and the cancellation period.



About Finance Watch

Finance Watch is an independently funded public interest association dedicated to making finance work for the good of society. Its mission is to strengthen the voice of society in the reform of financial regulation by conducting advocacy and presenting public interest arguments to lawmakers and the public. Finance Watch's members include consumer groups, housing associations, trade unions, NGOs, financial experts, academics and other civil society groups that collectively represent a large number of European citizens. Finance Watch's founding principles state that finance is essential for society in bringing capital to productive use in a transparent and sustainable manner, but that the legitimate pursuit of private interests by the financial industry should not be conducted to the detriment of society. For further information, see www.finance-watch.org

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