

Credit agreements for consumers

2002/0222(COD) - 07/10/2005 - Modified legislative proposal

The Commission adopted a modified proposal for a Directive on Consumer Credit following the opinion voted by the European Parliament (please see the summaries of 20/04/2004 and 28/10/2004.)

After the modified proposal was published, the Commission continued consultation with Member States and stakeholders. As a result, the Commission concluded that a consolidated text would be useful. In addition the consultations showed the need for further substantial modifications in order to avoid unintentionally burdening consumer credit business whilst at the same time ensuring a high level of protection for consumers. In particular:

-All mortgage credit is excluded from the scope of the proposal.

-The duty to offer advice to the consumer in the pre-contractual stage has been clarified and adapted to the circumstances of the credit offer.

-The flexibility associated with certain provisions is coupled with a mutual recognition clause aimed at ensuring that any differences in the resulting transposition will not constitute an obstacle to the internal market.

Main changes compared to the modified proposal of 28 October 2004:

Aim: only certain aspects are dealt with by the directive.

Definitions: the question of overdrafts is clarified and the definition of the total cost of credit is redrafted in line with the comments of Parliament and industry. The objective is to include only those costs corresponding to services concluded with or via the creditor. This definition serves as basis for the calculation of the Annual Percentage Rate of Charge (APR). The total lending rate is deleted as

requested by stakeholders and Parliament, as it might have been confusing for consumers.

Scope:

-Mortgage credit agreements: the first modified proposal covered equity releases, while excluding credit agreements concluded for housing purposes. However, determining the purpose of a loan is very difficult for the creditor, if not impossible, as he has no control on the use of the money he lends. In addition, mortgage credit agreements in general are very specific instruments with particular features which require to be addressed separately, irrespective of the purpose of the loan. Therefore, the Commission has excluded equity release from the scope. This corresponds to an amendment by Parliament strongly supported by industry.

-Surety agreements, guarantors: Surety agreements are now excluded from the scope, as the main issue in relation to sureties was linked to the question of mortgage credit. Guarantors are excluded from the scope as well. The Directive deals with credit agreements only. Both exclusions correspond to Parliament's amendments, and meet concerns put forward by the banking sector.

-Overdrafts: The European Parliament as well as the European banking industry have argued that overdrafts are valued for simplicity and low cost, and therefore, need not to be subject to the full range of requirements for credit agreements. They are submitted to a light regime only. However, a sufficient level

of information is necessary. Overdrafts are therefore subject to a limited number of contractual information requirements.

-Agreements above EUR 50 000: these are excluded as they are generally not concluded for consumption purposes but rather for housing purposes, and therefore do not require the same type of legislation as the average consumer credit.

Pre-contractual information: As advertising is already dealt with by the Directive on Unfair Commercial Practices (2005/29/EC), the Commission proposes only a list of mandatory information elements to be mentioned in advertising containing financial information on credit. Pre-contractual information allows consumers to compare offers. However, various stakeholders in the consultation process were concerned that an excess of information may be confusing. Some pre-contractual information requirements have therefore been deleted in the present modified proposal. Further, following requests from the banking sector, the present modified proposal aims at ensuring consistency with information requirements in existing EC law. The lender is requested to assess the consumer's creditworthiness on the basis of information disclosed by the latter and, where appropriate, consultation of databases. The concept of a duty to advise was modified. Contrary to some requests from the banking industry, the Commission maintains the concept that a creditor should not merely fulfil the pre-contractual information requirements, but should provide additional explanations in order to enable the consumer to take a well-informed decision. However it was clarified that the consumer is always responsible for his final decision to conclude a credit agreement. Therefore, the reference to advice is specified as a duty to put the consumer in a position to assess the advantages and drawbacks of the loan. In addition, Member States have been given more flexibility to adapt their implementation law to the situation on their markets.

Contractual information: The provisions on contractual information require mainly information already provided at the pre-contractual stage plus information on how to exercise the right of withdrawal and the right of early repayment. In case of a variable rate, the consumer should be informed of significant changes to the borrowing rate. However, it is in practice impossible to inform him of every change, as in certain cases the rate can change slightly every day. Therefore, the proposal foresees that consumers should be informed periodically and at least immediately in case of a significant change.

Database access: The obligation to set up national databases has been deleted, since this would go beyond the purpose of this Directive. Issues relating to data protection are already dealt with in the Data Protection Directive 95/46/EC. Therefore, the Commission proposes to guarantee only a mutual access to existing private and public databases on a non-discriminatory basis, which does not involve additional costs for the industry as the previous provision but, on the contrary, will help lowering a barrier to cross-border consumer credit.

Right of withdrawal: The present proposal foresees a possibility for consumers to withdraw from the credit agreement within 14 days. This delay allows consumers to shop around after conclusion of the agreement and possibly to find a better offer.

Linked transactions: When the consumer has a right to withdraw from the purchase agreement, he also has a right to withdraw from the linked credit agreement. This provision aims at avoiding that consumers have to keep a credit even when its very purpose has disappeared. However, the right to withdraw from the credit does not give a right to withdraw from the purchase agreement.

Early repayment: The consumer is granted a right to repay his credit earlier than initially agreed. However, early repayment has a cost for creditors. Therefore, following consultations with stakeholders and Member States, the proposal foresees that creditors may charge fair and objective fees to compensate the loss. Since the calculation of the compensation should be made on an objective basis, it is expected that this provision would only entail marginal costs for creditors.

Unfair terms: The proposal contains two examples of unfair terms specific to credit agreements and modifies the annex of Directive 93/13/EEC. The impact on industry, if any, will be very low, as the examples provided are in clear contradiction with usual good professional practice.

Harmonisation: The Commission suggests maintaining the full harmonisation approach, with a degree of flexibility for Member States in certain areas. The proposal now clarifies that only those elements explicitly dealt with in the text are fully harmonised whereas issues such as joint and several liability are left to the national legal systems. In some cases, the proposal gives leeway to national implementation, mainly due to existing heterogeneity as regards national markets or national legislation. This is the case, for instance, in the context of early repayment or overrunning. However, it is also necessary to ensure that the degree of flexibility provided for national implementation within the limits of the Directive does not contribute to raise additional barriers to the single market in consumer credit. Therefore, the Commission complements its full harmonisation approach with mutual recognition for a limited number of issues. This helps to reduce burden on businesses who want to offer consumer credit across borders. As a result of the proposed provision on mutual recognition, a creditor would only have to comply, for an activity in another Member State than the one he is established in, with legal requirements of its Member State of origin and not with those of the host Member State. In the area of contract law, this could lead to another result than foreseen by Article 5 of the Rome Convention. In an Article 5 situation, which would lead to the application of the law of the country where the consumer has his habitual residence, this latter law may establish standards that, in relation to the equivalent standards applicable in an incoming creditor's home country, restrict that creditors activity, for instance by being higher (or different) than his home country standards. In that case, if areas mentioned in the mutual recognition clause are concerned, the host Member State has to ensure that the said standards would not apply to the contract. Either the law chosen by the parties, or, in the absence of such a choice, the requirements of the creditor's home country law would continue to apply. The areas concerned by the mutual recognition clause are explicitly listed in the proposal. As regards early repayment and overrunning, a phasing-in period has been introduced in order to allow Member States to adapt.

Examples: The illustrative examples for calculation of the APR as foreseen in former Annex II of the proposal have been deleted in view of the Commission's overall target of better regulation and in order not to over-burden the legislative procedure.