Info

MEPs adopt consumer credit directive, cross-border credit easier and simpler

Two out of three Europeans use credit to buy furniture, a washing machine or a car. Yet the market in consumer credit is still largely a national one. Parliament adopted at second reading a directive aiming to stimulate the European market while still protecting consumers. The amendments adopted at second-reading should conclude the legislative procedure as they were negotiated with the Council in advance. Parliament's rapporteur for the consumer credit directive is Kurt Lechner (EPP-ED, DE).

The new directive aims to harmonise consumer credit contracts in a number of areas, such as standard information to be included in advertising provided to consumers before contracts are signed and when they are concluded, calculations of the total cost of a loan, the right to cancel and the right to pay off a loan early.

According to the Commission, the consumer credit market across the EU the picture is varied, as markets are in different stages of development. The outstanding consumer credit per person ranges from less than €100 in some Member States like Lithuania or Slovakia to over €3 000 in Member States like the UK or Ireland with the highest level of consumer credit. The consumer credit market in the EU is already worth over €800 billion, with an average annual growth rate of over 8%.

That shows the potential for big savings for consumers, if increased competition brings even a small reduction in the interest rates charged to consumers on such a significant amount.

According to ECB data the average rate charged on a consumer credit in the Euro area in 2007 varies from around 6% in the cheapest country (Finland) to over 12% in Portugal, the country with the highest interest rate. Other examples illustrate this variety of situations: 9.4% in Italy and Spain, 7.1% in France or 6.8% in Ireland. This suggests there are considerable potential benefits, for banks and consumers, in developing a cross border market in consumer credit.

The directive was proposed by the Commission in autumn 2002 and given a first reading by Parliament in April 2004. It took the Council until September this year to reach a common position on the issue. A political informal agreement has been reached with the Council just before the vote. The compromise proposed by several EP political groups, and agreeable to the Council was adopted by a large majority.

What will change?

The day the new directive will be implemented, all EU consumers will have the right to the same information for choosing the best offer in their country or another EU Member State. It will be easier to calculate the total cost of a loan offered by various banks, credit intermediaries or credit institution. Consumers will also be able to benefit from bank products that are not available in their own country.

It will be also easier for banks to offer their products to all European citizens. The new legislation should enable the European economy to take advantage of the potential of the consumer loans market which is worth some €800 billion annually. The way is to develop the cross-border trade in consumer credit. Removing obstacles should boost competition and prompt credit institutions to improve performance, by diversifying and enhancing their products for Europe's consumers. In spite of earlier EU regulations (the basic directive in the matter is from 1987) only 1 percent of consumer loans are cross-border.

The directive lays down the standard information that must be given to the consumer. It concerns information mentioned in advertising (when containing financial information on a loan), pre-contractual (which must be given to the consumer before the signing of the contract) and contractual information (included into the contract). With the aim being to enable consumers to take fully-informed decisions, lenders will be expected to provide information on the borrowing rate and on any charges included in the total cost of the credit to the consumer. The text adopted by European Parliament is less strict than that in the Council's common position as regards contractual and pre-contractual information which lenders are obliged to provide to their customers in the case of overdrafts .

As far as the harmonisation level is concerned, it will go further as regards the contractual information then when it comes to pre-contractual information (which must be provided to the consumer using the standard European consumer Credit Information form).

Definitions will be standardised EU-wide and will be used for instance as a basis for calculating the annual percentage rate of charge (APR). Other definitions will be standardised, for example concerning overdraft facilities.

Avoiding taking on too much debt

One priority is to protect consumers against taking on too much debt. The information provided by the lender must enable the borrower to take a responsible decision. The lender must also assess the solvency of the consumer before concluding a contract. Databases accessible by banks should make it easier to meet this requirement. But if the banks refuses a loan on these grounds, the customer will have the right, to see, without charge, the information in that database and where necessary correct any errors. Where legislation providing for similar measures already exists in a Member State, these mechanisms will be preserved. In other cases, they will have to be set up.

Right of withdrawal and right to pay off early

A right of cancellation within 14 days will also apply EU-wide.

The compensation cap to be paid by the client for early repayment was the biggest negotiating hurdle between the Council and the EP.

The new directive will give consumers the right to pay off loans early while also entitles the lender to ask a compensation for possible costs, fair and objectively justified, directly linked to early repayment of credit . The directive stipulates the rules by which the compensation to be paid by the client can be calculated and determines its maximal early played credit percentage ceiling.

The directive defines the situations when the compensation cannot be claimed and allows Member countries to provide that the creditor may exceptionally claim a higher compensation. This may happen if the bank can prove that the loss he suffered from early repayment exceeds the maximal basic amount defined in the directive. The harmonised method of calculating the loss is given in the text.

In the event of early repayment of credit the creditor will be entitled to fair and objectively justified compensation for possible costs directly linked to early repayment of credit provided that the early repayment falls within a period for which the borrowing rate is fixed. Such compensation may not exceed 1% of the amount of credit repaid early, if the period of time between the early repayment and the agreed termination of the credit agreement exceeds one year. If the period does not exceed one year, the compensation may not exceed 0.5% of the amount of credit repaid early.

Any compensation should not exceed the amount of interest the consumer would have paid during the period between the early repayment and the agreed date of termination of the credit agreement.

What loans are covered by the directive?

The new legislation will cover consumer loans between €200 and €75 000 which has to be repaid within more then one month. It will only cover credit contracts, not guarantors and other aspects of credit agreement law. The directive will apply only to loan contracts on which interest is paid, and not products such as deferred payment cards (charge cards) and will not cover the mortgage credits.

Finding the right balance

The situation varies greatly from one Member State to another, both in legal terms and as regards the credit habits of households, a situation which does not make harmonisation easier. In addition, the right balances must be struck. On the one hand, easier credit must not lead to a debt burden on households. On the other, consumer protection must not generate costs that could be intolerable to the financial health of banking institutions. On the one hand, better consumer protection means strengthening customers' rights to information; on the other hand, too many bureaucratic requirements might discourage banks from offering credit on favourable terms. This balancing act explains the long delay in arriving at a second reading.

Directive does not apply to:

(a) credit agreements which are secured either by a mortgage or by another comparable security commonly used in a Member State on immovable property or secured by a right related to immovable property;

(b) credit agreements the purpose of which is to acquire or retain property rights in land or in an existing or projected building;

(c) credit agreements involving a total amount of credit less than €200 or more than €75 000.

(d) hiring or leasing agreements where an obligation to purchase the object of the agreement is not laid down either by the agreement itself or by any separate agreement; such an obligation shall be deemed to exist if it is so decided unilaterally by the creditor;

(e) credit agreements in the form of an overdraft facility and where the credit has to be repaid within one month;

(f) credit agreements where the credit is granted free of interest and without any other charges and credit agreements under the terms of which the credit has to be repaid within three months and only insignificant charges are payable;

(g) credit agreements where the credit is granted by an employer to his employees as a secondary activity free of interest or at annual percentage rates of charge lower than those prevailing on the market and which are not offered to the public generally;

(h) credit agreements which are concluded with investment firms as defined in Article 4(1) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments or with credit institutions as defined in Article 4 of Directive 2006/48/EC for the purposes of allowing an investor to carry out a transaction relating to one or more of the instruments listed in Section C of Annex I to Directive 2004/39/EC, where the investment firm or credit institution granting the credit is involved in such transaction;

(i) credit agreements which are the outcome of a settlement reached in court or before another statutory authority;

Next steps

The Directive adopted by the European Parliament must be now formally agreed by the Council and will enter into force on the twentieth day following that of its publication in the Official Journal of the European Union. Member States have two years from the date of the entry into force for implementing this Directive. The Commission has to undertake every five years a review of the thresholds laid down in this Directive and its annexes and the percentages used to calculate the compensation payable in the event of early repayment.

British and Irish speakers in the debate 15 January in Strasbourg

Malcolm **Harbour** (West Midlands, Conservative, EPP-ED, UK) said: "Consumer credit is a really important mechanism for bringing consumers into the market place. We want a thriving and innovative market; we want companies actively offering a wide range of products and services tailored to the need of consumers to buy specific articles, products or services."

Arlene **McCarthy** (North West, Labour, PES, UK) said: "I believe it is a vast improvement on the original proposal it focuses on the essential elements and components to begin the opening of the market and to protect the consumer and those benefits I believe are enabling the consumers to compare offers for credit obliging the lender to assess the credit worthiness of the consumer, that will be important in the fight against debt across the EU. It will oblige the lender to explain and all creditors will be responsible for providing comprehensive and standard information now as a result of our amendments in a simplified format. I welcome the 14-day withdrawal … to early repayment."

Diana **Wallis** (Yorkshire and the Humber, Liberal Democrat, ALDE, UK) said: "As legislators facing that global backdrop, we need to do something. We need to stimulate the EU’s market in financial services, but of course, on the other hand, we also need to ensure that our consumers make sensible and informed choices and that they have all the information and the comparators available to them to do that. Many of us in this House, and particularly in this committee, have over the last couple of years sat through an enquiry of this Parliament into the demise of the British insurer, Equitable Life. We know what the consequences are for consumers in financial services if we get the cross-border regulatory regime wrong. In this instance we need it and we need to get it right, particularly in view of the global circumstances that we face."

Eoin **Ryan**, (Fianna Fáil, Dublin, UEN, IE) said: "I support the need to update EU legislation in this area. The last time we had a directive on this was in 1987 and certainly the consumer credit market has changed dramatically since then.

This EU directive on consumer credit loans seeks to introduce a greater level of competition into the €800 billion consumer credit market. It will bring legal certainty to consumers, which is absolutely vital if people are to shop around and to look for the best product which suits their needs. It will also help business to compete. When you look at the differences in consumer credit rates around Europe – 6% in some countries, up to 12% in others – it surely is time that the consumer got a better choice."

Godfrey **Bloom** (UKIP, Yorkshire and the Humber IND/DEM, UK) said: "I see not a great deal of experience so it is a question of the blind leading the blind and I think that this place which has not managed to audit its own books for nearly 11 years commenting on this is slightly absurd. The fact that you can actually have rules for Bucharest, London and Paris and consumers in those places is absolutely ludicrous and perhaps I could warn people like the UK Government who think that by bailing out banks to the tune of 50% of their entire reserves is fundamentally wrong so let me give one tip to the consumer if I may here. Never a lender or a borrower be and to governments let me tell you this. A fool and his money are soon parted."

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