



**Proposal for a
DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
on the harmonisation of the laws, regulations and administrative provisions
of the Member States concerning credit for consumers**

Expertise and Alternatives
developed for the
Verbraucherzentrale Bundesverband e. V. (vzbv),
the Federation of German Consumer Organisations

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Preface

This report was commissioned by the Verbraucherzentrale Bundesverband e.V. (vzbv), the Federation of German Consumer Organisations. It provides a general critique of consumer-friendly elements in the proposed new EU Consumer Credit Directive and identifies elements of its recommendations which are more problematic, as well as discussing the issues which lie at the root of this critique, namely the “Total Harmonisation” approach of the Proposal and the incomplete clarification of the Interest Rate Regulation. Part 3 sets out an annotated amended draft Consumer Credit Directive to take into account the objectives of consumer protection and the prevention of overindebtedness.

1 Recommendations

The present new consumer credit Directive as proposed has positive and negative aspects which do not compensate for each other. If the disadvantages were eliminated, the proposal could facilitate a significant step towards a sane and responsible consumer credit market. This report identifies these elements and provides a number of new proposals which, from a consumer perspective, could significantly improve its scope, effectiveness and adequacy.

The following recommendations are transposed into an alternative Draft of the Consumer Credit Proposal which is annexed to this report.

I. Elements that will benefit consumers in the future

The proposal of a new consumer credit Directive introduces **significant new individual items of consumer information, social consumer protection and standardisation**, based on progressive legislation in several member states, and Belgium and France in particular, which are overdue for implementation in all member states. It also addresses several loopholes in outdated EU regulation in the form of Directive 87/102/EEC, which was still based on the assumption that instalment credit was the major form of indebtedness, while credit card debt, combined products and variable credit are the main dangers in consumer finance in unregulated markets.

1. The Directive effectively addresses the new phenomenon of modern credit debts which have escaped existing regulations, such as **credit card credit** [Art. 12, 2.], **variable rate credit** [Art. 12, 4. 15,c-e)], **leasing** [Art. 15, f); 12,6.] and **overdrafts** [Art.21]
2. The Directive implements the “**law of one price**”, which states that prices for homogenous services must converge.¹
 - a) In particular, it addresses the enormous differences created by the application of arbitrary price calculation rules within and between member states, where **investment and savings products** are combined with credit into one economic function while remaining legally distinct as separate contracts. [Art. 20]
 - b) It effectively stops the allocation of credit cost to **linked credit life insurance** contracts and **card fees**. [Art.12, 2. and 3.]
 - c) It includes the afore-mentioned (see 1.) **new forms of consumer credit** in the APR calculation.
3. The Directive extends consumer protection and consumer information to **guarantors** who, under national legislation, are even more in need of efficient protection and information than the borrower himself, because they contract for debts wanting to help the borrower (not the creditor) with whom

¹ See Jentzsch, The Implications of the New Consumer Credit Directive for EU Credit Market Integration, Position Paper, Free University Berlin, April 22,2003 p 6

they have usually have family ties. It thus contributes to protection of family ties from economic exploitation by third parties. [Art.2 e); f); 10, 23 Draft Proposal]

4. The Directive restricts the collection of data and its misuse through special **data protection** [Art.7].
5. The Directive implements significant **social consumer protection rules** as commonly practiced in most member states and which are necessary for addressing rising overindebtedness in EU member states
 - a) the standardisation of **default notice and enforceability** [Art.24], introducing a duty to give reasons on early termination, to seek amicable solutions and to warn consumers.
 - b) restrictions on illicit **debt enforcement practices** [Art.27]
 - c) prohibition of **door-to-door sales** of credit [Art.5]
 - d) the introduction of a legal principle of “**responsible lending**” [Art.9]
 - e) prohibition of **cartel terms** which, through contractual terms or the de facto combination of products, bind consumers into other products without giving them freedom of choice [Art. 15 b), f)] or prohibiting the effective use of the capital borrowed. [Art.15 a)]
 - f) the duty to provide efficient **opportunities to repay**, especially in relation to open-ended credit and combined products [Art.20, 2.] and giving consumers the right to repay their debts whenever they can, prohibiting deterrent fines and fees. [Art.16]

II. Elements that will disadvantage consumers in the future

Irrespective of the enormous benefit of implementation of this proposal in terms of the protection of consumer against overindebtedness and misrepresentation in consumer credit at national level, it also has some serious disadvantages which would **jeopardise gains on behalf of consumer** in the member states and threaten future progress. Specifically, four elements should be firmly rejected by consumer organisations: the maximum harmonisation principle, the replacement of the hand-written form on the internet, the omission of consumer protection and prevention of overindebtedness from its stated objectives, and the new loopholes in the scope of its application, as well as the introduction of a new paternalistic philosophy about irresponsible borrowers.

6. The **Maximum Harmonisation** approach is unacceptable. It threatens consumer protection as a national cultural asset which adds to the diversity and subsidiarity approach of the EU. It also cuts into a significant amount of existing national consumer protection legislation. National states alone have hitherto developed consumer protection as a model for EU legislation. They should neither be hindered nor should their achievements be reduced. [Article 30 no. 1] Instead, a standardisation approach to information rights through prescription of a common form [Article 6 no. 3] may be acceptable.

7. The Directive should at least uphold standards set by the previous Directive. It should incorporate **consumer protection** and the **prevention of overindebtedness** into its goals [see Article 1], reinsert the **minimum harmonisation** clause and the article concerning **circumvention** [see Article 30] applicable to legal constructs achieving the same economic goals as those regulated by the Directive.
8. The Directive should be effective in **its scope** and not give in to various pressure groups.
 - a) It should prevent **leasing (hiring agreements)** from becoming a standardised circumvention. According to national law, transfer of the economic value of the financed items instead of the acquisition of ownership of the item should be the main indicator of the scope of its application. [Article 3, 2 letter b]
 - b) **Bank loans to bank employees** should not be exempted because there is no need to protect professional lenders from observation of consumer protection standards. [see Article 3, 2 (i)]
 - c) Consumer credit to **finance capital investment for savings** is a dangerous instrument which needs sufficient information and rights to early repayment. There is no reason to exclude it totally from the scope of the Directive. [see Article 3, 2 (i)]
 - d) However, credit over **one million Euros** should be excluded where the loan is not used for consumer purposes. [see Article 3 number 2 letter e]
 - e) **Mortgage credit** has long been inseparably linked with consumer credit and used for personal consumption other than real property (“second mortgage market”, repairs etc). It should, as is the case in many member states, be brought within the scope of the regulation. Specific regulations, as in other forms of credit such as overdrafts and credit cards, could be introduced. [Article 3 no.2 letter a]
9. There is no need for regulation for a **central database**. It is a matter for creditors to protect themselves against irrecoverable debt. The protection of creditors is not a valid objective of consumer credit protection legislation. As all countries have such databases, the state should confine itself to securing consumers’ rights in relation to these databases, notably through provisions governing **free access and the quality of the data**, but not its technical operation. [Articles 7 and 8]
10. The Directive should ensure the continued existence of **forms completed by hand** to prevent overindebtedness. The **Internet** is not the appropriate forum for making decisions about credit or entering into a guarantee. The **written form** can act as a warning and it is crucial in preventing overindebtedness. The electronic form never guarantees the personal decision of the debtor as does the written form. It only enables him to reserve this right. [Article 10 no. 1] Where it is a matter of merely providing information, the electronic form should ensure that the supplier is unable to change information after it has been received by the consumer. [Article 2 letter i; 6 no. 2]

III. Proposals for improving effectiveness of the regulation

The Directive should exclude unnecessary information and include necessary information, deal with all emerging combined products by a general concept of “linked transactions” which prevent further circumvention and include more social consumer protection

10. **Information rights** and time for reflection could be made more effective.

- a) Information should be centred on a table of amortisation which gives consumers the most significant information for their future debt commitment. [Article 6 no. 2 (b), (c)].
- b) There is no need for an additional interest rate such as the “total lending rate” [Art. 13].
- c) **Cost incurred through default** or implied through the exercise of the right of withdrawal should be disclosed properly in advance. [Article 6 no. 2 (i)]
- d) **Variable rate credit** should be regulated in one article covering the basic rate, the interval of adjustment, the margin of change and its relation to the rate initially agreed as well as its disclosure. [Article 14 no. 3]
- e) The **right of withdrawal** will correspond to a duty to repay the credit. However, the Directive should make it clear that the right of withdrawal exists in any case, not only if there have been repayments. Rules for debt recovery are sufficient to secure repayments and do not need additional sanctions in the form of the waiver of rights.

11. All “**linked transactions**” in which cost, risk or other disadvantages which occur in association with the credit contract, but which are not legally part of it, are transferred to and concealed in other, legally independent products and should be treated in the same way. Applied and customised under national law, this concept will facilitate the application of the Directive and protect consumers from future developments in product design. Examples of such combined products in the law could help to illustrate its meaning. Its introduction will also streamline the Directive significantly. [see Art. 2 letter d]. Linked transactions play an important role in calculation of the APR, early cancellation, information rights and other protective rules. [Article 2 letter d and h; 3 no. 1 and 2 letter b; 12 no. 2; 16 no. 2; 20]

12. The Directive should incorporate more **social consumer protection**.

- a) **Usury provisions** and rate ceilings, as are in force for the majority of people in the EU, are an effective means of helping vulnerable consumers in imperfect markets to evade exploitation and overindebtedness. It also creates trust and social responsibility and excludes predatory lenders. [Article 2 no. 2 (i); 13 no. 1]
- b) The **default interest rate** should be capped at a maximum level contained in the contractual interest rate in order to prevent arbitrary cancellation and exploitation. [Article 13 no. 2]

- c) Obstacles or delays to **early repayment** should be prevented. There is no need for special indemnities and the Directive should make clear that all pre-paid and pre-contracted costs relating to the time outstanding are refunded. [Article 16 no. 2]
 - d) **Anatocism** (interest on interest) should be banned in consumer credit contracts.
 - e) The exploitation of the needs of consumers for additional credit or lower repayments should not be exploited through irresponsible **refinancing**. The obligation to pay damages as well as certain sanctions, such as like interest-free credit, should discourage such exploitation. Consumers in need should not have early repayment of their credit restricted through fees. An additional exemption should be added to Art. 16,2.
13. **Responsible Lending** should become an effective, sanctioned and streamlined principle enshrined in law. It should cover not only the financial situation of the consumer but also the **product aspects** of lending. It should give rise to a right to claim **damages**. [Article 9]
14. The Directive should reduce the multiplicity of **interest rates** and **calculation methods**, substituting a single definition of the APR, instead of the contradictory legal and mathematical definitions.
- a) The Directive should apply only the correct definition in Art. 12 para. 1 and in Annexes I and II. The inherent "**cash flow**" **approach** or "growth" approach instead of "cost" calculation should be established as the only correct method. [Article 12] All references to costs elements should be transposed into the language of this cash flow approach i.e. to payments instead of cost and capital. [Art. 2 letter h] Instead of giving complex mathematical formulas, the Directive could restrict itself to one simple calculation formula which represents the growth rate of a fixed capital sum. This formula should be orientated towards the future instead of the present value because consumers are interested in the total debt burden represented in all future repayments instead of the discounted value which represents the view of investors.
 - b) There should only be two different types of interest rates: the APR for the purpose of disclosure and choice on the one hand and the interest rate used to calculate the interest due on the other. This rate should be used for interest calculation instead of interest representation would be easier to understand if it were defined as the "**Calculation Rate**". [Article 2 letter j]. As mentioned above, a third rate, the "**total lending rate**" introduces a specialist view of creditors seeking to show that their costs of outsourcing services (i.e. acquisition) are not a cost of credit. [Article 13]

2 Contents and Problems of the Draft Proposal

The European Commission has presented a new draft Consumer Credit Directive which will replace Directives 87/102/EEC and 90/88/EEC, as amended by Directive 98/7/EC as presently in force.

To use its own wording, the Commission intends to achieve three goals:

1. adaptation of the old Directives to new techniques of lending;
2. new distribution of rights and duties between consumers and creditors;
3. guarantee of a high level of consumer protection within the framework of a joint regulation which enables the industry further to develop its potential

The Commission intends to achieve these objectives through six principal measures:

1. New definition of the scope of application, and in particular a clear distinction from mortgage loans
2. Inclusion of credit brokerage
3. Introduction of an obligatory central database, allowing risk evaluation of individuals by creditors
4. Improved information for consumers and guarantors
5. Balancing responsibilities between consumers and professionals
6. Regulation of debt collection.

From a consumer viewpoint the new draft law will therefore basically introduce three new elements:

1. Standardisation of consumer credit law by prohibiting lower standards ("minimum harmonisation"] but also by prohibiting higher standards ("maximum harmonisation"] in the member states.
2. The new Directive will further clarify and rectify what is the key price parameter for enabling competition, transparency and international comparison, namely the Annual Percentage Rate of Charge. It will in future cover all forms of hidden costs, in particular from services and sales which do not form part of the credit contract but are associated with it. The APR will therefore be defined by all payments which are necessary for the consumer to take up the loan in question. ("WYSIWYG" approach]. But, in return, a second. "low APR" will be disclosed, representing the creditors' view, and including only price elements which they "earn". The traditional bank interest rate used as an easy form of interest calculation will still be permitted but it will be regulated especially where variable rates are used. Additional information on specific price parameters will be used.
3. The Directive will directly target overindebtedness for the first time by regulating debt-related factors like credit brokerage, door-to-door sales, guarantees, risk-related decisions for lending and debt collection. It will introduce social consumer protection. The driving philosophy behind these preventative measures will remain information. Some articles, such as the ones dealing

with lender liability and limitations on guarantees, provided for stronger protection of guarantors and the prohibition of door-to-door credit sales, as well as supervision of brokers, taking up national efforts for stricter social consumer protection.

The draft introduces significant new single items of consumer information, social consumer protection and standardisation, but falls short in terms of its principles, although maximum harmonisation principles claim to have spoken the last word through its provisions.

1. In terms of social consumer protection, the proposal raises minimum standards only in states where consumer credit is still underdeveloped, but it undermines the standards in other countries, in particular in the BENELUX countries, France, Austria, Germany and Scandinavia. Introducing the maximum harmonisation approach will thus limit and even threaten the "acquits national" (national progress) in some member states and hinder its further development. Cultural diversity must be accepted, especially in regulating overindebtedness, which has many causes and manifestations in the different member states. If the EU adheres to its basic approach of diversity in unity, it will create great advantages over economies which try to cope with rising overindebtedness through one-dimensional approaches to credit regulation.
2. The informational approach dominating the present draft relies on a basic belief that most market deficiencies can be cured through consumer awareness and choice. This philosophy also needs a unified approach to what the cost and benefits of "consumer credit" are. It requires a clear economic definition of consumer credit and consumer information. If this is not clarified and if the regulation continues to address the legal form rather than the economic content of credit, it will not only create information overload, but it will also fall short of addressing the emerging adverse social effects of new products at their roots.
3. Social consumer protection, which protects not only the consumer decision but above all the use of credit itself in relation to actual income is still spread across consumer credit legislation, antiquated debtor protection rules contained in civil law, such as the prohibition of anatocism and usury, case law based on the principles of good faith and good morals, and a clear distinction between civil and common law. All should have a general European basis in consumer credit law. The "Social Charter" approach and the "Free Market Approach" are both represented in the European Treaty. They should both also be represented in the Directives.
4. The Directive splits the consumer credit market into regulated unsecured credit and unregulated secured credit, between "consumer credit" and mortgage loans. This distinction is obsolete. The form of the security no longer represents a useful parameter for the distinction between the resources used to repay the loan. As consumer credit protection is basically a protection of the efficient use of the lifetime income of consumers who basically earn what they will consume during their lifetime, mortgage loans invested without any direct return on this investment should be treated in the same way.

Consumer organisations should therefore try to support the implementation of the detail of the regulations without buying into the Directive's restrictive philosophy in terms of national regulations.

2.1 Maximum Harmonisation in the Draft Law (Art. 30) and Minimum Harmonisation in the Amsterdam Treaty (Art.153)?

2.1.1 Maximum Harmonisation in Art. 30 of the new proposal

The title of Art. 30 reads: “Total harmonisation and imperative nature of the Directive's provisions” and continues:

Member States may not introduce provisions other than those laid down in this Directive, except with regard to: a) registration of credit agreements and surety agreements in accordance with Article 8 (4); b) the provisions concerning the burden of proof referred to in Article 33.

In its first preliminary draft the proposal expressly refers to “maximum harmonisation” and the change of the wording into “total harmonisation” does not make any significant contribution to its effectiveness in terms of national consumer protection. The Directive will allow only two exemptions for national regulation: the registration of contracts and the burden of proof when a broker acts “commercially” (Art. 33).

This is a significant change in EU regulation. Harmonisation of consumer protection rules in the past have always been based on rules minimum harmonisation.

In its Directive 94/19/EC of 30 May 1994 on deposit-guarantee schemes the minimum protection principle is still clearly stated as follows:

“Whereas, when restrictions on the activities of credit institutions are eliminated, consideration should be given to the situation which might arise if deposits in a credit institution that has branches in other Member States become unavailable; whereas it is **indispensable to ensure a harmonised minimum level of deposit protection** wherever deposits are located in the Community; whereas such deposit protection is as essential as the prudential rules for the completion of the single banking market;”

Art. 14 of the Distance Contracts Directive 97/7/EC of 20 May 1997 states:

Art. 14 Minimal clause

Member States may introduce or maintain, in the area covered by this Directive, more stringent provisions compatible with the Treaty, to ensure a higher level of consumer protection. Such provisions shall, where appropriate, include a ban, in the general interest, on the marketing of certain goods or services, particularly medicinal products, within their territory by means of distance contracts, with due regard for the Treaty.

Section III of the Cross-Border Credit Transfers Directive 97/5/EC OF 27 January 1997 is entitled:

Minimum obligations of institutions in respect of cross-border credit transfers

Article 15 of the Consumer Credit Directive 87/104/EEC stated:

This Directive shall not preclude Member States from retaining or adopting more stringent provisions to protect consumers consistent with their obligations under the Treaty.

Other references can be found in Art. 8 of the Standard Contract Terms Directive 93/13/EEC of 5 April 1993 or other consumer protection Directives.

Since the late 1990s, this policy was jeopardised by powerful forces at European level, centred around DG Market, which wanted to introduce the national control principle into consumer protection legislation as well, and into private law. While administrative supervisory law had gained its European dimension through this principle, the banking industry in particular considered that the right to export the level of consumer protection applicable in its countries of origin to the host country would facilitate cross-border lending. Private law is totally different from administrative law in so far as its objects are not state agencies able to co-operate across borders with other state agencies, but consumers who will only be aware of law in their own language, based on their own culture and conceived as part of existing rules in their respective societies. It is only consumer protection rules that consumers assume to be valid, without knowing them verbatim, which stand a chance of being enforced in practice. This is why the Rome Treaty on international private law implements the host country control principle for consumer law.

Although these distinctions seem to be quite clear, the US example of a “race to the bottom” in consumer protection law through the home country principle seems to have gained influence in the European court as well as the Commission and in legal literature. This may have induced DG Sanco, which is responsible for financial services and consumer protection, together with DG Market, to seek relief from a total harmonisation principle, which at least retains as an official EU objective the high level of consumer protection regulation aspired to in the Treaty, and is thus more than a set of national regulations, disseminated throughout EU territory by the sheer power of banks seeking to establish their head office in countries whose regulatory systems suit them.

Directive 2002/65/EU on the Distance Marketing of Financial Services therefore changed the philosophy and stated in no 34 of its deliberations:

(34) Since the objectives of this Directive, namely the establishment of common rules on the distance marketing of consumer financial services cannot be sufficiently achieved by the Member States and can therefore be better achieved at Community level, the Community may adopt measures, in accordance with the principles of subsidiarity as set out in Article 5 of the Treaty. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary to achieve that objective,

In the new proposal the reasons for a switch from minimum to maximum harmonisation are as follows in paragraph 5 of the general recommendations:

"(5) It is also necessary to promote the creation of a more transparent and efficient credit market. It is important that this market should offer a degree of consumer protection such that the free movement of credit offers can take place under optimum conditions for both those who offer credit and those who require it. This necessitates a process of maximum harmonisation, to assure all consumers in the Community of a high degree of protection of their interests and an equivalent level of information."

In the Explanatory Memorandum under 2.2, the Commission justifies the maximum harmonisation approach by its assumption that this Directive will offer also an optimum level of consumer protection:

“Measures offering a high degree of consumer protection have been drawn up in accordance with Article 153 (1) (3) (a) of the Treaty in conjunction with Article 95, as mentioned earlier. The aim of these protective measures is to strengthen the provisions put in place to establish the single market and they should enable the Member States to accept maximum harmonisation with no need for a general resort to further protective measures.”

The Commission further argues that consumer protection under national law will only be affected as far as this Directive regulates the relevant area. In this respect, rules on usury and interest rate ceilings are not supposed to fall under the scope of this Directive.:

“National rules concerning a rate ceiling for the APR or usury ceilings or other forms of fixed or estimated rate and usury ceilings are not touched because the actual Directive does not regulate this area.”

With this approach the Commission

- confuses the legal form of a Directive with the form of a Decree in breach of the distinction given in Art. 37 paragraph 2 3. of the Amsterdam Treaty and the rules of competence;
- cuts into existing national consumer protection legislation which has been developed under the minimum harmonisation principle;
- contradicts Art. 153 of the Treaty;
- introduces a reductionist understanding of “consumer protection” ;
- cuts across the principle of subsidiarity and cultural diversity underlying the European Union.

There may be a need for standardisation and this could be expressed in appropriate terms. In its present form, however, this Directive will directly undermine national consumer protection rules and thus reverse the EU tradition of strengthening consumer protection to compensate for a bigger market with increased inequality between individual consumers and banks operating at international level, which need to be balanced.

2.1.2 Minimum Harmonisation in the Amsterdam Treaty

2.1.2.1 Interpretation of Art. 153

Art. 153 of the Amsterdam Treaty states in clear terms the principle of minimum harmonisation as it applies to national consumer protection law:

"Member states cannot be prohibited to keep or develop stricter measures of consumer protection than provided for by paragraph 4"

The notion of "measures" covers all kind of actions, including legislative measures in the member states. The Commission itself addresses the articles contained in this Directive as “measures”. Art. 153 is only the most distinct expression of the high value the Treaty attributes to a high level of consumer

protection. The importance of Consumer protection as a driving force in European unification² and market integration is apparent in a number of other articles.

Art. 2 of the Treaty requires "harmonious, balanced and sustainable economic development" and sets the goals of "raising living standards and quality of life".

But this principle is embedded into a triangle of goals which are laid down in Art.3 of the Treaty.

Art. 3 paragraph 1 includes the following three objectives among the goals set for the European institutions: (c) free movement of capital and services, (h) harmonisation of the law and (t) consumer protection.

None of these goals can be directly sacrificed for the sake of the others. While the improvement of consumer protection and the free movement of capital and services are unconditional, the harmonisation of the law is not an objective as such, but a technical means of furthering the two other goals.³ Unlike the American process of unification, where the idea of a unified nation in a melting pot is prevalent and federal law dominates state law, Europe is built upon the principle of cultural diversity as a driving force for creativity and the protection of the cultural heritage. This principle is normally referred to as the **subsidiarity** principle. In the preface of the Draft for a new European Constitution "diversity in unity" is indeed the main principle governing the European Union of the future.

Consumer protection, especially in financial services, is part of this cultural heritage and art. 153 para. 5 is therefore a special homage to cultural diversity in consumer protection.

A good example of such cultural diversity can be found in usury law. As the Commission expressly states that national usury law is not affected by the present regulation, by implication it is only because the Directive does not regulate usury that national law will remain in force. This means that the Commission reserves a general right to itself to define which areas will be regulated at European level and which at national level. This is unacceptable and dangerous and violates the spirit and letter of the European Treaty.

However, not all consumer protection regulation is an expression of culture. As consumer protection can be divided into consumer protection in the form of information (protection of competition, information and rational choice) and social consumer protection (protection of culture and social standards), rules on the social protection of consumers require a special application of the minimum harmonisation principle. Informational rules in lending legislation, dealing with stating the truth, cooling-off periods, the duty to give fair and exhaustive advice, which have dominated the present Directive, address products which are already highly standardised in the European Union through the globalisation of the economy.

This is why harmonisation of consumer protection rules can neither be attributed to maximum nor to minimum principles, but must be based on the type of problems they seek to address. If they respond to

² vgl. Reichenbach, H. (1998) Aufgaben der Generaldirektion XXIV: Verbraucherpolitik und Gesundheits-schutz der Verbraucher, Neue Wirkungskreise, insbesondere nach dem Vertrag von Amsterdam, in: ZEuP, pp. 413, 417

³ Taschner, H.C. Mindestharmonisierung im Verbraucherschutzrecht – Stellungnahme zu Köndgen, in: Everling, U./Roth, W.-H. (1997) (eds) Mindestharmonisierung im europäischen Binnenmarkt, Nomos, Baden-Baden pp 159f, 173

the personal needs of consumers and their specific consumption patterns, they are linked to the culture of the nation concerned. If they are linked to transparency and price disclosure of standardised products, they have a more technical impact and should be standardised in order to make market control more efficient.

Informational consumer protection is therefore more open to standardisation than social consumer protection. The way variable rate credit is adjusted to market conditions, contracts are terminated, payments on arrears are compounded, default interest rates are capped or damages are calculated in case of default, or the way in which interest rate ceilings are regulated either on the basis of traditional usury law, including the prohibition of anatocism, or on the basis of modern concepts of law intended to cope with market failure, are variations which depend largely on the cultural heritage of each country.

The current proposal has entered the social consumer protection arena with a number of new rules, although the focus of the Directive will remain on information-based consumer protection. However, the Directive is weak in comparison with the abundance of national regulations on social consumer protection in continental European countries, which have historically always seen social rights to protect the vulnerable as the necessary counterpart of free choice on the market. These national rules are outlined in a recent report on national regulations concerning the prevention of overindebtedness⁴

National rules on social consumer protection differ significantly not only as far as their scope and intensity is concerned. They also have very different sanctions and actors. Some countries have a greater informal consensus on solidarity than others, some use administrations and others have an abundance of courts and judges, while others again have strong NGOs or central commissions in which all market players participate.

This is especially obvious in relation to interest rate ceilings. There is a tradition over more than 2000 years concerning usury in credit contracts, in which at least three significantly different approaches are used to serve the same goal of protecting consumers in the face of high and oppressive interest rates.

The Roman *laesio enormis* has been the basis for case law in Austria, Switzerland and Germany while France, Italy and Belgium as well as the Netherlands have implemented interest rate ceilings which express a less moral and a more macro-economic outlook, in which high interest rates are seen as an obstacle to the general productivity of small entities. Scandinavian countries seem to manage usury through their procedural mechanisms of a general bank moral and a tough consumer interest representation, because even without a ceiling they do not seem to have usury. On the other hand, the UK restricts the verdict of usury to a form of individual exploitation which in fact still allows interest rates in this market which would not be enforceable anywhere else. Instead the UK tries to limit these undesirable outcomes through more detailed supervision of financial services. In the USA, usury laws remain within the competence of national legislation, while truth in lending legislation is a matter for federal law. However, the national approach has weakened this legislation and led to its gradual abolition. The Calvinistic pro-credit cultures in the Anglo-Saxon countries, where there are virtually no rules on anatocism, usury and little social regulation on default, can be contrasted with the Catholic tradition of extensive credit regulation to protect individuals from overindebtedness.

⁴ Reifner, U./Niemi-Kieslinnen, J./Huls, N./Springeneer, H. Study of the Legislation relating to Consumer Overindebtedness in all European Union Member States - Contract Reference No. B5-1000/02/000353 - Institute for Financial Services e.V., Hamburg 2003

In its proposal, the Commission seems to acknowledge this fact as far as interest rate ceilings are concerned. It does not even try to harmonise these rules, although from a European perspective the difference between maximum interest rates in France for small business start-ups (less than 10% p.a.) and the UK (unlimited reaching as high as 500% p.a.) is certainly a significant obstacle to the free movement of capital and services which would need at least some harmonisation.

It is interesting to note that another DG of the Commission has now initiated a procedure against Italy. The Commission assumes that Italian usury law⁵ violates the free movement of capital because the usury rate seems to be too low for foreign competitors to invest in Italy.⁶

It does not, however, recognise that usury regulation is only a small fraction of social consumer protection rules for debtors in the member states. With its new provisions on early termination, variable rates, adjusted APR disclosure, which serves also as a yardstick for usury in many countries, it enters the realm of social consumer protection.

As total harmonisation does not distinguish between the different types of rules, it obviously also sacrifices cultural diversity in favour of unified markets. As social rights rely heavily on moral persuasion, it thus undermines the effectiveness of solidarity rules in the member states and will therefore not prevent overindebtedness but even weaken structures which act as a barrier to overindebtedness in most continental European states.

A comparison of European consumer bankruptcy schemes illustrates this cultural diversity. Different time periods for rehabilitation (between 3 and 7 years), differences in access (general access, minimum debts or minimum repayment facilities) and differences in the consequences (with or without discharge) as well as differences in ideology (punishment, re-education, fresh start or rehabilitation) show the different cultural basis of social regulation.

The Commission, which intends to provide debt prevention rules, may in fact thus cut into the social regulation of consumer credit as currently in force in France, Germany, the Netherlands, Belgium and the Scandinavian countries in particular. These effects may occur when courts, pleased to be able to reduce their workload, will decide that many more areas where national rules formerly applied are now covered by the Directive and thus no longer apply as a result of the principle of total harmonisation.

If the Commission intends to circumvent the application of the national control principle through total harmonisation, it is like the German saying of “*den Teufel mit dem Beelzebub austreiben*” (using Beelzebub to chase the devil away). Total harmonisation will tie down consumer organisations whose power lies in the national environment, thus lowering the potential for further development towards a higher level of consumer protection. These political effects are more significant than the legal effects of total harmonisation, which prevent suppliers from seducing small states into applying lower standards in order to attract big lenders.

⁵ Law N° 108 of 7. March 1996; Decree N° 394 of 29 December 2000 and Law Gesetz N° 24 of 24. February 2001

⁶ Press release of the European Union dated 25 July 2003

2.1.2.2 From consumer protection to consumer advantage: A dangerous policy shift in the European Commission

The Commission seems to reconcile its view of consumer protection with the argument that limiting consumer protection is to the advantage of the consumer. Liberalised services and the completion of the internal market are seen as a form of consumer protection in themselves, so that maximum harmonisation would not conflict with Art. 153. To implement Art. 59 (free flow of services) and Art. 3 paragraph 1(t) effectively would therefore suffice to justify maximum harmonisation and to promote the interests of consumers.

In its Green Book on "Financial Services: Protecting Consumer Interests"⁷ in 1996 as well as in its reply to the question of Amadeo (NI), Deputy to the European Parliament on 12 March 1997, expressing concern that the Commission would place consumer protection second to realisation of the internal market⁸, DG Internal Market stated:

"The Commission does not see consumer protection as a secondary or subordinated goal to the realisation of the internal market. Both goals are of equal importance, its implementation has to go hand in hand."

But it continues "If there were no advantages for the consumer - ... - the internal market would benefit only the suppliers of goods and services."

Implicitly in the Green Book, as well as in the reply, the notion "consumer protection" was replaced by "consumer advantage" as was also argued in legal doctrine where any harmonisation at all in this area was seen as impeding higher national consumer protection standards.⁹

In its 1998 action programme on financial services DG Market¹⁰ referred to the "user of financial services" while it continued to demand the "freedom of choice for consumers" and in the name of the "users/consumers" asks for the "abolition of all restrictions on cross-border consumer financial services". A "lean and modern framework of regulations" would be necessary. Transparency, less tax advantages and harmonisation of supervision¹¹ are seen as core elements going far beyond what consumer protection is about. Confusing users with consumers is not accidental. It shows that ideologically the Commission saw consumers merely as players in the market operating on the demand side who would profit from the best market in the same way as do suppliers.

But in fact the core element of consumer protection is "personal needs", which form the basis of consumption and which again underlies individual demand. These factors distinguish consumers from other players in the market, who merely seek to maximise their profit/advantages or minimise their costs, as opposed to satisfying their needs. Consumer needs require protection, while demand from

⁷ KOM (96)209

⁸ Amtsblatt C367, 4.12.1997 p.50

⁹ vgl. Taschner op. cit. ; Groeben in: Groeben/Thiesing/Ehlermann (1991) Kommentar zum EWG-Vertrag, 4th edn. Baden-Baden vol. 4, Anlage C Verbraucherpolitik (1991) Art. 100 margin no. 39; Köndgen, J. Mindestharmonisierung im europäischen Bankrecht – konzeptionelle Grundkagen – in: Everling, U./Roth, W.-H. op.cit. p 130

¹⁰ also "Finanzdienstleistungen: Abstecken eines Aktionsrahmens" KOM(1998) 625 final version 28.10.1998 pp.1/4

¹¹ also "Finanzdienstleistungen: Abstecken eines Aktionsrahmens" KOM(1998) 625 final version 28.10.1998 pp.2/4

other users may require information and support but not protection. In this respect, the Commission deeply misunderstood consumer protection and redefined it as a means to further the market as such.

In its 1998 action programme¹², the Commission compares national legal provisions primarily in order to ensure that the host country's regulations are "adequate".¹³ In its 1997 paper on "Financial Services: Strengthening Consumer Confidence"¹⁴ the consumer must have "the full benefit of the advantages of the internal market."¹⁵ "Strengthening of the role of the consumer"¹⁶, which can be achieved through further abolition of trade barriers identifies the "true consumer interest"¹⁷ which supposedly overcomes the distinction between consumer protection and consumer access to the benefits of the market. The 1999-2001 Consumer Policy Action Plan¹⁸ then goes a further step forward by distinguishing between "consumer interests at first glance" and "long-term consumer interests for long-term concerns for the environment and society".¹⁹

Consumer protection is now seen more as a question of practice and not of the law when information, education and advice as well as confidence in electronic payment devices, cross-border insurance brokerage and the introduction of the Euro have priority with the one single but interesting exemption in relation to overindebtedness.²⁰

The Green Paper on Consumer Protection in the European Union from 2 October 2001 addresses claims that "neither group is currently taking full advantage of the potential of the internal market" and proposes that

"the solution envisaged involves simplification of national rules and a more effective guarantee of consumer protection. Simplification of rules may also involve harmonising Community legislation in this area. The Green Paper also plans to identify the main areas for this harmonisation.

Simplification of existing rules and deregulation, where possible, can help both consumers and businesses. Reducing the burdens on businesses would increase their competitiveness, and consumers would have access to a greater choice of products at better prices."

Consumer protection and completion of the internal market are thus identified.

Consumer organisations, which are split in their orientation between test organisations and grass-root organisations, have failed to make clear that individual consumer protection and collective consumer advantages in the market are two different aspects and should carefully observe the integration of this new doctrine into EU law.

¹² also "Finanzdienstleistungen: Abstecken eines Aktionsrahmens" KOM(1998) 625 final version 28.10.1998 pp.2/4

¹³ also "Finanzdienstleistungen: Abstecken eines Aktionsrahmens" KOM(1998) 625 final version 28.10.1998 pp.3/4

¹⁴ KOM(97) 309 final version 26.6.1997

¹⁵ KOM(97) 309 final version 26.6.1997, p.3

¹⁶ KOM(97) 309 final version 26.6.1997, p.2

¹⁷ KOM(97) 309 final version 26.6.1997, p.4

¹⁸ 1.12.1998 KOM(1998) 696 final version

¹⁹ p.5

²⁰ p.19

2.1.2.3 From minimum harmonisation to standardisation: jurisprudence of the European Court

The European Court developed the principle of minimum harmonisation out of the exemption of the old Treaty for *ordre public* rules. In *Cassis-de-Dijon*²¹, national consumer protection had been accepted as a viable counterpart to the economic liberties of the EU Treaty.²² This principle was then called into question in *Keck*²³, *GB-Inno-BM*²⁴, *Rocher*²⁵ and *Clinique*²⁶, as well as in decisions concerning the German system of authorised tariffs in the insurance industry²⁷, in which national law was held to be in conflict with the principles of the Treaty, although the governments and industries concerned claimed that they defended national consumer protection.

Consumer organisations did ally themselves with the industries against which proceedings had been brought. In the insurance cases in particular, German consumer organisations instead took the Commission's view and actively asked for the abolition of such sham consumer protection laws, which were indeed laws to protect national industries and brands against foreign competition and consumer choice. The question which the court therefore had to decide was not whether national consumer protection could restrict the free circulation of goods and services, but whether such laws merited the label "consumer protection" or whether they were merely abusing this concept in order to close markets.²⁸

In its recent door-to-door selling decision²⁹, the court provides a strict minimum harmonisation interpretation to Art. 8 of the door-to-door selling Directive which "does not hinder national legislators in upholding or creating consumer protection laws in this area which are more in favour of the consumer than the Directive."

The court emphasises the same principle in Art. 15 of the Consumer Credit Directive³⁰, but it also states that such exemptions from the Directive have to be interpreted narrowly.³¹ In its ruling on

²¹ 20.2.1979 circular 120/78, collection 1979, 649 "Obstacles to movement in the Community resulting from the disparities between the national laws in question must be accepted in so far as those provisions may be recognized as being necessary in order to satisfy ... the defence of the consumer"

²² confirmed in den Oosthoek's Uitgeversmaatschappij 286/81 [1982] ECR 4575 (prohibition of package transactions with gifts in series' of dictionaries in the Netherlands); Buettner 328/87 [1989] ECR 1235 (prohibition of door-to-door sales of educational materials); expanded in Alpine Investment C 384 [1995] ECR I-1141 (where unsolicited telephone calls in financial services may also be generally prohibited under national legislation in order to protect the reputation of internal Dutch business)

²³ ECJ judgment dated. 24.11.1993 Refs C267/91 and C268/91 (published in EuZW 93, 770)

²⁴ Circular C362/88 dated 7.3. 1990, 1990 collection, I-667

²⁵ Circular C362/88

²⁶ Circular C-315/92 dated 2.2.1994 1994 collection, I-317 (EuZW 1994, 148)

²⁷ Circular 205/84 dated 4.12.1986 1986 collection, 3755; cf. also "Reinheitsgebot" Circular 178/84 v. 12.3. 1987 1987 collection, 1227

²⁸ Reich Europäisches Verbraucherschutzrecht, Nomos, Baden-Baden 1993 p 32): "The court thus becomes like a representative... the protector of what really means consumer protection..." Wilhelmsson Social Contract Law and European Integration, Dartmouth, Aldershot 1994 p 163); Plender The European Contracts Convention, The Rome Convention on the Choice of Law for Contracts, Sweet & Maxwell, London 1991 p 127; Hoffmann „Gerechtigkeitsprinzipien“ im Europäischen Verbraucherprivatrecht – Fortschreitende Privatrechtskodifikation als Teil des sozialen Europas, in Krämer, I./Micklitz, H./Tonner, K. Law and Diffuse Interest in the European Legal Order, Liber amicorum Norbert Reich, Nomos, Baden-Baden 1997 pp 291 ff, 297 ff; Hondius Consumer Law and Private Law: Where the Twains shall meet, in: Krämer EWG-Verbraucherrecht, Nomos, Baden-Baden 1985 p 311 f

²⁹ ECJ 13.12.2001 circular C-481/99 (door-to-door sale) no. 7

³⁰ op. cit. no.10

personal guarantees and the scope of application of the Consumer Credit Directive, the court³² again applied this narrow interpretation and held that guarantors do not fall within the scope of the Consumer Credit Directive but leaves it to national legislation apply these standards to guarantors.

A different attitude could be implied from the decision on the Directive on bank safety systems for investors. In this instance, the court³³ ruled that the Dutch system of bank safety was in fact lowered by the Directive because

"consumer protection is only one goal of the community and apparently not the only one. Because the Directive tries to further the freedom of services and settlement in the banking sector which without doubt require a high level of consumer protection the treaty does not require always to choose the highest level of consumer protection of all member states. "

But the court did not decide that the Dutch government could not give a higher level of safety to their national consumers in the Netherlands. It only had to decide whether Dutch banks could ask for equal treatment with foreign banks in supervisory law where the third banking Directive has already implemented the national control principle. Consumer protection law is basically private law which does not hinder different levels of bank supervision.

Similar arguments affect the court's *Alpine Investments BV* decision³⁴ concerning admission to the bonds market in the Netherlands. Laws which are "related to consumer protection issues or the protection of the financial services sector in the Netherlands"³⁵ may still conflict with the "free service requirement" of Art. 59.³⁶ As Dutch investment companies suffered from the prohibition of certain marketing methods, the court weighted its impact on their cross-border activities. But it also referred to the *Peralta Case*³⁷ stating that it is no infraction of Art.59 as such if one state upholds stricter rules than another state for similar services.

Art. 159 therefore represents a principle equivalent to that contained in Art. 59 in financial services. It justifies national legislation which gives more protection to consumers in general. But its effects on the market have to be balanced against its achievements. This is why whether consumer protection or protectionism prevails can be decided on a case by case basis.

2.1.2.4 Social consumer protection in credit contracts as a national cultural asset

Consumer protection, especially in consumer credit contracts, was mentioned in the Old Testament of the Bible as well as in the Koran, and is not merely an economic principle. It is certainly not the same as an "economic advantage" for consumers. Social consumer protection, like restrictions on credit licensing, on default interest, on payments after default, on credit marketing and credit brokerage or special judicial rights to levy the burden of debts, is much more than an advantage or a benefit to the consumer. It forms part of social relations and protects the effective income of consumers. It is therefore

³¹ op. cit. no.31 with reference also to ECJ, judgment dated 10.5.2001- - Circular C-203/99, Collection. 2001, I-3569 Tz.15 - Veedfald

³² ECJ 23.03.2000 circular C-208/98 (personal guarantee)

³³ ECJ 13.05.1997 C - 233/94

³⁴ ECJ 10.05.1995 circular C384/93 (Alpine Investments BV)

³⁵ Op.cit. no. 3a

³⁶ Op.cit. no.37

³⁷ ECJ July 14, 1994 C-379/92, Peralta, collection 1994, I-3453,n. 48 FIS <21291>

one of the principles in the Treaty which are derived from the subsidiarity principle, which upholds cultural diversity in the process of economic integration.

This kind of consumer protection needs to be adapted to different situations in different countries where different practices and structures create quite different hazards for consumers. Unless one would argue for a unified European society in language, habits and preferences, European harmonisation in this area cannot set the pace and take over the task of finding the right way to best practice. It must always refer to national developments and extend the best of it to those who have nothing by trying to keep up a minimum standard in all countries alike.

If, for example, in Sicily, small amounts of illegal credit are still a significant threat to consumers, the Italian legal order must provide tools adapted to cope with the problem. The position of consumers in the UK, where tallymen sell consumer credit on the doorstep, is different from that in most of the continental member states, where consumer credit is a legal monopoly of the banks. If, for example, the judge in France or in Finland has enormous power to make stop-payment orders where the debtor is in need, or if strict and effective consumer bankruptcy procedures exist as in Belgium, the Netherlands or Sweden, substantive consumer protection law must differ significantly from countries like Greece, Italy and Spain where no such regimes exist, or Austria and Germany where debt relief is difficult to access because of the long repayment periods. Economic differences are also important in Germany, where brokers play an insignificant role in consumer credit because many banks, especially the Savings Banks, do not co-operate with them, while in other countries they have a strong and sometimes irritating role. There are also important differences in relation to self-regulation. In smaller countries like the Netherlands, Belgium and Denmark, there is direct contact between consumer organisations and banks which allows for self-supervision. France has institutionalised such communication in its Credit Council, while other countries have no mechanisms for solving problematic structural deficits autonomously and therefore need stricter regulation of state supervision. In Germany, with its unique structure of 1200 state-subsidised debt advice agencies and about 400 consumer finance advice agencies, strict consumer protection laws in consumer credit are an important pre-condition for fruitful out-of-court settlements where banks factor in the cost of court procedures.

Consumer protection is therefore more than a consumer benefit. The Treaty itself makes a clear distinction between these two notions. Art. 81 and 82 refers to consumer benefits. In this rule on cartels, the financial advantage created by authorised cartels must be evenly distributed to consumers while it refers to consumer protection in Art. 153.

Consumer protection remains a special goal which is based on the diversity of national cultures.

2.1.3 Consumer Rights in National Legislation capped through the Maximum Harmonisation Principle

A look at the practical consequences of the new principle can further clarify how important it is to defend cultural diversity in the area of national consumer protection. The proposal claims that, within the scope of its regulation, in consumer information in particular, it provides a maximum of consumer protection in relation to current national legislation. However, this assumption is not totally justified.

Consumer information rights have arisen in national legislation independently long before or at the time of the enactment of the EU Directives, guaranteeing a wider range of information than the Directive provides. This was made possible by the minimum harmonisation principle in Art. 15.³⁸

It is only in some states, where the level of consumer indebtedness is still fairly low, that the new Directive will increase consumer rights. These states, such as Greece and Portugal, had no consumer protection legislation of their own, prior to introduction of the Consumer Credit Directives, and incorporated the Directives one by one into their national law³⁹.

2.1.3.1 Product information

There is still no comprehensive regulation of product information at European level. Instead, the efforts of several European countries at national level have already gone much further.

In France, for example, since the “*MURCEF Law*”⁴⁰ was passed, it has been compulsory to provide consumers with written terms and conditions when they open an account and any changes must be notified three months before they come into effect. Simply displaying general terms and conditions in the credit institution concerned no longer suffices.

However, the duties of life insurance providers in Great Britain go much further. They must make “Key Features” available to consumers prior to conclusion of the agreement and, where distance selling is involved, the documents must be sent to consumers within five working days. These “Key Features” were drafted by the Financial Services Authority⁴¹. Every insurance company must use the same format. The objective is to enhance competition by improving product comparability, but at the same time there is an explicit attempt to assist consumers to gain an improved knowledge of the product and to ensure that it is possible to compare the products of different companies. In addition to the purely factual contents of the “Key Features”, they also include the necessary information about them, frequently in the form of questions and answers. For example, there is an explanation that growth rates only represent examples and that they are dependant on future growth. They explain that there is a risk that an insurance agent may highly recommend a product because it pays him/her the highest commission and they set out the effect of costs on the investment. If these “Key Features” are indeed read by consumers, they promote their level of financial literacy because the statements they contain are simply expressed and understandable to “the man in the street”, and they provide information about all significant aspects of life assurance policies.

2.1.3.2 Information as to rights

Most national legislation relating to consumer credit includes already a right of withdrawal and in addition a provision for consumers to be advised of that right in the body of the agreement. In France, art. 311-15 *Code de la Consommation* also provides, in addition to information as to the existence of the right of withdrawal, for a detachable form in the credit agreement (*offre préalable*) for exercising it. This

³⁸ Art. 15 of Directive 87/102/EEC

³⁹ Domont-Naert, Johnson: Limits & Effectiveness of the Law – An Introduction in: Consumer Debt in Europe – The Birmingham Declaration, p. 26.

⁴⁰ Act no. 2001-1168 of 11 December 2001.

⁴¹ http://www.fsa.gov.uk/consumer/shop_around/products_services/mn_insurance_info_get.html.

relieves consumers of the need to formulate the notice of withdrawal themselves, something which is often difficult for non-lawyers to do. All consumers have to do is fill out the form, sign it and send it to the lender. The legal technicalities involved in the exercise of a right are also prescribed in other jurisdictions. For example, in Germany, § 692 I no. 5 ZPO (*Zivilprozessordnung* – Civil Proceedings Rules) contains a form for defending a writ. Existence of such forms lowers the barrier to exercising the right of withdrawal⁴². It is made easier for consumers to exercise their right to withdraw. In France, use of the form is not, however, compulsory; consumers may also withdraw from the agreement by using their own letter, the only requirement being that it must make clear that they wish to withdraw⁴³. The form therefore has only advantages for consumers. It makes withdrawal easier and, for less well-educated consumers in particular, it amounts to an improvement in the enforcement of their rights. Addition of a form also suggests to consumers that exercise of the right is not unusual, reducing psychological barriers.

2.1.3.3 Information as to price and costs

Because current European Directives, the new draft Consumer Credit Directive and the Code of Conduct on pre-contractual information relating to home loans already require or at least mention comprehensive information about the cost of credit. However, national legislatures have still found some scope for adding to these provisions:

2.1.3.3.1 Net amount of credit

In Germany, under § 492, para.1 no. 1 *BGB*, the net amount of credit must be stated. Under § 491 II no. 1 *BGB* the legal definition is given as the actual amount of credit paid to the consumer⁴⁴. This clarifies to consumers the common practice of deducting some of the costs and fees from the amount of the loan before it is paid over. The net amount of credit enables consumers to compare the amount they have to repay with the amount they actually receive. The difference between the total amount of the instalments to be paid and the net amount of credit corresponds to the total amount paid by consumers for credit⁴⁵. However, this tells consumers nothing at all about the actual commitment they are taking on in relation to their liquidity, so it is of little significance in terms of the prevention of overindebtedness.

2.1.3.3.2 Rate of interest on arrears

Art. 14 § 3 no. 11 of the Belgian Consumer Credit Act⁴⁶ requires that the default interest rate be stated. Such information as to the consequences of breaches of the agreement gives consumers information precisely in situations of crisis. Stating of the rate of interest on arrears makes clear to consumers that their debt will continue to mount up if they fail to make payments on time.

⁴² Kemper: Verbraucherschutzinstrumente, p. 376; Calais-Auloy: Le Crédit à la Consommation en France, p. 110.

⁴³ Calais-Auloy: Le Crédit à la Consommation en France, p. 110; Pétel-Teyssié: Prêt à intérêt, no. 111.

⁴⁴ cf. Bülow: Verbraucherkreditgesetz, § 4 margin note 64.

⁴⁵ Bülow: Verbraucherkreditgesetz, § 4 margin note 68.

⁴⁶ Act of 12 June 1991 relating to consumer credit.

2.1.3.3.3 Amount of deposit

In Belgium, where a purchase is made by instalments, the amount of any deposit due must also be stated⁴⁷. This information is of considerable importance to consumers, because payment of this deposit is usually a condition for the loan. If the deposit cannot be paid, the loan is not made. For precisely that reason, this information is less important in the prevention of overindebtedness through information. If consumers cannot pay the deposit, the loan will not be made and cannot therefore lead to overindebtedness. If the consumer is already in a situation of overindebtedness, and cannot therefore pay the deposit, overindebtedness has nothing to do with the loan in respect of which the deposit was to be paid.

2.1.3.4 Formal requirements

With regard to formal requirements, in addition to what is prescribed by the proposal national legislatures have introduced a series of different formalities in terms of written form and certification, applicable to various types of transaction and in different situations, in addition to those only prescribed by European law.

2.1.3.4.1 Additional two weeks on delays in payments

In Germany, under § 498 para.1, sub-para.1, no.2 *BGB*, lenders must allow borrowers a two-week extension in the event of a delay in payments of a consumer loan to enable them to make up the outstanding amount. This amounts to a suspension period. Lenders may only terminate the agreement upon expiry of this period. Lenders must send a notice stating that the total amount outstanding (previously not due for payment) will be demanded if the borrower does not pay the arrears within the time limit.

This notice gives consumers the opportunity to reflect on the consequences of their default to the extent that the time allowed makes possible reflection and comparison and this could give rise to a form of self-teaching. But this represents an ideal situation which would not arise in reality. Threats to terminate loans do not in most cases lead to financial literacy.

2.1.3.4.2 Offer of discussion where there are arrears

Simultaneously, where there are arrears, lenders in Germany must offer borrowers the opportunity of a discussion (§ 498, para.1, sub-para.2 *BGB*). This enables borrowers to explain their circumstances and breaks down their natural tendency to shy away from discussions with lenders. The contents of these discussions are, however, as unregulated as are the penalties for failing to offer them at all. Offering a discussion does not operate to validate a notice of termination for default⁴⁸. However, the underlying motive of bringing the parties together before termination of the agreement because of arrears, with a view to investigating potential ways of resolving the situation, makes a great deal of sense. This is further supported by the fact that information is made available to consumers at the very time when they most need it⁴⁹. This right thus presents one of the few forms of information targeted at consumers in

⁴⁷ Art. 41 no. 3 of the act of 12 June 1991 relating to consumer credit.

⁴⁸ Palandt: Gesetz zur Modernisierung des Schuldrechts. § 498, margin note 8.

⁴⁹ cf. Whitford: The Functions of Disclosure Regulation in Consumer Transactions, p. 264.

crisis. If such a discussion were in practice constructively carried out, it would be a perfect opportunity for educating consumers and potentially providing them with protection from overindebtedness, assuming it were not already too late.

2.1.3.4.3 Notarisation

Although not inside the EU Swiss law may also be pointed to as a potential model of another national legislation, where guarantees above 2000 Swiss francs must be certified by a notary public in accordance with art. 493 II *Obligationenrecht* (the Law of Obligations). Combined with the warnings and the evidential aspects generally associated with formal requirements, the purpose of this provision is to ensure that guarantors receive advice as to their rights⁵⁰. This is very much to be welcomed, especially for personal guarantees which are fraught with danger and can have incalculable consequences. However, this does involve additional costs⁵¹, usually borne by the borrower. The extent to which notarisation really ensures that the transaction is explained is also questionable. Certainly, the process should verify that the agreement accords with the actual wishes of the parties⁵², but ultimately it is impossible to explore the basis of those wishes and whether in fact the parties are clear about the possible consequences of a guarantee.

2.1.3.4.4 Hand-written endorsement

While the Directive will even allow a mouse click in France, art. 313-7 of the *Code de la Consommation* requires a handwritten declaration, whose text is prescribed by law, in order for a guarantee to take effect. Failure to observe this requirement renders the guarantee null and void⁵³. It is intended that this will make guarantors aware of the significance of the transaction and the seriousness of the situation⁵⁴. No deviation from the statutory formulation of the text is permitted⁵⁵. Guarantors must state that they are prepared to be held liable for a specified amount, for the payments, interest, penalties for breach and interest on arrears should the principal debtor default and the text is kept short enough for it to be written out without taking an inordinate amount of time⁵⁶. Guarantors are simultaneously given the substantive contents of the guarantee. The extent of their potential liability is made clear, as well as the fact that their entire income and assets are at risk. In addition, having to write out the declaration ensures that guarantors have really taken notice of this information, and it is done without additional cost.

The use of hand-writing is also used in France in purchases by instalment, where the borrower waives the right of withdrawal in order to have immediate delivery of the goods purchased (art. 311-24 *Code de la Consommation*). The waiver must, in addition to the express wish to have immediate delivery, contain a declaration as to awareness of the reduction of the period for withdrawal to three days from a

⁵⁰ Hofmeister: Rechtssicherheit und Verbraucherschutz – Form im nationalen und europäischen Recht, p. 43.

⁵¹ Kemper: Verbraucherschutzinstrumente, p. 223.

⁵² Hofmeister: Rechtssicherheit und Verbraucherschutz – Form im nationalen und europäischen Recht, p. 45.

⁵³ Pétel-Teyssié: Prêt à intérêt, no. 122.

⁵⁴ Kemper: Verbraucherschutzinstrumente, p. 223.

⁵⁵ Pétel-Teyssié: Prêt à intérêt, no. 122.

⁵⁶ The wording of the original is as follows: "En me portant caution de X..., dans la limite de la somme de ... couvrant le paiement du principal, des intérêts et, le cas échéant, des pénalités ou intérêts de retard et pour la durée de ..., je m'engage à rembourser au prêteur les sommes dues sur mes revenus et mes biens si X... n'y satisfait pas lui-même."

maximum of seven days (=the usual period for withdrawal under art. 311-15), ending upon delivery of the goods⁵⁷. This is a formal requirement which goes beyond the formalities prescribed by European Directives, but in general terms it leads to a restriction on the period for withdrawal which has not hitherto been envisaged by the Consumer Credit Directives and which therefore remains permissible.

In Belgium, handwriting is even required to a limited extent for conclusion of a consumer credit agreement. Consumers must not only sign the credit agreement, but also write under their signature the words “read and approved foreuros on loan⁵⁸”.

2.1.3.4.5 Statutory contract forms

In addition, financial service providers in a number of countries⁵⁹ are obliged to use statutory forms of contract which will be threatened if the maximum harmonisation principle gets through. Its aim is to improve comparability of products by prescribing that certain minimum items of information can be found at the same place in the contract, thus ensuring that, if contracts are set side by side, they can be compared at a glance⁶⁰.

In the case of the “*offre préalable*”, prescribed in France and Belgium in relation to consumer credit, lenders are compelled to make potential borrowers and guarantors (assuming they are a natural person) a binding offer in writing and in duplicate. The lender is bound by this offer for 15 days⁶¹. Unlike under current European law which the proposal intends to improve, those providing security are given the same information as the borrowers themselves. The “*offre préalable*” must contain a number of items of information. In France, this binding offer is subject only to acceptance of the borrower personally⁶², which in practice is usually the case.⁶³ Acceptance of the *offre préalable* otherwise gives effect to the agreement⁶⁴. In addition to the prescribed form of the contract in France, art. R. 311-6, para.2 of the *Code de la Consommation* requires that it be clear and legible and in a minimum of font size 8. This demonstrates that even statutes are able to affect the design of contracts. A compulsory minimum font size is feasible for all contracts and would at least introduce a verifiable minimum standard in terms of clarity of presentation.

Use of standard forms of agreement can thus give consumers a fundamentally improved picture of the information with which they must be provided.

⁵⁷ Pétel-Teyssié: Prêt à intérêt, no. 109.

⁵⁸ Art. 17 of the Act of 12 June 1991 in relation to consumer credit: “lu et approuvé pour ... euros à crédit” or “Gelezen en goedgekeurd voof ... euro op krediet”

⁵⁹ Eg. France and Belgium.

⁶⁰ Calais-Auloy: Le Crédit à la Consommation en France, in: Hörmann: Verbraucherkredit und Verbraucherinsolvenz, p. 108; Kemper: Verbraucherschutzinstrumente, p. 207; cf. ; Bräunig: Der Konsumentenkredit im französischen Recht, p. 60.

⁶¹ France: Code de la Consommation, art. L.311-8; Belgium: Act of 12 June in relation to consumer credit, art. 14 § 1; Calais-Auloy: Le Crédit à la Consommation en France, in Hörmann: Verbraucherkredit und Verbraucherinsolvenz, pp. 107f.; Bräunig: Der Konsumentenkredit im französischen Recht, p. 58.

⁶² Code de la Consommation, art. L.311-15; Calais-Auloy: Le Crédit à la Consommation en France, in Hörmann: Verbraucherkredit und Verbraucherinsolvenz, p. 111; Pétel-Teyssié: Prêt à intérêt, no. 105.

⁶³ Calais-Auloy: Le Crédit à la Consommation en France, in Hörmann: Verbraucherkredit und Verbraucherinsolvenz, p. 112.

⁶⁴ Code de la Consommation, art. L.311-15.

2.1.3.4.6 Cooling-off periods

In France, lenders must send a written offer by post, free of charge to prospective borrowers and guarantors (assuming that they are natural persons) in the case of loans secured on real estate, and that offer must contain specified information⁶⁵. The offer cannot be accepted by the prospective borrower before the expiry of 10 days following receipt of the offer⁶⁶. Consumers are thus compelled to have a cooling-off period. This procedure is feasible at least in relation to larger loans. It also entails a certain amount of coercion of consumers. However, where loans are secured by a charge over land, which are in any case subject to some delay because of the various formalities involved, a compulsory cooling-off period could force consumers to consider the seriousness of their decision and encourage them to make careful product comparisons. This could prevent impulsive borrowing and thereby potential overindebtedness through making premature commitments.

2.1.3.4.7 Express warnings

In Belgium lenders must add to the amount written down by borrowers adjacent to their signature, in a separate line and in bold type, the following sentence: "Never sign an incomplete contract"⁶⁷.

In Great Britain, consumers must be warned in wording prescribed by the Secretary of State and contained in information handed out prior to conclusion of the agreement, that they must be sure, before entering into the agreement, that they are able to repay the sums borrowed⁶⁸.

Although both of these warnings certainly contain important statements and the Belgian one at least, because of where it is and its bold type, is more likely to be noticed by the consumer, it is still questionable whether these simple warnings will be taken seriously, or whether they will merely be dismissed as a burdensome formality. Moreover, this form of emphasis on a single warning notice creates the hidden danger that all other information will be perceived as being of lesser importance and thus hardly taken into account at all.

Art. 14 of the "*loi MURCEF*"⁶⁹ from 11 December 2001, modifying art. L.311-9 of the *Code de la Consommation* requires that all cards enabling consumers to borrow at a time of their choosing must be defined as "credit cards" (*cartes de crédit*). This provision is intended to protect consumers from taking out unintended loans in the form of the ever-increasing numbers of in-store cards and cards issued by other lenders.

2.1.4 Standardisation instead of Total Harmonisation

A general statement which requires total or maximum harmonisation for national consumer credit legislation, and especially social consumer credit legislation, contradicts not only Art. 153 no. 5 but also

⁶⁵ Code de la Consommation, art. L.312-7, L.312-8.

⁶⁶ Kemper: Verbraucherschutzinstrumente, S. 227; Code de la Consommation Art. L.312-10.

⁶⁷ Art. 14 § 4 no. 2 of the Act of 12 June 1991 in relation to consumer credit: "Ne signez jamais un contrat non rempli".

⁶⁸ Consumer Credit (Quotations) Regulations 1989, Schedule 1, no. 18: "Be sure you can afford the repayments before entering into a credit agreement."

⁶⁹ Act no. 2001-1168 of 11 December 2001.

the spirit of the Treaty and the principles of subsidiarity and cultural diversity which underline the European unification process. Art. 30 N° 1 should therefore be eliminated from the draft of the Directive.

Maximum or total harmonisation of consumer protection on the EU level is effectively forbidden by the Treaty. If, for the sake of more market interchange between member states, more harmonisation is necessary, the Commission must seek to achieve these objectives indirectly by standardising the rules which concern the product itself and how it is presented to the consumers. If, for example, products are standardised terms of the costs elements which have to be disclosed, this will certainly affect consumer protection legislation indirectly. This is acceptable with the regulation of the Treaty itself. Because such unified consumer legislation standardising financial products has the same effects as a Europe-wide cartel, Art. 81 and 82 of the Treaty should be applied by analogy to the extent that this standardisation should be allowed only if it is necessary for the reasons mentioned in Art. 81 and only if “the consumers get a fair share” of its outcome.

A general maximum harmonisation approach in national consumer protection law is in conflict with the letter and spirit of the European Treaty. Consumer protection is a national cultural asset which has the same value as the principle of the free flow of services and capital. Art. 153 no.5 protects diversity as a special expression of the subsidiary principle. A Directive which in general contradicts this principle is not valid. In addition to this principal objection, the wording of the maximum harmonisation principle is so broad that it will be impossible for local jurisdictions or national legislators to establish which areas are covered and thus excluded from national consumer protection provisions, and which are not. The Directive lacks the necessary legal certainty.

Instead of maximum harmonisation, the Directive could emphasise the standardisation of credit product rules, the effect of which will also directly benefit consumers. Europe-wide standardisation of this nature is always possible if it neither affects consumer protection (the technical rules) or the technique, the appearance and the marketing of consumer credit products. Informational consumer protection could therefore be standardised. Furthermore, articles which create institutions or licenses should be standardised because, under the national control and mutual recognition principle, consumers would otherwise be confronted with a multiplicity of differently supervised and licensed foreign institutions in their own country.

However, standardisation in this form should be left to private bodies such as the ISA or DIN, which have more experience and effective means for further harmonising market conditions than the European Commission.

If the Commission also makes the form of a legal information sheet compulsory, the requisite standardisation would at least be achieved in the most important area of consumer information.

2.1.4.1 Free flow of services and capital requires standardisation not maximum harmonisation

Closer scrutiny of Art.30 n.1 of the Draft Directive suggests that the Commission in fact intends to achieve standardisation, not maximum harmonisation, but fails to express this properly. It is not rules more favourable to consumers than the rules contained in the Directive that are forbidden, but all rules which “*differ*” from the rules in the Directive.

In the deliberation on the “impact of the proposal on business”, the Commission argues that “credit offers will become easier to compare as a result of being standardised.” This is certainly necessary where technology plays an important role, so that in the recently passed Directive on Distance Selling of Financial Services, no. 5 of its deliberations reads:

“Given the high level of consumer protection in this Directive, member states will not be allowed to make rules other than the rules enacted in the area of harmonisation given by this Directive.”

The same reason has already formed part of a draft mortgage Directive, where, instead of a maximum harmonisation principle, the Directive provided that national legislation should not discriminate against “financial techniques” which, in accordance with EU-law, were allowed and used in another member state. This approach has also been widely supported in the literature which, in the name of the freedom of services, asked for the extension of the national control approach to banking supervision in the third banking Directive to be applied to private law and consumer protection as well. Unlike this draft, however, it was generally claimed that the standardisation of products was necessary, but not limits on national consumer protection.

The free movement of services and capital may be substantially advanced by standardisation. As financial products are highly dependent on the law (some even argue that credit, investment and insurance are basically the sale of rights and duties), the design of the product depends to a great extent on the law governing the sale of such products.

If the appearance of the product is regulated by national law then it will be difficult to market it in another country.

Although the level of consumer protection may be very much the same, some products may be excluded from the market only because they do not comply with the techniques proscribed in the host country for the sake of consumer protection. Consumers may therefore not have the opportunity of enlarged choice between national and foreign products, and this reduces the potential for competition.

Standardisation may therefore be necessary to allow similar products to be marketed in all countries. But this standardisation only concerns the product and its appearance.

This means that informational consumer protection as regulated in particular in articles 10,12 and 14 would be the prime candidate for standardisation because these articles govern the image and the marketing of the product.

Moreover, articles requiring member states to introduce additional supervision of credit brokers (Art. 28) or a database of payment defaults () or the introduction of out-of-court settlement institutions (Art. 32), are in fact regulations concerning banking supervision and therefore underlie the principle of mutual recognition and national control in the third banking Directive. In this area, standardisation is necessary in the interests of consumers, because consumers need to know which form of control is also exercised on the foreign supplier and what preconditions he or she can assume.

Some of the instances of standardisation do not involve maximum harmonisation but are already regulated in specific norms, so that a general standardisation principle is unnecessary. Two techniques

can be mentioned: the minimum is already the maximum possible consumer protection in this area, as in all instances of totally prohibited practices, such as in door-to-door sales. The other technique concerns rules which leave the technique up to the national legislator, defining only objectives and required outcomes. In this type of regulation, such as the provision for a cooling-off period, maximum harmonisation could only affect objectives and outcomes, which would be difficult to assess.

2.1.4.2 Limits of Standardisation

On the other hand, social consumer protection in terms of the contents of the contract, especially with respect to consumer rights after the contract has been concluded, do not need such standardisation. Consumer protection relating to insolvency, delays, debt adjustment, default interest, usury, interest rate ceiling and which has been defined as "social consumer protection" needs only minimum requirements of consumer protection in all member states.

In this area, member states have quite different philosophies in their regulation. In Belgium and France, a "solidarity approach" prevails, in which the State supervises the manner in which debtors are treated, in Germany and Austria a meritorious and moralistic approach gives relief to debtors who try hard to keep up with their payments, in the UK and Italy a more liberal view of debtors as small entrepreneurs is apparent, while in the smaller states a community approach tries to allocate responsibility to creditors for coping with these problems and offering amicable solutions.

The Commission has its own approach to overindebtedness, which is very much based on informational theory, assuming that information about high-risk debtors for creditors and information about high-risk transactions, combined with some supervision of professionals will solve the problem. This assumption has not yet passed the test of effectiveness in national legal systems. In the USA in particular, long experience suggests that such an approach has little effect on levels of overindebtedness, while more substantive regulations in Sweden, Finland, France and the Benelux countries have neither hindered the banks in marketing their products nor created a significant amount of abuse, but they have, on the other hand, kept the level of overindebtedness relatively low.

The Commission cannot therefore claim to have the ultimate and only remedy to such problems. It should also resist the temptation to standardise these measures and attempt to starve them before they can flourish, in the interest of promoting creative developments in Europe in an area where the American counterpart seems to have lost any ideas for solutions.

2.1.4.3 The Procedure for Standardisation

Standardisation does not need a Directive but could be implemented through self-regulation if the Directive were to set general principles of transparency and information referring for its form to procedures like ISA or DIN, in which suppliers themselves standardise the way this information is given to consumers. Such norms could have a legal presumption of fulfilling the requirements of the Directive.

2.1.4.4 Effects of General Standardisation on Consumer Protection

The following table gives a rough overview about the areas which could be standardised.

	Consumer Credit Directive 2002	National Legislation	National Legislation has more/less consumer protection	Standardisation?
RATIONAL CHOICE				
Duties to indicate costs elements	Nearly complete list	less exhaustive list	less information on the national level	yes
APR calculation	Integrated approach (combined products)	no clear legislation, piecemeal	less	yes
Cooling-off	open requirements	different solutions in the frame of the Directive	no difference in substance	yes (with openness to techniques)
Door-to-door-sale	Prohibition	partly prohibited, part right to rescind	maximum is minimum	not necessary
SUBSTANTIVE PROTECTION				
Limitations on arbitrary Variable interest rates	certain clarification	more regulation in F on such clauses	more	no
Protection of Guarantors and Co-Liability	Information rights and limitation for unlimited contracts	strict rules on family guarantors in D, A, S, UK	more	no
Default Interest Rate	No	Limitations (ceilings; anatocism; repayment rules to cover capital first)	more	no
Protection against abrupt termination of the contract	No	bona fide jurisprudence, delays	more	no
Refinancing	No	Prohibition to exploit difficult situations (D, SF, F)	more	no
Insolvency rules	no EU regulation	nearly all countries have different individual bankruptcy schemes	more	no
SCOPE of APPLICATION				
Mortgage Loans	No	most countries apply consumer credit legislation to mortgage loans	more	no

	Consumer Credit Directive 2002	National Legislation	National Legislation has more/less consumer protection	Standardisation?
Linked Products	broad application	less broad application	less (the new minimum is already a maximum)	no
Exemptions	Significantly reduced in the Draft	have been reduced in the member states before	similar (minimum is maximum)	not necessary
Professions	No rules	credit monopoly for banks in most countries but UK, IRL and B	more	no

2.2 Regulation of the Interest Rates

2.2.1 The different regulations

The regulations governing the disclosure of the different interest rates could be significantly improved. There are two mathematically contradictory definitions of interest rates and three different interest rates to be disclosed, which are referred to in a number of different articles in a way that lenders and consumers will find difficult to understand and apply properly. This report sets out these different and diffuse rules and presents a model for simplification of the approach to make it more consistent with economic development from mere consumer credit to financial services packages.

The Directive provides quite exhaustive regulation of interest rates, as shown in the following overview

APR Definition Cost Approach	Art. 2 letter h) “annual percentage <i>rate</i> of charge” means the total cost of credit to the consumer expressed as an annual percentage of the total amount of credit granted;
APR Definition Cash Flow Approach	Art. 12, 1. The annual percentage <i>rate</i> of charge, which equates, on an annual basis, the present value of all commitments (drawdowns, repayments and charges), future or existing, agreed by the creditor and the borrower, shall be calculated in accordance with the mathematical formula set out in Annex I. Examples of the method of calculation are given in Annex II, by way of illustration.

APR Calculation: Cash Flow Approach	<p>Art. 6 para. 2. Letter h) the annual percentage <i>rate</i> of charge and the total lending <i>rate</i>, by means of a representative example mentioning all the financial data and assumptions used for calculating the said <i>rates</i>;</p> <p>Art. 10 para. 2 letter b) the data referred to in Article 6 (2), with the annual percentage <i>rate</i> of charge and the lending <i>rate</i> calculated at the time the credit agreement is concluded on the basis of all the financial data and assumptions applicable to the agreement;</p> <p>Art. 20 n.3 2nd sentence: The annual percentage <i>rate</i> of charge and the total lending <i>rate</i> shall be calculated on the basis of the total commitment subscribed to by the consumer.</p>
APR Calculation: Cost-Approach	<p>Art. 12 no.2. For the purpose of calculating the annual percentage <i>rate</i> of charge, the total cost of the credit to the consumer shall be determined, with the exception of charges payable by the consumer for non-compliance with any of his commitments laid down in the credit agreement and charges other than the purchase price which, for purchases of goods or services, he is obliged to pay whether the transaction is paid in cash or on credit.</p> <p>The costs of maintaining an account recording both payment transactions and credit transactions, the costs of using a card or other means of payment for both payment transactions and drawdowns, and the costs relating to payment transactions in general shall be regarded as credit costs unless they have been clearly and separately shown in the credit agreement or in any other agreement concluded with the consumer.</p> <p>Costs relating to insurance premiums shall be included in the total cost of the credit if the insurance is taken out when the credit agreement is concluded.</p> <p>Art. 20 no. 3. Payments, premiums and recurrent or non-recurrent charges payable by the consumer under the ancillary agreement referred to in paragraph 1, together with interest and charges under the credit agreement, shall constitute the total cost of the credit. The annual percentage <i>rate</i> of charge and the total lending <i>rate</i> shall be calculated on the basis of the total commitment subscribed to by the consumer..</p>

<p>APR Calculation: Cash Flow</p>	<p>Art. 12 3. The calculation of the annual percentage <i>rate</i> of charge shall be based on the Assumption that the credit contract will remain valid for the period agreed and the Creditor and the consumer will fulfil their obligations under the terms and by the dates agreed</p> <p>4. In the case of credit agreements containing clauses allowing variations in the borrowing <i>rate</i> contained in the annual percentage <i>rate</i> of charge but unquantifiable at the time of calculation, the annual percentage <i>rate</i> of charge shall be calculated on the assumption that the borrowing <i>rate</i> and other charges will remain fixed in relation to the initial level and will remain applicable until the end of the credit agreement.</p> <p>5. Where necessary, the following assumptions may be adopted in calculating the annual percentage <i>rate</i> of charge:</p> <p>a) if a credit agreement gives the consumer freedom of drawdown, the total amount of credit shall deemed to be drawn down immediately and in full;</p> <p>b) if there is no fixed timetable for repayment, and one cannot be deduced from the terms of the agreement and the means for repaying the credit granted, the duration of the credit shall be deemed to be one year;</p> <p>c) unless otherwise specified, where the agreement provides for more than one repayment date, the credit will be made available and the repayments made on the earliest date provided for in the agreement;</p> <p>6. Where a credit agreement is drawn up in the form of a hire agreement with an option to purchase and the agreement provides for a number of dates on which the purchase option may be exercised, the annual percentage <i>rate</i> of charge shall be calculated for each of these dates. Where the residual value cannot be determined, the goods hired shall be subject to linear amortisation that makes its value equal to zero at the end of the normal hire period laid down in the credit agreement.</p> <p>7. Where a credit agreement provides for a prior or simultaneous constitution of savings and the borrowing <i>rate</i> is set in relation to these savings, the annual percentage <i>rate</i> of charge shall be calculated in accordance with the procedure set out in Annex III.</p>
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BANK APR	<p>1. For the purpose of calculating the total lending <i>rate</i>, the sums levied by the creditor shall be determined, with the exception of charges payable by the consumer for non-compliance with any of his commitments laid down in the credit agreement and charges other than the purchase price which, for purchases of goods or services, he is obliged to pay whether the transaction is paid in cash or on credit.</p> <p>2. The costs of maintaining an account recording both payment transactions and credit transactions, the costs of using a card or another means of payment for both payment transactions and drawdowns, and the costs relating to payment transactions in general shall be regarded as sums levied by the creditor unless they have been clearly and separately shown in the credit agreement or in any other agreement concluded with the consumer.</p> <p>3. The following shall be excluded from the sums levied by the creditor for the purposes of calculating the total lending <i>rate</i>:</p> <p>a) costs associated with ancillary services relating to the credit agreement, which the consumer is free to obtain from the creditor or any other provider;</p> <p>b) costs payable by the consumer on conclusion of the credit agreement to persons other than the creditor, in particular the notary, tax authorities, registrar of mortgages, and any costs in general imposed by the authority responsible for registration and sureties.</p> <p>4. The total lending <i>rate</i> shall be calculated in accordance with the procedures and assumptions referred to in Article 12 (3) - (7) and Annexes I and II. Art. 13 1.</p>
BANK RATE	<p>Art. 8 para. 2 letter g) where applicable, the borrowing <i>rate</i>, the conditions governing the application of this <i>rate</i> and any index or reference <i>rate</i> applicable to the initial borrowing <i>rate</i>, as well as the periods, conditions and procedures for varying the borrowing <i>rate</i>;</p> <p>Art. 2 para. 2 letter k) “borrowing <i>rate</i>” means the interest <i>rate</i> expressed as a periodic percentage applied for a given period to the amount of credit drawn down;</p>

BANK RATE: variable	<p>Article 14 Borrowing <i>rate</i></p> <ol style="list-style-type: none"> 1. The borrowing <i>rate</i> may be fixed or variable. 2. Where one or a number of fixed borrowing <i>rates</i> have been established, they shall apply for the duration of the period specified in the credit agreement. 3. A variable borrowing <i>rate</i> may not vary until the end of agreed periods provided for in the credit agreement and may do so only in line with the agreed index or reference <i>rate</i>. 4. The consumer shall be informed of any change to the borrowing <i>rate</i>, on paper or on another durable medium. <p>This information must include the new annual percentage <i>rate</i> of charge, the creditor's new total lending <i>rate</i> and, where applicable, the new amortisation table. The calculation of the new annual percentage <i>rate</i> of charge and the creditor's new Total lending <i>rate</i> shall be based on Article 12 (3).</p>
BANK RATE: Interest Calculation	<p>Article 16 Early repayment</p> <ol style="list-style-type: none"> 2. Any indemnity claimed by the creditor for early repayment shall be fair and objective and shall be calculated on the basis of actuarial principles.
BANK RATE: Disclosure	<p>Art. 21 Article 21 Credit agreement in the form of an advance on a current account or a debit account</p> <p>Letter f) the last agreed borrowing <i>rate</i>;</p> <p>letter g) the total amount of interest due;</p>

2.2.2 The regulatory problem

The Directive puts emphasis on the regulation of the interest rate. The interest rate has traditionally two functions: representation and calculation.

- *Representation*: The interest rate (typically the APR) represents the price of the credit. It serves as a means of information for the consumer in order to evaluate the price of the product and compare it with other products.
- *Calculation*: Interest rates serve as a tool to calculate how much interest is due or has to be refunded or is contained in a certain sum.

From the consumer's point of view, one single interest rate would eliminate all misunderstandings. But for technical reasons this is not (yet) possible because the mathematical true interest rate is difficult to apply to interest calculation without the use of computers.

A mathematically correct calculation of the true interest rates is derived from the capital growth function in natural science. A capital C_0 (*present value*) grows in t years with a growth-rate of $(1+i)$ (if i is the traditional interest rate) into a capital C_t (future value) according to the formula:

$$C_t = C_0(1+i)^t$$

This correct capital growth view has no direct relationship to the "interest" which represents the "cost" of credit and which appears important for comparing cash sales with credit sales. Interest has to be identified in a second step by calculating the difference between C_t and C_0 . The formula is neither complicated nor difficult to understand, but it can only be calculated with the help of computers. Moreover, it only discloses the effects of costs elements on the credit but not their origin.

This is why, in cases where costs elements, and interest in particular, have to be calculated according to a different general standard formula, which has the advantage that it allows calculations without computers and is focused on the interest itself.

$$Interest = C_0 * t * i$$

However, this formula has major drawbacks. It lacks the essential mathematical definition of the point at which unpaid interest is due and should be added to the capital, when it again bears interest. It is not a complete approach to the prices of loans, but rather an add-on approach, because all elements must be added to the interest which derive from price calculations and are not based on time but on the amount of capital (provisions) or the cost of additional services (fees).

This open-ended nature of the "bank interest rate" has created numerous variations in its calculation which make it impossible to compare bank interest rates.

The following variations are widespread:

- Difference in **time** i.e. a year with 360 days or 12 equal months of 30 days, the omission of the 31st as an interest-bearing day, fictitious times like interest-bearing times before the capital has been extended.
- **Compounding periods** for interest and/or for the repayments vary from one to twelve months inclusive.
- **Anatocism** is widespread to the extent that interest is paid out of credit either from a separate account or under a separate contract, which raises the amount of effective interest payments.
- **Products are split** into investments and credit, so that the interest gained is credited against interest due. In this case, the difference between the two interest rates results in more interest being payable by the consumer than stated at the outset.
- **Costs elements** are farmed out to other products which are sometimes more virtual and have little or no direct benefit for the consumer, or costs are allocated as one-off payments which are not represented in the interest rate.

There is no doubt that it would be significant progress in legislation and markets if the mathematically correct and single interest rate were the only one confronting consumers and all other price calculations remained internal information for suppliers relevant internally to their various organisations. It is only if this goal is achieved that credit can be treated in the same way as all other goods, in which a single price also represents very different elements like cost of time, service fees, prices and provisions without the need for the supplier to offer so many different variations.

Historically, however, development has followed the opposite course. The modern and true interest rate (APR) has gradually been developed from the old interest rate as a tool when price disclosure and markets became more important. This is why even the modern APR was hitherto insufficiently accurate, as well as being open to falsification and it was this issue which first had to be remedied before the old system could be gradually transposed into the new system.

Technically, a single price system would be easy to achieve. It would lower transaction costs significantly, further international competition and it would teach consumers that only one system and principle concerns them, namely that capital grows with time. Additional credit augments the capital disproportionately, repayments reduce it to the same amount.

There is no doubt that all interest calculations would then have to be computerised. Modern products are so sophisticated that today nobody can calculate them without a computer even if the traditional formula and the split of prices are allowed.

Consumer activists should emphasise this objective, which will make the credit market more transparent, diminish fraud substantially, give consumers the right information about the implications of debt for them and make competition between very different providers with very different products possible.

Different ways of achieving this goal can be pursued in conjunction or as alternatives:

- Making the APR more inclusive and comprehensive, thus eliminating all elements of old forms of interest calculation.
- Introduction of the APR as a tool for interest calculation and not merely a form of price disclosure, thus gradually replacing the chaos of conventional interest rates.
- Standardisation of the traditional interest calculation in order to bring it closer to the standardised APR calculation.

The Commission has taken steps in all three directions.

In Art. 12 ff and Annexes I and II, it makes the APR more inclusive and complete, it introduces the APR for the calculation of interest in Art. 16 no. 2 (interest refund on early repayment) and it starts to standardise the traditional bank interest rate in Art. 14.

However, although this represents a move in the right direction, reflecting the interests of all partners in the economy who want a competitive internal market with a high degree of transparency and rationality, there are flaws in its realisation:

APR

- The definition of the APR still lacks clarity. Instead of giving unique and easy definitions which may guide readers through the jungle of examples, the examples and specific definitions remain piecemeal and contradictory.
 - The traditional bank rate definition using credit cost instead of capital growth has not yet been totally abandoned.
 - The coverage of new products and techniques has been done product by product, which invites suppliers to look for new opportunities for avoidance
- The progress in achieving an inclusive and correct APR has been undermined by the introduction of a second “APR” which reflects the perspective of the supplier-side and incorporates only their costs elements. This third category of interest rates should be eliminated at any price.
- The way the APR calculation is presented to the public makes it impossible for consumers to monitor the application of the Directive. It addresses only mathematicians and does not seek to explain it simply.
- The APR should also be used as a tool for calculating interest where the contract does not define the interest calculation. This is especially the case for all forms of early repayments in different products.

Bank Interest Rate

- The standardisation of the bank interest rate is less intensive than has already been achieved at national level. In particular, there is no need to allow arbitrary bank years, deviating from calendar years or to allow different compounding periods.

2.2.3 The Construction of the APR in the Directive

2.2.3.1 Implementation of Art. 1A of the present Directive

In its 1998 report for the European Commission, iff evaluated the problems in implementation of the old APR legislation. Its findings still apply in understanding the efforts made by the Commission to cope with these problems but it also reveals where the Commission has not taken the steps necessary for remedying this inefficiency.

1. With regard to existing harmonisation of APR costs elements in the Member States, the law in all countries mainly refers to the Directive using its wording and its exemptions. A minimum standard of APR disclosure has been reached Europe-wide. Although there are quite important differences in the costs structure of consumer credit contracts (1) these differences are mostly not specific to one country, and even occur between different products within the same country and (2) there seems to be a consensus among providers in practice about a minimum standard. Accordingly, in all Member States all payments concerning services directly connected to the loan are included. Such services include interest, administration fees and brokers' fees.

As to all other fees, practice assumes that the exemptions provided by the Directive apply. Consequently the following costs elements are not included:

- insurance fees irrespective of the purpose of the insurance;
 - fees for bank accounts and cards; and
 - notary fees and postage.
1. There are three services to which the Directive seems to be applied differently in Member States:
 - Endowment life insurance credit where, despite the fact that the consumer has no choice and is obliged by the contract itself to take the hidden payment protection insurance, Germany and the UK seem to exclude such premiums irrespective of the form they take. This seems to be in clear contradiction with the Directive. But it has to be stated that such products, although widespread in mortgage loans, are not common in consumer credit as defined in the Directive. Further, German courts have ruled that endowment life insurance credit as consumer credit amounts to a misleading product, giving rise to compensatory damages in favour of consumers if they can demonstrate that there were less costly products available on the market. Accordingly, the practical importance of such products in consumer credit is minimal.
 - In Austria, France and Greece, taxes are imposed on loans, but they treat it differently with in relation to the APR. In the author's view, the Directive treats such costs as "costs of credit"

because they are inseparably linked to the loan and make the product comparatively more expensive, without offering additional services if this product is purchased in a country where such extra charges are imposed. So the purpose of the Directive - to make offers comparable in different Member States - is not met if such specific charges are not included. But again, the amount of the taxes is not so significant that its exclusion can be expected to give rise to significant effects on the market.

- The finance charge for Payment Protection Insurance premiums arises where such financing is common, as in Germany, the UK, Scandinavia (but not in France) is mostly counted as part of the credit cost, but some banks leave it out. Even if, as will be argued later, most countries in practice exclude PPI premiums from the APR because they assume that it is “non-obligatory“, this is certainly not the case for finance charges which are obligatory and specific to insurance products. Certainly, banks which omit this cost appear to contravene the Directive, as well as national law.
2. These differences in terms of the standards in all Member States would have been eliminated by the courts if those courts had had sufficient opportunities for monitoring the application of the Directive. In the meantime, the German Supreme Court⁷⁰ has clearly stated that credit products combined with savings facilities must be regarded as a single credit contract and all payments made in respect of either the loan or the linked investment product must to be counted as part of the total amount of credit. But this decision is far from being implemented.
 3. The purpose of the Directive is not only harmonisation but also consumer protection. The goal of the APR disclosure rules should therefore be defined as follows:
 - Transparency for consumers to enable them to compare the different credit products available on the market, in order to exercise a rational choice for the best and most cost-effective product; and
 - Disclosure of particularly high costs in relation to consumer credit, which are especially onerous for low-income consumers in view of their lack of bargaining power, in order to stigmatise these providers and, in some countries, to seek legal redress based on statutory interest rate ceilings and usury legislation.

In the context of high consumer protection standards and the effective implementation of regulations, the factual situation in the Member States is still unsatisfactory. In practice, up to 30% of standard costs paid by consumers under a consumer credit agreement are not represented by the present APR definition. The exemptions contained in the Directive concerning some linked products such as insurance and bank account fees have led to their total exclusion. Sophisticated restrictions on the application of these exemptions in the Directive itself have no practical effect. Accordingly, this regulation has failed to achieve its goals. The effects of this situation are visible in the following phenomena:

⁷⁰ Bundesgerichtshof Neue Juristische Wochenschrift 2002 p 957

- Payment Protection Insurance has developed into a way of generally outsourcing credit risks at the expense of the consumer. The products are disadvantageous, extremely costly and applied inappropriately and to that extent are used far too often. It seems as if the remuneration paid to the banks for selling insurance products has become a main source of additional income for credit providers, avoiding competitive pressures;
 - Fees specifically charged on bank current accounts are not yet an economic problem but, with the spread of credit card lending - which is no longer linked to overdraft credit on a current account but offers its own credit facilities - increasingly fees for credit are allocated using payment devices, thus escaping APR-legislation;
 - Combined endowment products, which divert repayments of the loan into a form of savings agreement with lower interest returns on the savings than are charged on the loan are becoming more prevalent. Products like “endowment capital life credit”, “secured credit cards”, instalment or overdraft credit where assets are requested as security are already on the market, undermining transparency and rational choice as well as usury legislation.
 - Zero interest credit is extended by banks owned by automobile companies as an incentive to buy cars. In fact such low interest rates are often paid partly by a denial of discounts that ordinary cash purchasers get.
4. The single mathematical formula is effectively harmonising the way of calculating the APR. The recalculation of APRs showed no mathematical deviations. All deviations stemmed only from the inclusion or exclusion of additional costs elements. There are therefore no mathematical arguments which may be raised for the inclusion or exclusion of associated services and costs. The mathematical formula, where $K_1 = K_0 * (1 + i)^t$, is sufficient to calculate all kinds of credit and other services - with the help of spreadsheet software and iterations - if the payments by the consumer and the provider as well as the time when these payments are effected (payment flow calculation) are known. Sophisticated formulae are unnecessary and mostly only applicable to specific standardised credit contracts, tending to hide normative assumptions in mathematical language. The trend towards individualised products necessitates payment flow calculations where each single payment may be defined separately, excluding all kinds of mathematical formulae.
5. Most national legislation fails to clarify the question concerning the link between a cost element appearing in a credit contract and the credit cost itself. National legislation understands the Directive as follows:
- Some national jurisdictions apply a cash flow definition and others a costs element definition. Indeed Art. 1 uses a concept of credit prices as “costs” elements. Art. 1a, which was incorporated into the original Directive in order to implement the sole correct mathematical formula refers to all payments made within a credit relationship. The first definition was adequate as long as linear formulae were in use, in which the APR was calculated on the basis of a comparison between cost according to time and net capital alone. Introducing the compounding period into the calculation of modern and correct mathematical procedures requires the monitoring of all payments between creditor and borrower, irrespective of which part of the loan (repayment of the principal or payment

of costs or fees) is concerned. The old definition in Art.1 has become obsolete because it is mathematically not functional. The definition in Art.1a instead is adequate and clear.

- In the light of the definition in Art. 1a, the question of the inclusion of costs elements into the APR calculation has shifted from a statement of which costs elements have been paid “for the loan” to the question of which payments are linked to the exchange between creditor and borrower. In fact, the core question is that of which services are provided in association with the extension of the consumer credit and are “linked” to the credit contract, so that these payments are incorporated into the APR calculation. National legislators have not given any clear definition of which services have to be seen as “linked” to a loan such that their payment flow should be incorporated into the calculation of the APR applicable to the loan. In fact, the Directive is partly understood as supporting a purely legal view, in which the legal obligation to contract additional services is the sole criterion for its inclusion while other national legislation seems to further a more economic view in which economic constraints suffice to qualify additional services as linked services.
6. The report formulates a new Art. 1(d) and a new sub-paragraph (e) on “linked transactions”. Its main intention is
- to use solely the APR definition based on capital growth
 - the insertion of a general definition of “linked transactions” which is similar to the approach already used in Art. 11 of the Directive to safeguard consumer rights in linked transactions of purchases and credit. This definition has to include the criteria as well as the indicators of services whose payment flow will be included into APR calculation;
 - to replace the exemptions by a list of positive and negative examples in the Annex which force the national rule making bodies and the banks to focus on the general principles instead of formal aspects which are easier to fulfil in order to escape the inclusion of such linked services;
 - to separate general definitions of linked services from the definition of products which are seen as examples of linked or unlinked services.

2.2.3.2 The APR definition in the New Directive

2.2.3.2.1 Uniform Definition

The new proposal still uses two different approaches: the costs approach and the growth approach.

The costs approach is unnecessary to apply Art. 2 (h), which provides that the total cost of credit to the consumer must be expressed in an annual percentage rate. The same definition is referred to in Art. 12 para. 2, which gives a definition of the total costs to be incorporated into the regulation. Both definitions have nothing to do with the mathematical model largely prescribed and explained in the Directive.

Art. 12 para.1 as well as the mathematical definition in Annex I which is taken up in all the commentaries, and examples in Annex II use the correct definition. In this definition, the total cash flow between consumers and suppliers is used to identify capital growth. The APR is then defined as the

interest rate which renders the present value of all payments of the consumer equal to the present value of all payments the consumer effectively receives.

This could have been explained through a very simple example.

If the consumer receives €1,000 as credit and has to pay back €1,100 in one year then the present value of €1,100 will equal €1,000 if a growth factor of 1.1 (=1 + 10%) is applied or, which would amount to the same thing, the future value of €1,000 will equal €1,100 in one year if the same growth rate is applied.

$$1000_t = \frac{1100}{(1+10\%)^1}$$

or

$$1100_t = 1000_0(1 + 10\%)^1$$

The strict application of the formula and the use of only one definition would solve several problems.

2.2.3.2.2 A comprehensible, consumer-friendly calculation

Firstly, it would solve the problem of enabling consumers to understand the complicated mathematical formulae. This is necessary because the Draft Directive demands that the creditor give a representative example of the APR calculation, disclosing all its elements before the contract is concluded.

The Directive itself fails to give such examples. Instead of the existing Annex, which is designed for specialists and professionals, the Directive could describe how such an APR calculation would be done in practice. This would consist of the following steps, which most consumers who have used a spreadsheet programme like Excel, Lotus etc. will understand.

"The APR is calculated using a spreadsheet.

In this spreadsheet, the first column contains all dates of any payments made between the parties from the payment of the capital to all interest and repayments as well as the costs due. Payments by the creditor are then entered in the second column and those of the consumer into the third column.

The fourth column serves to calculate the APR. Its first row contains the difference between payments at the first date. This is where the credit started. The second row is calculated out of the capital in the first row plus the payments of the creditor minus the payments of the debtor in the second row multiplied with a growth rate which is 1 + an interest rate which should be stored in a separate place. This growth rate will have an exponent, which is the difference between the date in the second row and the date in the first row, expressed in days divided by 365.125.

The APR is then calculated by using the "target value" function of spreadsheet which tries out interest rates until the last row of the fourth column contains the future value which is the sum due at the end of the credit contract (normally "0")."

The spreadsheet and the formula for the APR calculation system could then be presented in a simple format and then given as examples for all forms of linked credit.

A	B	C	D	E
1		APR ➔	15.69%	
2		Payments and Debits from Creditor	Payments from Debtor	Capital due
3	01.01.02	2000		2000.00
4	01.02.02		200	1824.90
5	01.03.02		200	1645.41
6	01.04.02		200	1465.89
7	01.05.02	50	200	1333.55
8	01.06.02		200	1150.16
9	01.07.02		200	964.01
10	01.08.02		200	776.01
11	01.09.02		200	585.67
12	01.10.02		200	392.73
13	01.11.02		200	197.62
14	01.12.02		200	0.00

Cell E4 contains = (1+\$D\$1)^((B4-B3)/365,125)*(+E3)-D4+C4

Cell E5 contains = (1+\$D\$1)^((B5-B4)/365,125)*(+E4)-D5+C5

Cell E6 contains = (1+\$D\$1)^((B6-B5)/365,125)*(+E5)-D6+C6

etc.

Instead of abstract mathematical formulae, consumers and judges, who all find it difficult to understand, would be in a position to check bank calculations. Banks would have an easy way of explaining their calculations by giving consumers ready-made spreadsheet file via e-mail or the internet.

2.2.3.2.3 Linked Transaction

This clear-cut definition would also solve the multitude of problems which arise when costs elements are discussed in relation to their integration into the APR calculation. All payments into linked transactions would be treated as consumer or creditor payments and therefore would have only to be introduced into the spreadsheet at the appropriate date.

This is especially easy using the present draft. It represents significant progress in terms of the combination of investment products and credit contracts, in which repayments against the loan are diverted into an investment product and which will in future be treated as one product under Art. 12 (7) of the Draft Directive. All insurance and current account fees will also be integrated.

There is now one single, important criterion, namely whether such products must be considered as part of the credit arrangement and therefore taken into account when the APR is calculated.

It only remains to consider whether the insurance has been contracted in association with the loan. It is therefore the relationship between the two contracts which is significant, not whether certain payments can be seen as "costs elements of the credit".

2.2.3.3 Art. 12 redefined under the Cash Flow Approach

Indeed, all paragraphs under Art.12 which describe the "costs elements" of other products and taking them into account within the APR calculation could be explained much easier in cash flow terms.

- No 2 (1) first half: Costs concerning late payments are not costs at the time the contract was made. This exemption is therefore unnecessary.
- No 2 (1) second half: sale prices which are not credited should not be excluded. They neutralise themselves when the value of the goods and the price are entered under creditor and debtor payments, where they add up to "0". The exemption is unnecessary.
- No 2. (2): Cost of payment services (account, card) are excluded if there is an additional contract for them. This is a fallback into the old contractual philosophy, where the definition of a contract suffices to exclude these costs. In practice, there will always been a separate contract, so that these costs will be excluded even if they are contracted only to obtain the credit (see the practice of Citibank and many credit card companies to force debtors to open a second bank account purely in relation to the credit contract). This exemption should be deleted. It should instead be regulated, as an example of a linked contract: "Payment services are linked services if their primary goal is to facilitate credit administration or access."
- No 2 (3): There should be no special provision for insurance premiums because insurance contracts may contain quite different forms of payments. Some risk insurance even has endowment functions. The cash flow approach alone reflects its effect on the loan. It should therefore read: "Insurance contracts are linked transactions when they are contracted at the time the credit contract is concluded." (using the wording of the draft)
- No 3: The fiction of a valid contract and payments according to the contract of origin can easily be omitted because the initial definition of the APR contains the reference "to the obligations of the contract at the time the contract is concluded".
- No. 4: For variable rate credit it is sufficient to define such credit as "calculated as if the initial rate would be fixed."
- No. 5: The fictions in relation to missing elements can remain as they are
- No. 6: If there are different times for termination of a linked agreement between lease and credit, the prescription for different APRs to be calculated is a way for the consumer to see the advantages of some of these terms. It has long since been applicable in the United States to reverse mortgages where life-expectancy plays a role. American law prescribes three APRs: for short, average and long expectancy.

- No. 7 is a kind of non-regulation, because it refers to Annex III, in which the calculation of combined credit and savings products is demonstrated. It should be replaced by inclusion into of the examples of a "linked transaction": "especially if the repayment of the principal is diverted into a savings, investment or endowment product". As Art. 30 defines this kind of product, it would be sufficient just to refer to Art. 30 as an example of a linked transaction. Art. 20 para. 3, which refers to the cost approach in linked transactions, would then also become superfluous.

2.2.4 Banker's APR Art. 13

There is no need for a special APR reflecting the banker's perspective. As the Commission points out, this APR had been demanded by lenders in the consultations.

The APR is an interest rate which discloses the price of the product to the demand side, which alone can exercise choice. It misleads consumer demand if a second legally legitimised APR is disclosed.

Banks are in any case free to give all kinds of other indicators of the price of their products. Long-term lenders in particular have disclosed a second, lower APR if the loan was extended through intermediaries, whose charges were deducted from the APR. This practice disappeared, because it amounted to misleading and unfair competition. In future, lenders would legitimately disclose an APR which would not represent the true cost to consumers.

As, unlike the American example, the European Directive does not prescribe any form for APR disclosure and in particular does not use a legally defined table where the only information is that which is prescribed by law, creditors may continue to disguise the true APR by an excess of other information and interest rates.

Instead of allowing the provision of a second APR, the Directive should prescribe a form set out in a box containing only legally prescribed information, whose form may be prescribed in the Annex to the Directive. This would give consumers from all countries a quick, understandable, fair and true view of the terms of the loan and the effects on it of linked products.

2.2.5 Interest Rate Calculation Art. 14

The bank interest rate used for the calculation of interest should no longer be left to the discretion of the supply side. While the conditions of variable rates have been regulated in the Directive, the general conditions of these calculations must also be standardised. These are

2.2.5.1 Compounding period

This period should follow the payments. Consumers expect that their payments are made in respect of the interest due. This is why this meets their expectations for recalculation as well. All other clauses should be void.

2.2.5.2 Annual basis

Interest rates should be based on annual, not on monthly or daily, rates. They should include default interest rates because choosing shorter periods lowers the interest rate and is misleading.

2.2.5.3 True interest rates

Bank interest rates should also have a minimum of rationality in relation to the loan. This means that they should be calculated with regard to the capital outstanding, and not to any fictitious capital, as is still the case in many instalment contracts, where a fictitious rate is calculated on the initial amount of the loan for the whole life-time of the loan, irrespective of its gradual repayment.

2.2.5.4 Variable rates

Art. 14 No 3 and 4 transpose national law into EU standards. But they fall short in two important respects.

Firstly, the periods in which the variable interest rate is adapted to the contract should be "equal" and not be left to the discretion of the initial contract. Loan agreements could otherwise become financial options and futures with elements of gambling.

Secondly, regulations should stipulate the change in the base interest rate to which the variable rate is linked that is sufficient and necessary to change the rate applicable to the loan. Normally, the margin could be one-tenth of a percent.

Finally, the Directive would improve the understanding of variable rates if it gave a definition which could read:

"A variable rate in a credit contract links the bank interest rate to an objective market interest rate to which it will be adapted in equally designed time periods, when the change in this market rate exceeds a defined margin and leaves no discretion to the creditor. Each adaptation should be disclosed to the consumer, together with the newly calculated APR and an adaptation of the original repayment plan."

3 Alternative Proposal and Itemised Critique of the Directive

Proposal and Corrections	Comments
CHAPTER 1: AIM, DEFINITIONS AND SCOPE	CHAPTER 1: AIM, DEFINITIONS AND SCOPE
Article 1 Aim	Article 1 fails to enumerate the three most important goals of the Directive. Chapters II, III, VI, IX expressly refer to the protection of consumers, even in their headings.
<p>The aim of this Directive is to <u>protect consumers, to prevent overindebtedness, and to harmonise the laws, regulations and administrative procedures of the Member States concerning agreements covering credit granted to consumers and surety agreements entered into by consumers.</u></p>	Chapter. The prevention of overindebtedness and consumer protection should be explicitly stated to be aims of the Directive.
Article 2 Definitions	
For the purpose of this Directive:	
a) “consumer” means a natural person who, in transactions covered by this Directive, is acting for purposes which can be regarded as outside his trade or profession;	b) Reference to the status of the provider is atypical in the law. From a consumer perspective, protection in the form of proof that the loan was extended in the pursuit of trade, business or profession is often difficult and also unnecessary. The distinction should be made functional and correspond to the definition of “consumer” under a) where it relates to the for-profit activity. This is normally done by reference to a “commercial” purpose.
b) “creditor” means a natural or legal person who grants or promises to grant credit <u>commercially in the course of his trade, business or profession;</u>	
c) “credit agreement” means an agreement whereby a creditor grants or promises to grant to a consumer credit in the form of a deferred payment, loan or other similar financial accommodation. <u>Agreements for the provision on a continuing basis of services (private or public), where the consumer has the right to pay for them for the duration of their provision by means of instalments, are not deemed to be credit agreements for the purposes of this Directive;</u>	c) Exempting repeated services by this additional definition is superfluous and dangerous. It may be used to exclude financed services altogether (such as financed tourism). The important element of credit is already addressed by the words “deferred” and “loan”. Both indicate with sufficient precision that capital is provided commercially before the counter-obligation is fulfilled. Credit is always the provision of capital which is defined by the difference in time between the fulfilment of the

d*) “linked transaction”: any other agreement linked to the credit in order to facilitate economically the extension of credit, the provision of capital, the administration of the credit, the form or safety of its repayment.

A linked transaction arises in particular where

1. the repayment of the capital is diverted for future amortisation into any form of savings, endowments, capital life or other investment (“endowment credit”)

2. payment services are primarily provided to facilitate credit administration and repayment

3. the purchase of goods or services is financed by the credit agreement and where the provider has participated in the provision of the credit or the creditor in the provision of those purchases in any form (“financed contracts”)

4. ~~f) “surety agreement” means an ancillary agreement concluded by a guarantor and guaranteeing or promising to guarantee the fulfilment of any form of credit granted to a natural or legal person is guaranteed by a consumer (“surety agreement”);~~

5. an insurance contract credit if the insurance is taken out when the credit agreement is concluded.

e) ~~e)~~ “credit intermediary” means a natural or legal person who, ~~for a fee, habitually~~ acts commercially

as an intermediary by presenting or offering credit agreements, undertaking other preparatory work for such agreements, or concluding such agreements; ~~the fee may take the form of cash or any other agreed form of financial consideration;~~

e) ~~“surety agreement” means an ancillary~~

corresponding obligations in a contract.

d*) The Directive should acknowledge “linked transactions” as a form of consumer credit. This would make the Directive slim, easier to understand and to apply and would prevent loopholes and circumvention. This definition comprises all forms of credit packages, where credit is integrated into financial services, such as endowment credit contracts, special bank accounts or credit cards which divert costs elements into a different product, financial leasing or financed transactions where costs elements are hidden in the remuneration of other services. A modern Directive should recognise that the enormous development within consumer finance no longer involves traditional loans and instalment contracts alone but increasingly the whole range of financial services.

For 1. see the definition in letter

For 5. See the definition in Article 12.

Letter d) now e) should again use the word “commercially” which is well known in the law. The definition given is not consistent. Intermediaries sometimes receive their money from the creditor, sometimes they charge the debtor directly. The definition given is too complicated. The Directive should use the same words and especially words which are also understandable to consumers. To enumerate technical details of remuneration gives room for avoidance. The word “commercially” reflects the for-profit activities, indicates that the consumer pays in one way or another for this service and characterises the whole regulation.

f) Protection of guarantors cannot be linked to the legal form of the guarantee. Although it may usually be in the form of a contract, there may be other forms where the property of third parties is offered as security within the security agreement of a third party. (See the German system of unlinked

~~agreement concluded by a guarantor and guaranteeing or promising to guarantee the fulfilment of any form of credit granted to natural or legal persons;~~

f) ~~“guarantor” means a consumer providing any security for the credit by consent including a surety agreement;~~

g) ~~“total cost of credit to the consumer” means all the costs, including borrowing interest, indemnities, commissions, taxes, insurance premiums and any other kind of charge which the consumer has to pay to facilitate for the credit within the credit agreement or any other linked transaction;~~

h) ~~“annual percentage rate of charge” means the rate of charge, which equates, on an annual basis, to the present value of all commitments (drawdowns, repayments and charges), future or existing, agreed by the creditor and the borrower consented to in the credit agreement or any linked transaction.~~

~~the total cost of the credit to the consumer expressed as an annual percentage of the total amount of credit granted;~~

i) ~~“sums levied by the creditor” means all the mandatory costs associated with the credit agreement and paid to the creditor by the consumer;~~

j) ~~“total lending rate” means the sums levied by the creditor expressed as an annual percentage of the total amount of credit;~~

i) “usury rate” means an “annual percentage rate of charge” whose calculation and adaptation to market conditions is defined by law according to average interest rates fixed objectively by a public body in regular time intervals which is multiplied by a legally defined factor in order to limit the cost which can be consented to in

securities like the *Grundschild*)

g) There are two conflicting definitions of the APR in the Directive, the costs-orientated definition in this article and the growth-orientated definition of Article 12. The Directive should be streamlined to give one single definition of credit cost and annual percentage rate of charge. This will make the regulation much more comprehensive, easy to understand and less exposed to avoidance. For this purpose, only the mathematically correct definition of a cash flow-based APR as developed in Article 12 and the Annex should be used. The notion of “linked transaction” should be used. The courts and national legislators will still have to identify costs elements which are solely dedicated to an additional service outside the provision of capital, and those which are contained within the linked transaction and are hidden costs elements of the credit transaction itself. As courts tended in the past to apply a narrow definition of “for the credit”, excluding any insurance premiums, it should be clear that indirect pressure to enter into linked transactions is covered by reference to a mere “facilitation” of credit.

h) the newly introduced false suppliers’ “APR” will mislead consumers. It will open the door to false advertising etc. The Directive will directly contradict its own purpose of preventing avoidance as outlined in article 16 of the Directive currently in force. Art. 16 has been omitted from this draft, but is a necessary tool for guaranteeing consumer protection and should be reinserted.

i) superfluous because of the definition of a linked transaction

The APR is solely and world-wide an indicator where consumers can recognise what the cost of this credit means for them with respect to similar offers. An APR for providers of credit is unnecessary because providers have all the means to identify their cost. For consumers it is

consumer credit contracts.

highly misleading

~~j) k)~~ “~~calculation borrowing~~ rate” means the interest rate ~~expressed as a periodic percentage applied used to calculate the sums owed to the creditor for the use of a given period to the amount of credit drawn down;~~

(i) must be read in conjunction with the new Art. 12 of this Directive in order to establish a common system for dealing with usury in the EU.

~~k) l)~~ “residual value” means the ~~purchase~~ price of the financed goods ~~or services~~ applicable at the time when the ~~purchase~~ option or the property transfer option is exercised;

Almost all European countries have usury rates or interest rate ceilings which prevent exorbitant pricing in credit and the systematic exploitation of consumers who feel or are personally forced to take up credit, or to prolong credit at any price. While most countries like France, Italy, the Benelux countries and the Scandinavian countries prefer administratively the fixed interest rate ceiling, Germany and Austria use the old systems of defining usury linked to the concept of “bona fide”. In all systems, the interest rate ceiling is fixed according to a market rate at about 150 to 200% of the average market rate applicable in consumer credit. This margin gives enough scope for allocating different risks and service intensity in consumer credit and has proven to be acceptable to the credit industry. The increase in confidence and trust in such regulated consumer credit systems has even kept the rate of exclusion from mainstream banking relatively low, while those few countries who still accept lending at any rate of interest have experienced a withdrawal of banks from this area, increased denial of access and a grey market which especially places at risk those consumers who face temporary income problems or are already overindebted. All goals of this Directive: harmonisation, consumer protection and the prevention of overindebtedness necessitate this core regulation. The present situation leads to fundamentally different systems of costs allocation and hinders cross-border lending. They operate to the detriment of the economic interests of vulnerable consumers and they are to a large extent a reason for overindebtedness which rises through unscrupulous refinancing and ever higher interest rates.

~~j) m)~~ “drawdown” means an amount of credit made available to the consumer in the form of a deferred payment, loan or other similar financial accommodation;

~~k) n)~~ “total amount of credit” means the ceiling or the sum of all drawdowns that are likely to be agreed;

~~l) o)~~ “durable medium” means any instrument which enables the consumer to store information addressed personally to him in a way which makes it exclusively accessible to him for future reference for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information stored;

~~p)~~ “~~third party providing constitution of capital~~” means ~~any natural or legal person, other than the creditor or consumer, who gives the consumer or, where applicable, the creditor an undertaking, through an agreement appended to the credit agreement, to constitute the capital to be repaid under such credit agreement.~~

k) The Directive has one clear and correct

definition of the APR and not many different ones. The definition in sub-paragraph (h) is outdated and refers to a time where interest rates were still calculated without regard to interest compounding. In the past, the notion of “cost of credit” has given way to a large range of different applications under national law. Harmonisation can only be achieved if the legislator uses a single correct definition. Moreover, the Directive as a whole will be much more comprehensive and much shorter. Here again, the notion “linked transaction” helps to clarify what the word “associated” expresses.

l) There is no reason to exclude “financed services” which play an ever-increasing role in the economy.

o) It should be clear that the Internet and any medium which still allows access and consequently alteration by the provider are not sufficient because proof of the information given initially is not guaranteed.

p) This definition is unnecessary and difficult to understand if the concept of “linked transaction” is used. It only appears in Article 20, while the notion “third party” is used more often in the Directive with the meaning it has in most jurisdictions, referring to persons who are not party to the contract in question. The present definition refers to a special form of “linked transaction”, in which repayment of the capital due and the payment of interest are artificially separated into two different contracts. A credit contract linked to endowment insurance diverts the repayment into a savings product and promises that at the end of the credit contract the savings product will provide for the amortisation of the loan.

Article 3 Scope

1. This Directive applies to credit agreements and surety agreements and where applicable to linked transactions.

2. This Directive shall in total or partially as indicated not apply to the following credit agreements and, where applicable, any corresponding surety agreements:

a) Art. 5, 16, 19 to credit agreements the aim of which is to grant credit for the purchase or transformation of private immovable property that the consumer owns or is seeking to acquire and which are secured either by a mortgage on immovable property or by a surety commonly used in a Member State for this purpose;

b) hiring agreements unless the consumer has no right of cancellation and during the lifetime of the contract the total payments made in this contract and any other linked transaction equals less than 80% of the cash price plus average financing fees. ~~Which exclude the passing of the title to the hirer or to persons entitled by him;~~

c) credit agreements under the terms of which the consumer is required to repay the credit in a single payment within a period not exceeding three months, without the payment of interest or any other charges;

d) credit agreements which meet the following conditions:

i) they are granted by an employer to the employees the creditor as a secondary activity, i.e. outside the sphere of his principal commercial or professional activity,

ii) they are granted at annual percentage rates of charge lower than those prevailing on the market, and

2a) It is still unclear why mortgage loans are exempted. Consumers also need protection when they pay for their homes. The voluntary rules applied by the mortgage industry are no substitute for the requirements of statutory consumer protection and the prevention of overindebtedness. The effect will be a split market, in which suppliers of credit will increasingly try to use unregulated mortgage loans indirectly for lending for all purposes. The legislator will thus endanger the homes of consumers. Moreover, there is an growing second mortgage market, in which the distinction between the use of the capital for the acquisition or transformation of real estate property and other purposes is fading. It is also unclear how this purpose will be evaluated: factually or legally?

The Commission should again reflect on the integration of housing finance into the scope of the Directive, as most member states have done in national legislation—.

Only articles concerning early repayment (16) as well as the ban on door-to-door contracts (5) and the regulation on linked transactions as far as the acquisition of real estate is concerned would need exemption in the present market situation.

b) The present definition weakens the actual position of consumers in leasing contracts. As the wording of the contract is mostly defined by lenders, it is easy to circumvent the consumer protection provided by inserting a simple clause reserving the property to the seller although most the amortisation, including payments in respect of the price plus interest, has been already achieved. It is then offered to the lessee for the residual price. In economic terms there is no difference between these “rental” contracts and instalment purchase or hire purchase contracts. The courts have therefore held that it does not create a legal option over the title but rather represents the fact

iii) they are not offered to the public generally;

~~e) credit agreements concluded with investment firms within the meaning of Article 1 (2) of Council Directive 93/22/EEC for the purposes of allowing an investor to carry out a transaction relating to one or more of the instruments listed in Section B of the Annex to that Directive, where the firm granting the credit is involved in such transaction.~~

~~OJ L 141, 11.6.1993, p.27.~~

~~OJ L 141, 11.6.1993, p.27.~~

e) Credit contracts where the capital is more than one million Euros.

that most of the capital has been amortised during the lifetime of the contract. This national consumer protection law would be overruled by this definition. This why an exception is proposed which defines the central distinction between hiring (right of cancellation, maintaining of the property) from financing (total governance of the use value of the acquired products)

d) If the purpose of this sub-paragraph is to favour credit from employers to employees it should be clearly and openly stated. If not, all annexed credit given to lure consumers into a particular non-financial transaction would also be exempted. It should be clearly stated that only employers can benefit from this exemption. Bank credit to employees would not be covered, which amounts to significant progress.

The word “and” would make clear the cumulative nature of these conditions.

e) The present crisis in the commercial securities market has revealed that many consumers have been lured into debt by false promises of the rewards from speculating in commercial securities on credit. This is the most dangerous form of consumer credit. Why should there be no adequate information, and no advice or responsibility? As credit for speculation is mostly not instalment credit, most articles would not apply in any case. It would also benefit from the overdraft exemptions, because this is the predominant form of such credit. Finally, banks can easily distinguish between professional investors and consumers who invest accidentally. In this case, the debtor would not be a consumer. To protect the stock market from over-regulation, the Directive could exclude credit contracts where the capital is more than a million Euros.

CHAPTER II – INFORMATION AND PRACTICES PRELIMINARY TO THE FORMATION OF THE AGREEMENT

Article 4 Advertising

Without prejudice to Council Directive 84/450/EEC, any advertising or any offer displayed at Business premises that includes information on ~~the cost of credit~~~~credit agreements~~, in particular in relation to ~~fees, repayment facilities and amounts in particular as regards the or the borrowing rate, total lending rate~~~~total calculation rate~~ should also show the ~~and~~ annual percentage rate of charge ~~and the conditions under which such products are available. All information;~~ shall be provided in a clear and comprehensible manner, with due regard, in particular, to the principles of good faith in commercial transactions. The commercial purpose of this information must be made clear.

The Directive emphasises the APR as the major parameter for consumers. It amounts to a significant draw-back if in future advertising of costs elements as well as repayment facilities (“low instalment”) can be made without reference to the APR. A general clause providing for fair advertising is not sufficient and is inconsistent with the philosophy underlying this regulation.

Article 5 Ban on negotiation of credit and surety agreements outside business premises

The negotiation of a credit or a surety agreement outside business premises in the Circumstances referred to in Article 1 of Council Directive 85/577/EEC shall be prohibited.

This article reinstates the situation as it was under German law before the Directive on door-to-door sales was passed. It therefore only corrects the errors committed by the Commission through ignoring the existing situation in the member states.

Under Art. 56 paragraph 1 No 6 of the German *Gewerbeordnung* derived from the 19th century door-to-door sales of credit were prohibited. The courts have also held that also these contracts were void, so that consumers could keep the loan without paying any costs or interest. The Supreme Court changed its mind when the right to withdraw from door-to-door contracts was introduced, arguing that the legislator knew the old rules and would not have given this new right if it was less than the consumer could claim in any case. This was the first time in Germany that an EU-Directive,

which consciously intended to improve consumer protection, in fact weakened it

Article 6 Exchange of information in advance and duty to provide advice

~~1. Without prejudice to the application of Directive 95/46/EC, and in particular Article 6 thereof, the creditor and, where applicable, the credit intermediary may request of a consumer seeking a credit agreement, and any guarantor, only such information as is adequate, relevant and not excessive, with a view to assessing their financial situation and their ability to repay. The consumer and guarantor shall reply accurately and in full to any such request for information.~~

~~2. The creditor and, where applicable, the credit intermediary shall provide the consumer in writing with all the exact and complete information needed in respect of the credit agreement under consideration, the product its advantages and drawbacks for such consumers which usually apply to these products. The consumer shall receive this information on paper or on another durable medium before the conclusion of the credit agreement. Without prejudice to Article 5 of Directive .../.../EC [on the distance marketing of Financial services to consumers and amending Council Directives 90/619/EEC, 97/7/EC and 98/27/EC], the information provided must include a concise and clear description of the product, its advantages, and any drawbacks. In particular the information must refer to:~~

- ~~a) the sureties and insurance required;~~
- ~~b) the duration of the credit agreement and;~~
- ~~e) the amount, number and frequency of payments to be made shown in a table of payments in which the time (days of month), the applicable interest rate, as well as those parts of the payment needed for the payment of interest and for the amortisation of the capital is clearly visible for each period, using the form in Annex 2~~

1. There is no need to regulate the questions a banker can put to the consumer, especially as the subject is already regulated under article 7 of this Directive. Firstly, this article is very vague and leaves all discretion to the courts (“necessary, adequate and not excessive”). Secondly, this regulation does not fit into legislation specific to consumer credit because it concerns data protection and the protection of privacy in general which has been developed into a contractual obligation through case law in many jurisdictions.

It seems as if No 1 has in fact been used especially to justify the last sentence of this paragraph, which is a striking new development in using consumer protection legislation to impose the burden of additional duties on consumers.

There is no need to impose a legal obligation on consumers to reply accurately to their creditors. Such duties already exist without exemption in contract law. Creditors have long incorporated such duties into agreements and the courts enforce them. Imposing such duties on consumers contradicts the spirit and tradition of consumer protection legislation favouring the weaker party and not burdening it with additional duties unless these duties are necessary to make additional rights viable.

2. This article could be shortened and made more concise. Its special danger lies in the hidden abolition of written information even beyond the scope of the distance selling Directive. It would in future even be allowed to e-mail the information to consumers or to hand them a floppy disk. Written information in credit affairs is a basic and necessary warning for consumers who are in danger of overindebtedness.

of this Directive;

d) *the recurrent and non-recurrent charges, including additional non-recurring costs which the consumer has to pay on concluding a credit agreement, such as taxes, administrative costs, legal fees and assessment costs with regard to the sureties required;*

e) *the total amount of credit and the conditions governing the drawdown of the credit;*

f) *where applicable, the cash price of the financed goods or services, the down payment due and the residual value;*

g) *where applicable, the ~~borrowing rate~~ calculation rate, the conditions governing the application of this rate and any index or reference rate applicable to the initial ~~borrowing rate~~ calculation rate, as well as the periods, conditions and procedures for varying the ~~borrowing rate~~ calculation rate;*

h) *the annual percentage rate of charge and the ~~total lending rate~~ total calculation rate, by means of a representative example mentioning all the financial data and assumptions used for calculating the said rates;*

i) *the period during which the right of withdrawal may be exercised and the costs implied onto the consumers. In the cases referred to in Article 3 (3) of Directive .../.../EC [on the distance Marketing of financial services to consumers and amending Council Directives 90/619/EEC, 97/7/EC and 98/27/EC], this information must include at least the items referred to in points c), e), and h) of this paragraph in the form allowed by this Directive..*

~~3. The creditor or, where applicable, the credit intermediary, shall seek to establish, among the credit agreements they usually offer or arrange, the most appropriate type and total amount of~~

b) Information will have no effect on consumers in danger of overindebtedness unless it is presented in a standardised, general and adequate form for consumers, avoiding overload, and which can be studied and explained in schools and adult education on financial literacy.

Experience in consumer protection has shown that consumers do not think in abstract categories but look to the single payments with regard to their monthly income and expenditure. This is why a table of repayments due from the contract in the form of a cash flow table is the most appropriate form of consumer information. All other information is secondary and needed in particular for price comparison and shopping around. It should also be harmonised in the way agreed by the European mortgage banks using a single form of information throughout Europe. This would also facilitate cross-border sales of credit because consumers would know where to look even in a foreign language. Such forms have long been used in the American Uniform Consumer Credit Code for APR disclosure and do not hinder competition and product development because they merely represent the products in a uniformly understandable language.

(third sentence) The Directive on the distance selling of financial services has accepted the need to put much of the preparatory work for financial services onto the Internet. This can be justified because consumers who already use the internet for such products should have sufficient e-literacy. The exemptions for written information should therefore be restricted to this type of business and should not affect ordinary credit contracts outside the internet. This could be made clear by a general allusion to this Directive.

3. It is questionable whether the Directive should regulate such vague duties without providing for sanctions. The choice between “agreements they

~~credit taking into account the financial situation of the consumer, the advantages and disadvantages associated with the product proposed, and the purpose of the credit.~~

3. The Commission will be empowered to draw up a standardised formula which must be used by all suppliers to give the information prescribed by this Directive.

~~4. Paragraphs 1, 2 and 3 do not apply to suppliers of goods or services acting as credit intermediaries in an ancillary capacity.~~

usually offer or arrange” favours predatory lenders who only offer contracts which are to the detriment of consumers.

This is why a general liability for improvident lending and predatory lending, as is already incorporated into most legal systems in the member states (see the liability of culpa in contrahendo for improvident lending (Art. 313 BGB)), should also be part of the Directive but possibly at a more prominent place (see art. 9) and not restricted to information duties.

3. Instead a standardised formula should be prescribed as is presently in use in the mortgage industry, drawn up by the lenders’ associations itself. A similar formula is also successfully in use in the United States for Truth in Lending, which gives every consumer the opportunity quickly to identify where and under which headings the necessary information can be found. It will be especially helpful in the context of cross-border credit use.

4. It is not clear why creditors in linked transactions should totally be exempted from these information duties. Overindebtedness stems mainly from credit card debts and linked transactions from mail order companies or big department stores, which are usually the last resort for credit when no other bank credit is available. Consumers should know, especially in cases where the temptation of immediate acquisition of coveted goods and services clouds judgment in relation to the debt incurred and the burden to be taken on. If creditors extend such credit on a regular basis (which is usually the case because this form of credit is not extended through small businesses without the help of a bank) they can also afford to use computerised print-outs for the necessary information.

CHAPTER III – PROTECTION OF PRIVACY

Article 7 Collection and processing of data

Personal data obtained from consumers, guarantors or any other person in connection with the conclusion and management of agreements covered by this Directive, ~~and in particular by Article 6 (1),~~ may be processed only for the purpose of assessing the financial situation of those persons and their ability to repay.

Article 7ff gives the wrong message to the credit industry and perpetuates false assumptions on the reasons of overindebtedness.

All empirical data reveals that most credit contracts in which consumers run into repayment difficulties were concluded in a situation where the repayment was still feasible. Unforeseen events such as unemployment, loss of income, illness, divorce and health problems cause difficulties in terms of household liquidity which turns into credit problems. (see already Caplovitz, Consumers in Trouble – A Study of Debtors in Default, 1983)

Article 8 Central database

~~1. Without prejudice to the application of Directive 95/46/EC, Member States shall ensure the operation on their territory of a central database for the purpose of registration of consumers and guarantors who have defaulted. This database may take the form of a network of databases. Creditors must consult the database prior to any commitment on the part of the consumer or guarantor, subject to the restrictions referred to in Article 9. The consumer and, where appropriate, the guarantor shall, if they so request, be informed of the result of any consultation immediately and without charge. 2. Access to the central database in another Member State shall be ensured under the same conditions as for firms and individuals in that Member State, either directly or via the central database of the home Member State.~~

To help these consumers, credit contracts should generally provide for such mishaps and crises.

This article seems instead to suggest that too much credit has been extended to these consumers. In fact, we presently face the opposite problem in the credit market. Increasingly, consumers are cut off from credit resources because banks feel that small amounts of credit do not guarantee sufficient profit. Usury legislation in particular is the target of the critique.

3. Personal data received under paragraph 1 may be processed only for the purpose of assessing the financial situation of the consumer and guarantor and their ability to repay. The data shall be destroyed immediately after the conclusion of the credit or surety agreement or the refusal by the creditor of the application for credit or the proposed surety.

If such a database were made compulsory, it would serve as an easy pretext for excluding low income consumers from obtaining further credit. Creditors will argue that the law does not allow them to give access to credit to certain consumers. Banks should have the ability to give credit to consumers in difficult situations and with a bad credit history if they can assume that provision of this capital will effectively help them to recover economically, to restructure their debts and to earn their own income.

~~4. The central database referred to in paragraph~~

As is the case in the third world, debt problems experienced by consumers cannot be solved by their exclusion them from obtaining further credit,

~~1 may include the registration of credit agreements and surety agreements.~~

but by including them in the market through fresh capital. It is a matter for the lender's discretion to decide which risks they want to take on, because ultimately it is they who have to bear it. The paternalistic view expressed by this article does not help and moreover contravenes the freedom of contract to the detriment of consumers.

CHAPTER IV: FORMATION OF CREDIT AND SURETY AGREEMENTS

Article 9 Responsible lending

~~Where the creditor concludes a credit agreement or surety agreement or increases the total amount of credit or the amount guaranteed, The creditor is liable for damages caused by the sale of credit contracts which are obviously inadequate with regard to the financial situation of the consumer, his prospective ability to make repayments, the purpose of the credit, its costs and the specific risks of the consumer or his group of which the creditor should be aware. He is assumed to have previously assessed, by any means at his disposal, whether the consumer and, where appropriate, the guarantor can reasonably be expected to discharge their obligations under the agreement.~~

Article 10 Information that must be included in credit and surety agreements

1. Credit agreements and surety agreements shall be drawn up on paper ~~or on another durable medium~~. All the contracting parties, including the guarantor and the credit intermediary, shall receive a copy of the credit agreement. The guarantor shall receive a copy of the surety agreement. Agreements shall mention the existence or non-existence of out-of-court complaint and redress procedures accessible to consumers who are party to a contract and, if such procedures exist, the formalities for gaining access to them.

2. The credit agreement shall include:

a) the names and addresses of the contracting parties as well as the name and address of the

“Responsible lending” requires a definition adapted to the legal values inherent in the private law systems within the EU. This regulation appears to assume that responsible lending lies in denying credit to consumers who have experienced problems in the past and where these problems are visible in the databases kept by lenders.

Responsible lending should be a much broader concept, including all aspects of lending and not merely those concerning lenders’ interests; they should also accord with the interests of consumers.

Article 10 and 6 both regulate the same information. They should be integrated and harmonised to prevent unnecessary repetitions.

Art. 6 enumerates

a) the sureties and insurance required;

b) the duration of the credit agreement and the amount, number and frequency of payments to be made, shown in a table of payments in which the applicable interest rate, as well as the parts of the payment needed for the payment of interest and for the amortisation of the capital is clearly visible for each period of time (days of the month) used in the form in Annex 2 of this Directive

d) recurrent and non-recurrent charges, including additional non-recurring costs

which the consumer has to pay on concluding a

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- | | |
|---|---|
| <p><i>credit intermediary involved;</i></p> | <p><u>credit agreement, such as taxes,</u></p> |
| <p><i>b) the data referred to in Article 6 (2), with the annual percentage rate of charge and the lending rate calculated at the time the credit agreement is concluded on the basis of all the financial data and assumptions applicable to the agreement;</i></p> | <p><u>administrative costs, legal fees and assessment costs with regard to the sureties required;</u></p> <p><u>e) the total amount of credit and the conditions governing the drawdown of the credit;</u></p> |
| <p><i>c) where capital amortisation is involved, a statement of account in the form of an amortisation table, the payments owing, and the periods and conditions relating to the payment of these amounts;</i></p> | <p><u>f) where applicable, the cash price of the financed goods or services, the deposit due and the residual value;</u></p> <p><u>g) where applicable, the calculation rate, the conditions governing the application of this rate and any index or reference rate applicable to the initial calculation rate, as well as the periods, conditions and procedures for varying the calculation rate;</u></p> |
| <p><i>d) if charges and interest are to be paid without capital amortisation, a statement showing the periods and conditions for the payment of the borrowing interest and of the associated recurrent and non-recurrent charges;</i></p> | <p><u>h) the annual percentage rate of charge and the total calculation rate, by means of a representative example mentioning all the financial data and assumptions used for calculating the said rates;</u></p> |
| <p><i>e) a statement of the cost components that are not included in the calculation of the annual percentage rate of charge but are to be paid by the consumer under certain circumstances, namely the commitment fee, the charges relating to unauthorised drawdowns in excess of the total amount of credit and the charges for defaulting, plus a list setting out the circumstances;</i></p> | <p><u>i) the period during which the right of withdrawal may be exercised and the costs for the consumers;</u></p> |
| <p><i>f) where applicable, the goods and/or services being financed;</i></p> | |
| <p><i>g) entitlement to early repayment, as well as the procedure to be applied by the consumer in order to exercise this right;</i></p> | |
| <p><i>h) the procedure to be followed to exercise the right of withdrawal.</i></p> | |

The table referred to in c) shall contain a breakdown of each repayment to show capital amortisation, the interest calculated on the basis of the ~~borrowing rate~~calculation rate and, where applicable, the additional costs. If, in the case referred to in c), a new drawdown is not possible

without the consent of the creditor, the creditor's decision shall be communicated on paper or on another durable medium. It shall be made available to the consumer and contain the amended data to which this paragraph refers. Where the exact amount of these components referred to in e) is known, it shall be shown. Otherwise, and as a minimum requirement, these costs must be ascertainable in the credit agreement on the basis of an indication of the percentage linked to a reference rate, a calculation method or the most realistic estimate possible. In such cases the creditor shall make available to the consumer on paper or on another durable medium a breakdown of these costs without delay or, at the latest, when they are to be applied.

3. The surety agreement shall state the maximum amount guaranteed, as well as the charges for defaulting to be applied in accordance with the procedure referred to in paragraph 2 (e).

Article 11 Right of withdrawal

Unchanged

1. *The consumer shall have a period of fourteen calendar days to withdraw his acceptance of the credit agreement without giving any reason. This period shall begin on the day a copy of the credit agreement concluded is transmitted to the consumer.*

2. *The consumer shall notify the creditor of his withdrawal before expiry of the period referred to in paragraph 1 and in accordance with national legislation regarding proof. The deadline shall be deemed to have been observed if this notification, which must be on paper or on another durable medium that is available and accessible to the creditor, is dispatched before the deadline expires.*

3. *Exercise of the right of withdrawal shall oblige the consumer simultaneously to return to the creditor the sums of money or goods that he has received by virtue of the credit agreement, in so far as provision thereof is governed by the credit agreement. The consumer shall pay interest due for the period during which credit was drawn, calculated on the basis of the agreed annual percentage rate of charge. No other indemnity may be claimed in connection with withdrawal. Any down payment effected by the consumer under the credit agreement shall be repaid to the consumer without delay.*

4. *Paragraphs 1, 2 and 3 shall not apply to credit agreements secured by a mortgage or similar surety, credit agreements for housing or credit agreements cancelled under:*

a) *Article 6 of Directive ../2002/EC [on the distance marketing of financial services*

to consumers and amending Council Directives 90/619/EC, 97/7/EC and 98/27/EC];

b) Article 6 (4) of Directive 97/7/EC of the European Parliament and of the Council;

c) Article 7 of Directive 94/47/EC of the European Parliament and the Council. OJ L 144, 4.6.1997, p.19.

CHAPTER V – ANNUAL PERCENTAGE RATE OF CHARGE AND **BORROWING RATE** **CALCULATION RATE**

Article 12 Annual percentage rate of charge

1. The annual percentage rate of charge, which equates, on an annual basis, the present value of all commitments (drawdowns, repayments and charges), future or existing, agreed by the creditor and the borrower, shall be calculated in accordance with the mathematically correct formula representing the growth of capital according to a growth rate in which the exponent of the growth rate contains the time expressed in days between for which a capital remains unchanged divided by 365.25 days. The method is explained in set out in Annex I, and Examples of the method of calculation are given in Annex II, by way of illustration.

2. For the purpose of calculating the annual percentage rate of charge, the cash flow total cost of the credit to the consumer shall be determined including any kind of payments within linked transactions, with the exception of charges payable by the consumer for non-compliance with any of his commitments laid down in the credit agreement, and charges other than the purchase price which, for purchases of goods or services, he is obliged to pay whether the transaction is paid in cash or on credit. The costs of maintaining an account recording both payment transactions and credit transactions, the costs of using a card or another means of payment for both payment transactions and drawdowns, and the costs relating to payment transactions in general shall be regarded as credit costs unless they have been clearly and separately shown in the credit agreement or in any other agreement concluded with the consumer. Costs relating to insurance premiums shall be included in the total cost of the credit if

1. The definition of the APR, although a mathematical formula, can be expressed within the wording of the Directive. If the Directive excludes any other of the outdated parameters for the calculation of the APR, it should do so using the proper wording and not with reference to an annex which appears only to have technical explanations. In fact, the core element of the new APR regulation is the mathematical formula itself.

2. The Directive switches between the two definitions of the APR, the one based on outdated costs and the mathematically correct approach based on cash flow. With the introduction of the term “linked transaction”, a definition of costs to be included is superfluous.

5 a) For overdraft credit and other lines of credit, the assumption given in the Directive is unfair. If a creditor requires fixed fees irrespective of how much of the line of credit will in fact be used, the effective interest rate and the burden for the consumer will be much higher than indicated in the APR. Creditors should calculate their fees in relation to the amount of credit which is in fact taken out. If they do not do so, taking either fixed fees or fees relating to the line of credit, these fees will be underrepresented in the APR. To give creditors an incentive to calculate the correct fees, the Directive should make a compromise and calculate the APR at the average a consumer may take out from a line of credit.

7. This paragraph, including the Annexes, is not necessary if the cash flow approach as well as the term “linked transaction” is taken seriously.

~~the insurance is taken out when the credit agreement is concluded.~~

3. The calculation of the annual percentage rate of charge shall be based on the assumption that the credit contract will remain valid for the period agreed and the creditor and the consumer will fulfil their obligations under the terms and by the dates agreed

4. In the case of credit agreements containing clauses allowing variations in the ~~borrowing rate calculation rate~~ contained in the annual percentage rate of charge but unquantifiable at the time of calculation, the annual percentage rate of charge shall be calculated on the assumption that the ~~borrowing rate calculation rate~~ and other charges will remain fixed in relation to the initial level and will remain applicable until the end of the credit agreement.

5. Where necessary, the following assumptions may be adopted in calculating the annual percentage rate of charge:

a) if a credit agreement gives the consumer freedom of drawdown, ~~half of~~ the total amount of credit shall be deemed to be drawn down immediately and in full;

b) if there is no fixed timetable for repayment, and one cannot be deduced from the terms of the agreement and the means for repaying the credit granted, the duration of the credit shall be deemed to be one year;

c) unless otherwise specified, where the agreement provides for more than one repayment date, the credit will be made available and the repayments made on the earliest date provided for in the agreement;

6. Where a credit agreement is drawn up in the form of a hire agreement with an option to purchase and the agreement provides for a

number of dates on which the purchase option may be exercised, the annual percentage rate of charge shall be calculated for each of ~~the~~ these dates. Where the residual value cannot be determined, the goods hired shall be subject to Linear amortisation that makes its value equal to zero at the end of the normal hire Period laid down in the credit agreement.

~~*7. Where a credit agreement provides for a prior or simultaneous constitution of savings and the borrowing rate calculation rate is set in relation to these savings, the annual percentage rate of charge shall be calculated in accordance with the procedure set out in Annex III.*~~

Art. 13 Usury and Default Interest Rate

1. Remuneration for the extension of credit may be charged only if the annual percentage rate of charge is less than the usury rate.

2. Member states will regulate the maximum interest rate charged on the outstanding capital in case of default in a manner which will not exceed the calculation rate agreed in the credit contract.

1. For definition and purpose see above Art. 1(i). There are different models for possible sanctions. If only the parts of the credit cost exceeding the usury rate are not recoverable, usury would be risk-free for the creditor. The same is still true for sanctions where the APR is reduced to the average market rate. It is only if the credit costs are completely irrecoverable in usury cases that creditors will face sufficient risk to make them observe these rules, and consumers will have sufficient incentives to pursue their rights.

The campaign during the 1980s in Germany showed that, even at that time, less than 5% of those who would have been entitled to a refund took advantage of this strict German regulation. But it has been effective to the extent that openly usurious credit has become the exception. At present, usurious credit is hidden in linked transactions, a problem which is addressed in this Directive as well.

2. There should be no incentive for lenders to cancel credit agreements only in order to gain higher interest than before.

There is no need for a misleading additional “lending rate” which will render credit contracts even more complicated for consumers.

Article 13 Total lending rate

~~1. For the purpose of calculating the total lending rate, the sums levied by the creditor shall be determined, with the exception of charges payable by the consumer for noncompliance with any of his commitments laid down in the credit agreement and charges other than the purchase price which, for purchases of goods or services, he is obliged to pay whether the transaction is paid in cash or on credit.~~

~~2. The costs of maintaining an account recording both payment transactions and credit transactions, the costs of using a card or another means of payment for both payment transactions and drawdowns, and the costs relating to payment transactions in general shall be~~

~~regarded as sums levied by the creditor unless they have been clearly and separately shown in the credit agreement or in any other agreement concluded with the consumer.~~

~~3. The following shall be excluded from the sums levied by the creditor for the purposes of calculating the total lending rate:~~

~~a) costs associated with ancillary services relating to the credit agreement, which the consumer is free to obtain from the creditor or any other provider;~~

~~b) costs payable by the consumer on conclusion of the credit agreement to persons other than the creditor, in particular the notary, tax authorities, registrar of~~

~~mortgages, and any costs in general imposed by the authority responsible for registration and sureties.~~

~~4. The total lending rate shall be calculated in accordance with the procedures and assumptions referred to in Article 12 (3) - (7) and Annexes I and II.~~

Article 14 ~~Borrowing rate~~ Calculation rate

1. The ~~borrowing rate~~ calculation rate may be fixed or variable.

2. Where one or a number of fixed ~~borrowing rate~~ calculation rates have been established, they shall apply for the duration of the period specified in the credit agreement.

3. A variable ~~borrowing rate~~ calculation rate shall ~~may not~~ vary until the end of agreed ~~even~~ periods provided for in the credit agreement ~~and may do so only if in line with~~ the agreed ~~objective~~ index or reference rate ~~deviates at a certain margin. It shall relate to the net initial calculation rate proposed when the credit agreement was concluded and should not exclude all forms of rebate, reduction or other advantages.~~ ~~4.~~ The consumer shall be informed of any change to the ~~borrowing rate~~ calculation rate, on paper or on another durable medium. This information must include the new annual percentage rate of charge, the creditor's new total lending rate and, where applicable, the new amortisation table. The calculation of the new annual percentage rate of charge and the creditor's new total lending rate shall be based on Article 12 (3).

3. The variable calculation rate is a dangerous instrument because it shifts all risk to the consumer. This is why regulation must be thorough in order to prevent unforeseen changes, arbitrary use and overindebtedness.

For this purpose, the regulation scattered between a standard contract term regulation (article 15) and a strict regulation (article 14 3. + 4.) should be integrated into one paragraph within article 14 No 3.

CHAPTER VI – UNFAIR TERMS**Article 15 Unfair terms**

Without prejudice to the application of Directive 93/13/EEC to the agreement as a whole ~~or to the implication the clauses may have for other rules contained in this Directive~~, terms in a credit agreement or surety agreement shall be regarded as unfair if their object or effect is to:

a) impose on the consumer, as a condition for a drawdown, a requirement to leave as surety, in full or in part, the sums borrowed or granted, or to use them, in full or in part, to constitute a deposit

The proposal moves away from a coherent approach in that it switches to standard contract terms law. This law is regulated according to other especially general principles. It is preferable that this Directive use strict rules because they have the same effect on standard contract terms and can be argued also in standard contract law.

It should be made clear in particular that unfair terms are not just void but may also contribute to assessing whether there is a breach of other rules contained in this Directive. If, for example, a drawdown is agreed, it will affect the APR, which

or purchase securities or other financial instruments, unless the consumer obtains the same rate for such deposit, purchase or surety as the agreed annual percentage rate of charge; should be calculated according to the true amount of credit given to the consumer. It may also affect the usury ceiling. Clauses which are void therefore still count as this type of breach.

b) oblige the consumer, when concluding a credit agreement, to enter into another contract with the creditor, credit intermediary or a third party designated by them, unless the costs thereof are included in the total cost of the credit; d) and e) It is confusing that variable rates are regulated in three different places. Consumers should have a coherent view of all regulations concerning this form of credit agreement in one place. This is why these regulations have been transferred into article 14

c) vary any contractual costs, indemnities or charges other than the ~~borrowing rate calculation rate~~;

~~*d) introduce rules on the variability of the borrowing rate calculation rate that discriminate against the consumer;*~~

~~*e) introduce a system involving a variable borrowing rate calculation rate which does not relate to the net initial borrowing rate calculation rate proposed when the credit agreement was concluded and which would exclude all forms of rebate, reduction or other advantages;*~~

f) oblige the consumer to use the same creditor to refinance the residual value and, in general, any final payment on a credit agreement for financing the purchase of movable property or a service.

CHAPTER VII – PERFORMANCE OF A CREDIT AGREEMENT

Article 16 Early repayment

1. The consumer shall be entitled to discharge fully or partially his obligations under a credit agreement ~~at any before the time~~ before the time fixed in the agreement.

2. The consumer shall have a right to a full refund of prepaid or precalculated interest or other payments within linked transactions inherent in the outstanding debt.. Any indemnity claimed by the creditor for early repayment shall be fair and objective and shall be calculated on the basis of actuarial principles. No indemnity shall be claimed:

~~a) for credit agreements where the period used to fix the borrowing rate calculation rate is less than one year;~~

~~b) if repayment has been made under an insurance contract intended to provide a conventional credit repayment guarantee;~~

~~c) for credit agreements which provide for payment of charges and interest without capital amortisation, with the exception of the credit agreements referred to in Article 20.~~

Article 17 Assignment of rights

Where the creditor's rights under a credit agreement or surety agreement are assigned to a third party, the consumer and, where applicable, the guarantor, shall be entitled to plead against the assignee of the creditor's rights under that agreement any defence which was available to him against the original creditor, including set-off where the latter is permitted in the Member State concerned.

1. Some countries have misinterpreted the previous right to early repayment by introducing a minimum term for the life of the loan, which may amount to as much as one year as it does in Germany. It should be clear that effective discharge is only possible if the consumer is able to repay the debt at any time without punishment.

2. The proposal now seems to permit indemnities. This will destroy the effects of No 1. If the regulation should be effective no "new" indemnities but only fees which cover the costs which arise from the administration of the early repayment can be claimed.

Lenders are sufficiently well-protected through the fact that the refund is limited to interest and insurance premiums and other fees which can be seen as the counterpart of future services. In particular, it does not comprise the initial fees so that lenders are compensated for their work in entering into the contract.

A clear and strict rule also makes further exemptions unnecessary and streamlines the Directive.

Unchanged

Article 18 Ban on the use of bills of exchange and other securities

Unchanged

The creditor or assignee of the creditor's rights under a credit agreement or surety agreement shall not require or invite the consumer or guarantor to guarantee payment of their commitments under that agreement by means of a bill of exchange or promissory note. Moreover, the consumer or guarantor shall not be required to sign a cheque guaranteeing repayment, in full or in part, of the amount due.

Article 19 Joint and several liability

Unchanged

1. Member States shall ensure that the existence of a credit agreement shall not in any way affect the rights of the consumer against the supplier of goods or services purchased by means of such an agreement in cases where the goods or services are not supplied or are otherwise not in conformity with the contract for their supply.

2. If the supplier of goods or services has acted as credit intermediary, the creditor and the supplier shall be jointly and severally liable for indemnifying the consumer where the goods or services the purchase of which has been financed by the credit agreement are not supplied, or are supplied only in part, or are not in conformity with the contract for their supply.

CHAPTER VIII – SPECIFIC CREDIT AGREEMENTS

Article 20 Separation of Amortisation and Credit Agreements in Linked Transactions~~Credit agreement providing constitution of capital~~

The wording of the Directive is not comprehensive. The article refers to a special form of linked transactions. There is no need for an additional concept.

1. If payments made by the consumer do not give rise to an immediate corresponding amortisation of the total amount of credit, but are used to constitute capital during periods and under

conditions laid down in the credit agreement, such constitution of capital shall be based on an ancillary agreement attached to the credit agreement.

2. The ancillary agreement referred to in paragraph 1 shall provide for an unconditional

guarantee of repayment of the total amount of credit drawn down. If the third party ~~providing constitution of capital~~ fails to comply with his obligations, the creditor shall assume the risk.

3. Payments, premiums and recurrent or non-recurrent charges payable by the consumer under the ancillary agreement referred to in paragraph 1, together with interest and charges under the credit agreement, shall constitute the total cost of the credit. The annual percentage rate of charge and the total lending rate shall be calculated on the basis of the total commitment subscribed to by the consumer.

Article 21 Credit agreement in the form of an advance on a current account or a debit account

unchanged

Where a credit agreement covers credit in the form of an advance on a current account or debit account, the consumer shall be regularly informed of his debit situation by means of a statement of account, on paper or on another durable medium, containing the following information:

- a) the precise period to which the statement of account relates;*
- b) the amounts and dates of drawdowns;*
- c) where applicable, the outstanding balance due from the previous statement, and the date thereof;*
- d) the date and amount of charges due;*
- e) the dates and amounts of payments made by the consumer;*
- f) the last agreed ~~borrowing rate~~ calculation rate;*
- g) the total amount of interest due;*
- h) where applicable, the minimum amount to be paid;*
- i) where applicable, the new balance outstanding;*
- j) the new total amount outstanding, including any interest on arrears or penalties.*

Article 22 Open-end credit agreement

Either party may terminate an open-end credit agreement by giving three months' notice drawn up on paper or on another durable medium in accordance with the procedures laid down in the credit agreement and in accordance with national legislation regarding proof irrespective of a more

The proposal would prohibit lines of credit, which would give consumers more security in credit use. It should be made clear that, if consumers reach an agreement which guarantees the line of credit for longer than three months, it is still permissible. A consumer protection Directive should not introduce rights for the supplier.

favourable agreement for the consumer.

CHAPTER IX: PERFORMANCE OF A SURETY AGREEMENT

Article 23 Performance of a surety agreement unchanged

1. A guarantor may conclude a surety agreement guaranteeing repayment under an open-end credit agreement for a period of three years only. This surety may be extended only with the specific agreement of the guarantor at the end of that period.

2. The creditor may take action against the guarantor only if the consumer, having defaulted on repayment of the credit, has failed to comply with a default notice within three months.

3. The amount guaranteed may only equal the outstanding balance of the total amount of credit and any arrears in accordance with the credit agreement, with the exclusion of any other indemnities or penalties provided for by the credit agreement.

CHAPTER X: NON-PERFORMANCE OF A CREDIT AGREEMENT

Article 24 Default notice and enforceability unchanged

1. Member States shall ensure that:

a) creditors, their representatives and any other assignee of the creditor's rights under a credit agreement or surety agreement may not take disproportionate measures to recover amounts due to them in the event of non-performance of such agreements;

b) the creditor may demand immediate payment in the event of default or invoke a clause providing an express resolute condition only through a prior default notice requesting the consumer or, where applicable, the guarantor to comply with his obligations under the agreement

within a reasonable period of time or to apply for rescheduling of the debt;

c) the creditor may not suspend the consumer's drawdown rights unless he justifies his decision and is required to inform the consumer without delay;

d) in the event of non-performance of their obligations or in the event of early repayment, the consumer and the guarantor are entitled, on request and without delay, to receive a detailed statement of account, free of charge, allowing them to verify the charges and interest claimed.

2. A default notice as referred to in paragraph 1 (b) is not necessary:

a) in the event of manifest fraud, evidence of which shall be provided by the creditor or the assignee of the creditor's rights;

b) where the consumer alienates the property financed before the total amount of credit is repaid or uses the property in a manner inconsistent with the conditions of the credit agreement, and where the creditor or the assignee of the creditor's rights has a preferential claim, right of possession or reservation of title on the property financed, provided that the consumer has been informed of the existence of such preferential claim, right of possession or reservation of title prior to the conclusion of the contract.

Article 25 Overrunning of the total amount of credit and tacit overdraft unchanged

1. In the event of an authorised temporary overrunning of the total amount of credit or a tacit overdraft, the creditor shall inform the consumer without delay, in writing or on another durable medium, of the amount involved and the ~~borrowing rate~~calculation rate applicable. No penalties, charges or interest on arrears shall be included.

2. The creditor shall inform the consumer without delay that he has overrun the credit amount or is in an unauthorised overdraft situation and shall inform him of the ~~borrowing rate~~calculation rate and/or the charges or penalties applicable.

3. Any overrunning or overdraft as referred to in this article shall be rectified within three months, where necessary through a new credit agreement providing for a higher total amount of credit.

Article 26 Repossession of goods Unchanged

In the case of credit agreements for the acquisition of goods, Member States shall lay down the conditions under which goods may be repossessed. If the consumer has not given his specific consent at the moment the creditor proceeds for repossession and if he has already made payments corresponding to a third of the total amount of credit, the goods financed may not be repossessed unless by judicial proceedings. Member States shall further ensure that, where the creditor repossess the goods, the account between the parties is made up so as to ensure that repossession does not entail any unjustified enrichment.

Article 27 Recovery Unchanged

1. Natural or legal persons who undertake, as their principal or as a secondary activity, and not

as part of any court procedure, the recovery of debts arising from a credit agreement or surety agreement, or who intervene in this respect, may not, in any form whatsoever, either directly or indirectly, claim any fee or indemnity from the consumer or guarantor for their intervention, unless such fees or indemnities are specifically agreed in the credit agreement or surety agreement.

2. In the context of the recovery of debts arising from a credit agreement or surety agreement, the following shall be prohibited:

a) any document which, as a result of its appearance, wrongly gives the impression that it is from a judicial or debt mediation authority;

b) written communications containing incorrect information on the consequences of defaulting on payment;

c) unauthorised repossession of goods without judicial proceedings or the specific consent referred to in Article 26;

d) any inscription on an envelope which makes it clear that the correspondence concerns the recovery of a debt;

e) collection of charges not provided for by the credit agreement or surety agreement;

f) any contact with the neighbours, relatives or employer of the consumer or guarantor, especially any communication of, or request for, information on the solvency of the consumer or guarantor, without prejudice to actions forming part of statutory seizure procedures as established by Member States;

g) physical or psychological harassment of a consumer or guarantor;

h) recovery of a lapsed debt.

CHAPTER XI: REGISTRATION, STATUS AND CONTROL OF CREDITORS AND CREDIT INTERMEDIARIES

Article 28 Registration of creditors and credit intermediaries unchanged

1. Member States shall ensure that creditors and credit intermediaries apply for registration. The obligation to register does not apply to credit intermediaries for whom a creditor or another credit intermediary assumes responsibility under the terms of his own registration. This assumption of responsibility must be made clear in a notice on the premises of credit intermediaries not required to register.

2. Member States shall:

a) ensure that the activities of creditors and credit intermediaries are subject to inspection or monitoring by an institution or official body;

b) establish appropriate bodies to receive complaints concerning credit agreements, surety agreements and credit and surety conditions, and to provide consumers and guarantors with relevant information or advice on this subject.

3. Member States may stipulate that registration as referred to in the first subparagraph of paragraph 1 of this article shall not be necessary where the creditor or credit intermediary concerned is a "credit institution" within the meaning of Article 1(1) of Directive 2000/12/EC of the European Parliament and of the Council⁴⁵ and is authorised in accordance with the provisions of that Directive. Where a creditor or credit intermediary is both registered under the provisions of the First subparagraph of paragraph 1 of this article and authorised under the provisions of Directive 2000/12/EC of the

European Parliament and of the Council, and the latter authorisation is subsequently withdrawn, the competent authority which has registered the creditor or credit intermediary shall be informed and shall decide whether the creditor or credit intermediary may continue to grant or arrange credit or whether his registration should be cancelled.

Article 29 Obligations of credit intermediaries unchanged

Member States shall ensure that a credit intermediary:

a) indicates in advertising and documentation intended for clients the extent of his powers, in particular whether he works exclusively with one or more creditors or as an independent broker;

b) communicates to all creditors contacted the total amount of other credit offers he has requested or received for the same consumer or guarantor during the two months preceding conclusion of the credit agreement;

c) does not receive, directly or indirectly, any fee, in whatever form, from a consumer who has requested his services, unless all the following conditions are met:

i) the amount of the fee is stated in the credit agreement,

ii) the credit intermediary does not receive a fee from the creditor,

iii) the credit agreement for which he has acted is actually concluded.

Art. 30 Circumvention and Minimum harmonisation

1. Member States shall ensure that credit agreements shall not derogate, to the detriment of the consumer, from the provisions of national law implementing or corresponding to this Directive. 2. Member States shall further ensure that the provisions which they adopt in implementation of this Directive are not circumvented as a result of the way in which agreements are formulated, in particular by the devise of distributing the amount of credit over several agreements.

Art. 15 of the present Directive relating to minimum harmonisation in conformity with the EU Treaty should be upheld.

The Directive should equally reinsert the old Art. 14 which prevented its derogation through the misuse of legal forms.

2. This Directive shall not preclude Member States from retaining or adopting more stringent provisions to protect consumers consistent with their obligations under the Treaty.

Annex I

The calculation is done on the basis that a capital C_0 (present value) grows in t years with a growth-rate of $(1+i)$ (if i is the traditional interest rate) into a capital C_t (future value) according to the formula: $C_t = C_0(1+i)^t$

The APR is calculated by means of a spreadsheet.

In this spreadsheet, the first column contains all data relating to payments agreed between the parties (payment of the capital, interest payments and repayments, as well as costs debited to the account). Payments by the creditor are entered in the second column and those by the consumer in the third column.

The fourth column serves to calculate the APR. Its first row contains the balance of payments at the first date. This is where the credit started. The second row is calculated from the figures in the first row plus payments by the creditor minus payments by the debtor in the second row multiplied by a growth rate which is $1 +$ an interest rate which should be stored in an additional place. This growth rate will have an exponent, which is the difference between the date of the second row and the date of the first row in days divided by 365.125.

The APR is then calculated using the "target value" function of a spreadsheet, which tries out interest rates until the last row of the fourth column contains the future value which is the sum due at the end of the credit contract (normally "0")."

(the following tables illustrate the spreadsheet calculation as presented in the text).

The proposed Annexes are far too complicated for lay-people, including lawyers and consumer advocates, and they contain too much unnecessary information for experts.

For experts, the mathematical growth function is sufficient to explain how calculations should be done. (There is no other mathematical secret in this calculation not already expressed in this formulation.) For consumers, recourse to computerised spreadsheets simplifies the calculation and opens the way to wider public control of bank behaviour. The rule-makers should acknowledge that the computer conquered the world 30 years ago and makes the traditional financial mathematical formulae superfluous in that computers compensate for aggregate calculation through speed.

This gives consumers the opportunity to understand the growth function by just understanding one step of the iterations.