

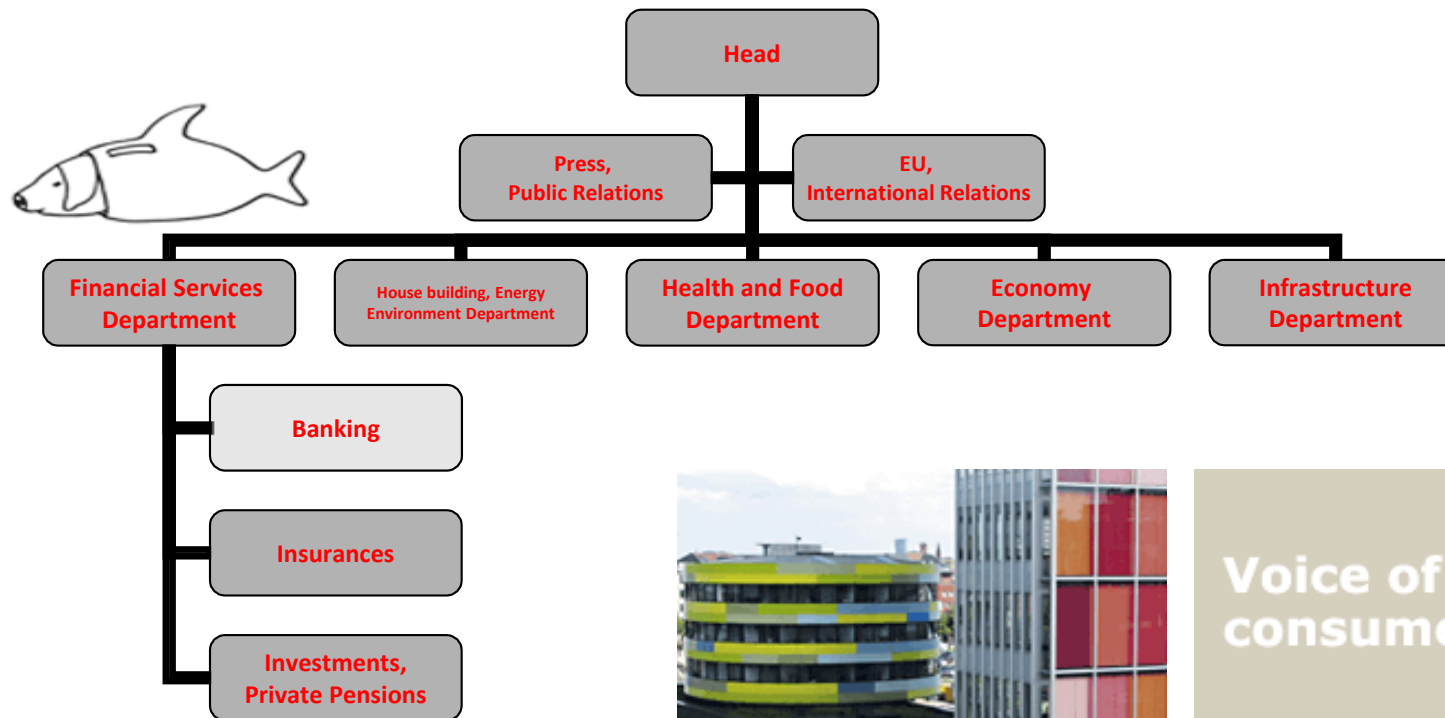
Concepts of consumer protection with consumer credit

Legal provisions and experiences in Germany
With some hints on interesting EU developments

Frank-Christian Pauli
vzbv Germany

consumer centres
of Germany's
16 federal states

24 other
consumer-oriented
organizations and
associations



Voice of the
consumer

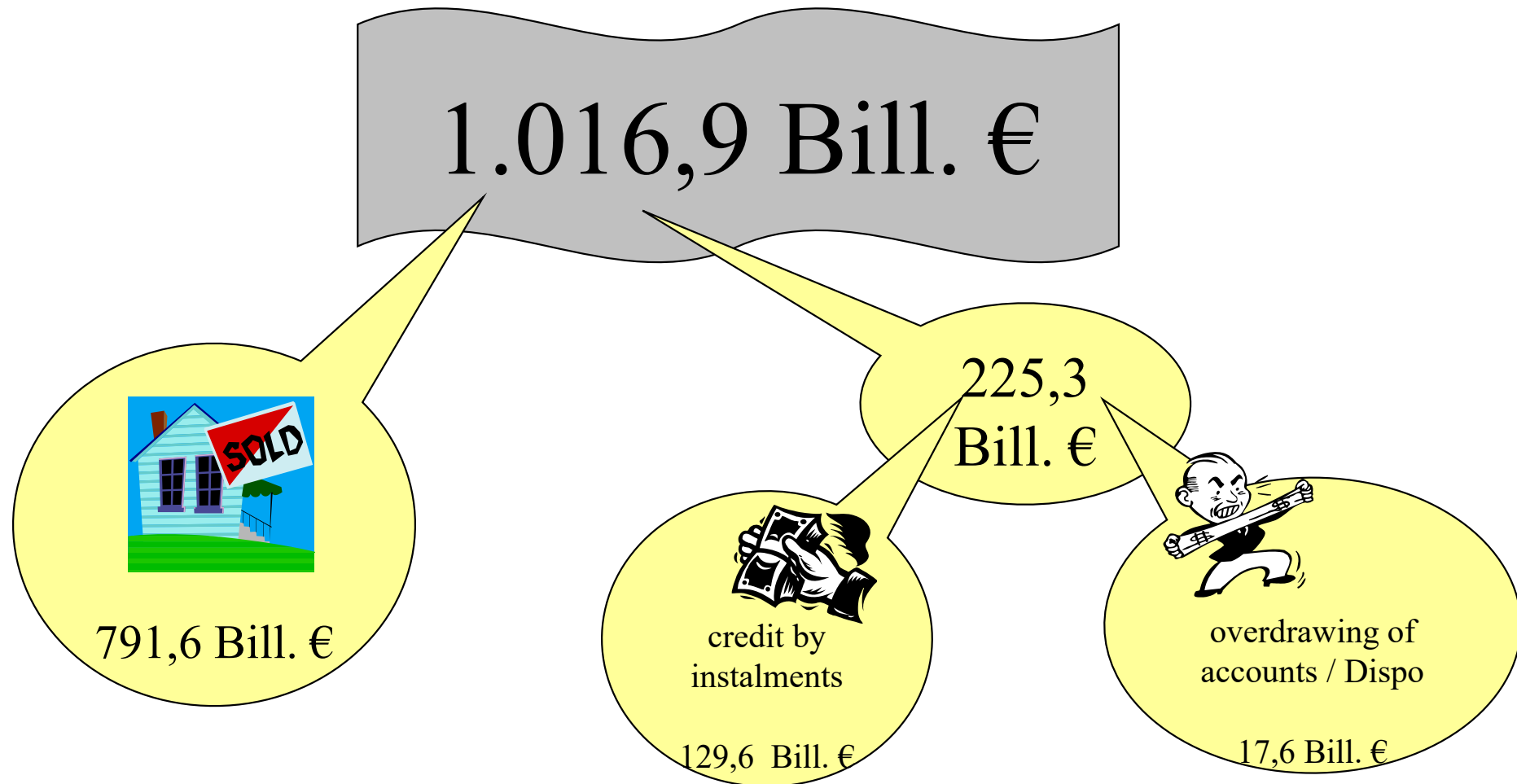
Member of BEUC and CI

What we do ...



- ❖ We represent the interests of consumers in public and vis-à-vis legislators, the private sector and civil society.
- ❖ Our goal is to protect and empower the consumer. We do this by lobbying and campaigning at national and European levels, by taking collective legal action on behalf of consumers and by ensuring that our message receives broad media coverage. We also provide professional training for the staff of consumer organisations.
- ❖ Consumer advice is provided at a regional level by the 16 consumer centres of the German states (Verbraucherzentralen)

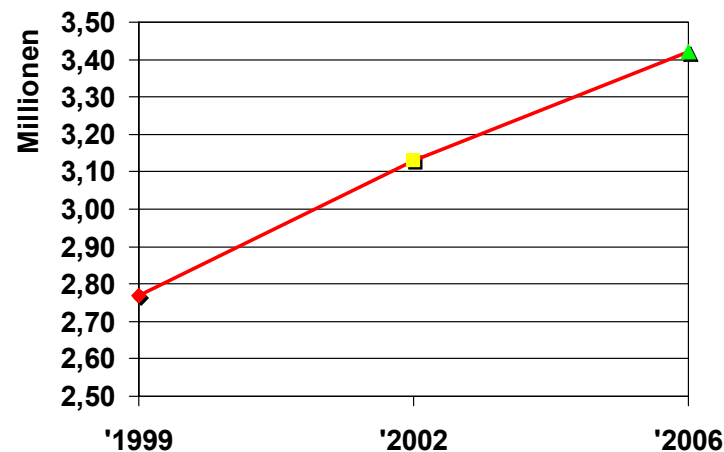
Credit Amount by Consumers in Germany (Q2 2007)

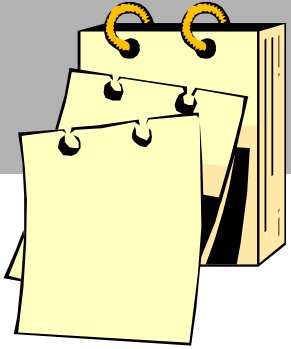


The Opposite Side of the Medal



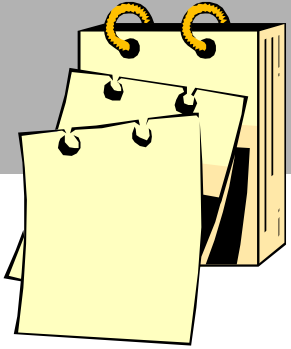
More than 3,42 Mill. households are over-indebted! Every tenth!





Short review on development of consumer credits in Germany I

- ❖ 1950s, 1960s – Having debts socially avoided – Market on private credits insignificant
- ❖ 1970s – With secured economic situations, long-term employment – consumer credit market arises – no specific regulations so far



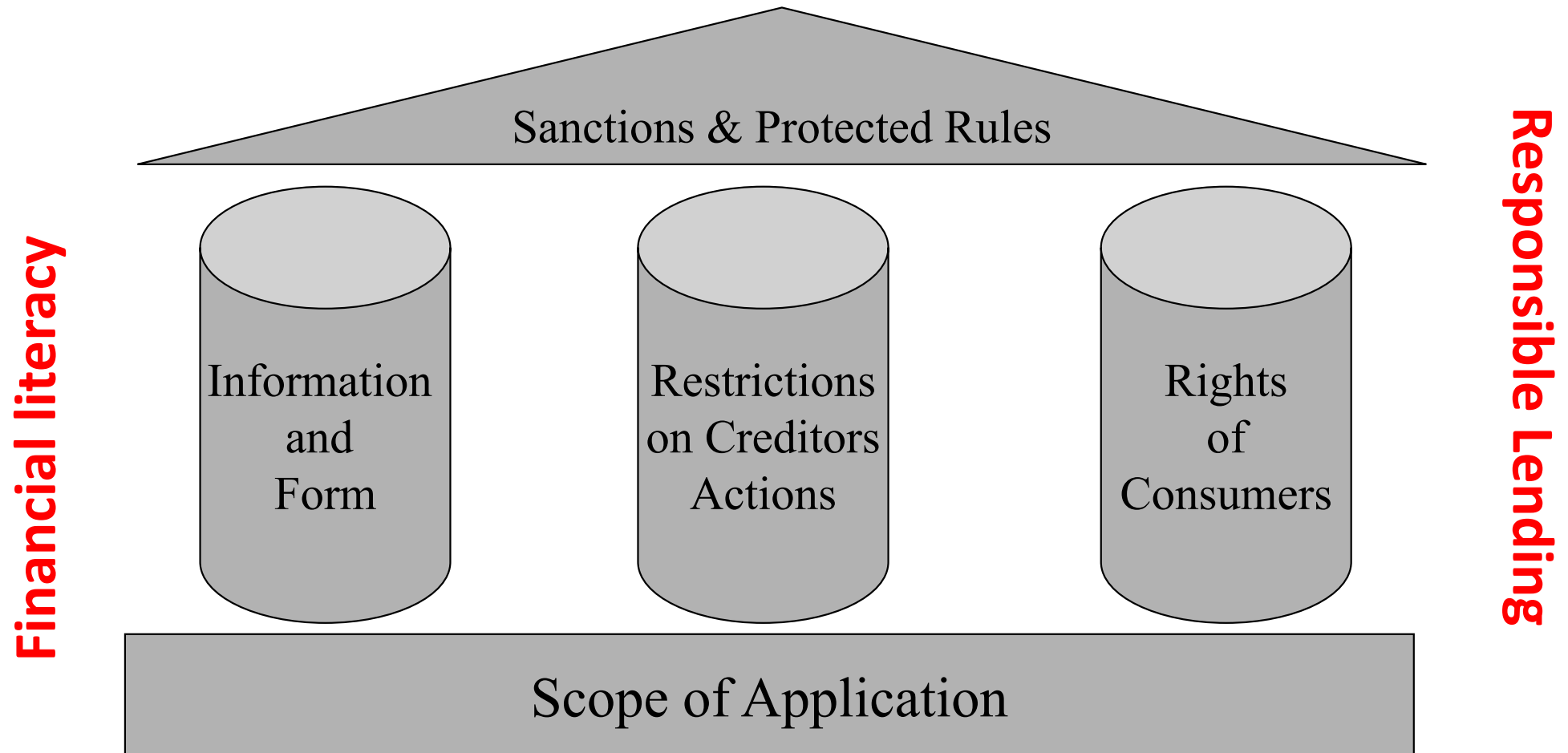
Short review on development of consumer credits in Germany II

- ❖ 1980s – Consumer Credits have become socially acceptable yet continuity of employment started to diminish
- ❖ Main causes of default:
 - ❖ Job loss
 - ❖ Founding Families and Divorce

Problems leading to this

- ❖ Too restricted or too easy access to credit
- ❖ Overestimated financial capacities – underestimated costs and duties
- ❖ Irresponsible lending
- ❖ Unsuitable handling of financial distress

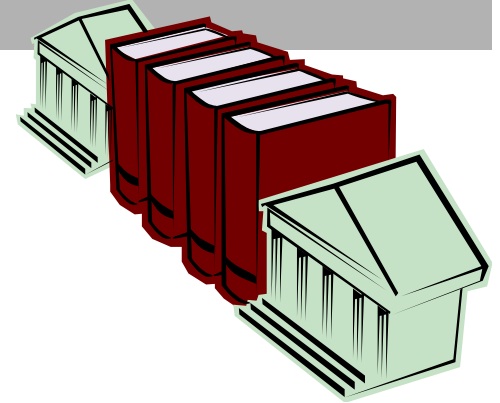
Consumer Credit Regulations





EU – Consumer Credit Directive

- ❖ 1986 – Consumer Credit Directive (87/102/EEC) → 1990 Consumer Credit Law in Germany
- ❖ Since 2002 new draft in development, to be concluded probably by 2008
- ❖ Common rules for an internal market
- ❖ Maximum harmonisation of some important definitions & issues
- ❖ Like APRC, like Standard Information
- ❖ Differences in national legislation – do not expect full set of rules of new CCD



German Law - Today

❖ Civil Code (BGB)

❖ Law of Contract (2nd Book)

❖ Special Types of Contract (8th chapter)

- Credit Contracts (§§ 488 – 507)
 - Consumer Credit Contracts (§§ 491- 498)
 - Moratorium, payment by instalments, Consumer Leasing (§§ 499 – 504)
 - Contract by instalments in payment and fulfillment (§ 505)
 - Further Rules (§§ 506 and 507)

❖ Law of Property (3rd Book)

General Rule to Specific Rule (lex specialis)

Information and Form – Why?

- ❖ Consumers right to chose and compare – market regulation
- ❖ Prevention of false interpretation of costs and repayment issues
- ❖ Warning of significance of contract

Information and Form – Rules

- ❖ At least in writing, copy has to be given to consumer
- ❖ ordinary contract has to contain:
 - ❖ net amount of credit, limit
 - ❖ total amount of payments (repayments, interests, costs) in case of variations according to current conditions
 - ❖ Conditions of repayment, ending of contract
 - ❖ Interest rates, all known costs in detail, all other costs in reason, incl. provisions
 - ❖ **annual percentage rate**, conditions of change
 - ❖ any insurance costs in relation to the contract
 - ❖ Securities

The Annual Percentage Rate of Costs

Main indicator of costs, comparable

Problems in Germany:

- ❖ Residual debt insurance costs
- ❖ Hidden costs and repayment risks with further products as means of repayment
- ❖ Risked based-pricing – no easy market comparison, potentially discriminating, higher costs for weaker consumers = higher potential of failure



The APRC

- ❖ „Total cost of the credit“ – Consumers view!
- ❖ „all the costs, including interest, commissions, taxes and any other kind of fees which the consumer has to pay ... and which are known to the creditor except for notary costs; costs relating to ancillary services ..., in particular insurance premiums, are also included if, in addition, the conclusion ... is compulsory for obtaining the credit either at all or on the terms and conditions marketed“
- ❖ „Cash-Flow Method“
- ❖ Assumptions for adverts and precontractual information

Variable Interest Rates

- ❖ Dangerous from a consumer's perspective
- ❖ Should give exact rule on how adjustments are done (amount, caps, index, periods)



Standard Information Sheet

- ❖ Annex 2 of new CCD
- ❖ Ordered, predefined Form
 - ❖ Readable
 - ❖ Comprehensible
 - ❖ Comparable
 - ❖ Health Warnings



SIS content discussed

- ❖ Information shall be given in a logical order. Amount of credit, total cost of contract (with APRC), monthly installments, payments, use of repayment (how they will be accounted on interests, credit amount etc.), securities.
- ❖ Total cost of credits shall be broken down into cost elements and must indicate the parameters of change concerning variable rates.
- ❖ Important Legal Hints e.g. right of withdrawal (not a yes/no option. simply state the right and its terms of application)



Article 5
Pre-contractual information³¹

1. [...]
2. In good time before the consumer is bound by any credit agreement or offer, the creditor and, where applicable, the credit intermediary shall provide the consumer, on paper or on another durable medium, with the information needed for the conclusion of the credit agreement under consideration. That information shall include a clear and concise description of the product. The information shall refer to:
 - (a) the duration of the credit agreement;
 - (b) the total amount of credit and the conditions governing the drawdown;
 - (ba) in case of a credit in the form of deferred payment for a good or service, the product or service and its cash price;
 - (c) the borrowing rate, the conditions governing the application of the borrowing rate and, where available, any index or reference rate applicable to the initial borrowing rate, as well as the periods, conditions and procedure for varying the borrowing rate. If different borrowing rates apply in different circumstances, the above mentioned information on all the applicable rates;
 - (d) the annual percentage rate of charge and the total amount payable by the consumer, by means of a representative example mentioning all the [...] assumptions used for calculating this rate; where the consumer has informed the creditor of one or more components of his preferred credit, such as the duration of the credit agreement and the total amount of credit, the creditor has to take into account these components;

³¹ LU: reservation following the deletion of Article 21(2).
LU/SE/UK: more information should be provided (e.g. on creditor's identity, creditor's geographical address).





verbraucherzentrale

Bundesverband



(Headlines)

1. Information on the creditor / intermediary
(Reason: Identification and contact)
Name, Address, Phone, other options of contact

2. Basic concept and information about the contract

Amount and conditions governing the drawdown	
If applicable: Product or Service and Cash Price	
Duration of the Credit Agreement	
APRC	
Description of the product (including fixed or variable rates, instrument of repayment if applicable)	Rate and assumptions used for calculating this rate in accordance to Art. 5 2. (c)
Sureties required	

(Reason: to make it easy to compare with other products, and to ensure that the consumer knows what he/she is committing oneself to).

3. Costs of the Contract

Costs relating to the credit contract

Commissions	
Taxes	
If applicable Notary costs	
Insurances	
If applicable Costs for maintaining an account for payment transactions / drawdowns	
If applicable Costs for using means of payment for payment transactions/drawdowns	
Obligatory services which cannot yet be stated with their costs	

Reason: All the costs (amount) at a glance.

4. Repayment Scheme and assessment of the evolution of the variable interest rate if applicable

Amount of payments	
Number of payments	
Frequency of payments	



Information obligations

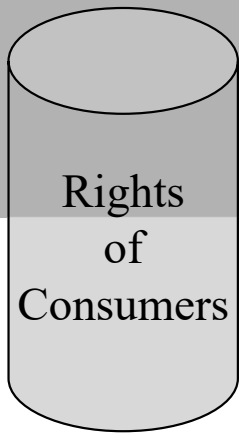
– a matter of timing

- ❖ Advertisement (assumptions, base)
- ❖ Precontractual Information (case-related, in good time before conclusion)
- ❖ Contractual Information

Restrictions
on Creditors
Actions

Restrictions in action concerning creditors

- ❖ Prevention of over-indebtedness
- ❖ = prevention of premature failure of contract
- ❖ Protection against aggravating conditions of consumers rights e.g. by means of cession
- ❖ Rules on interest rates in case of payment failure
- ❖ Rules on returning financed goods

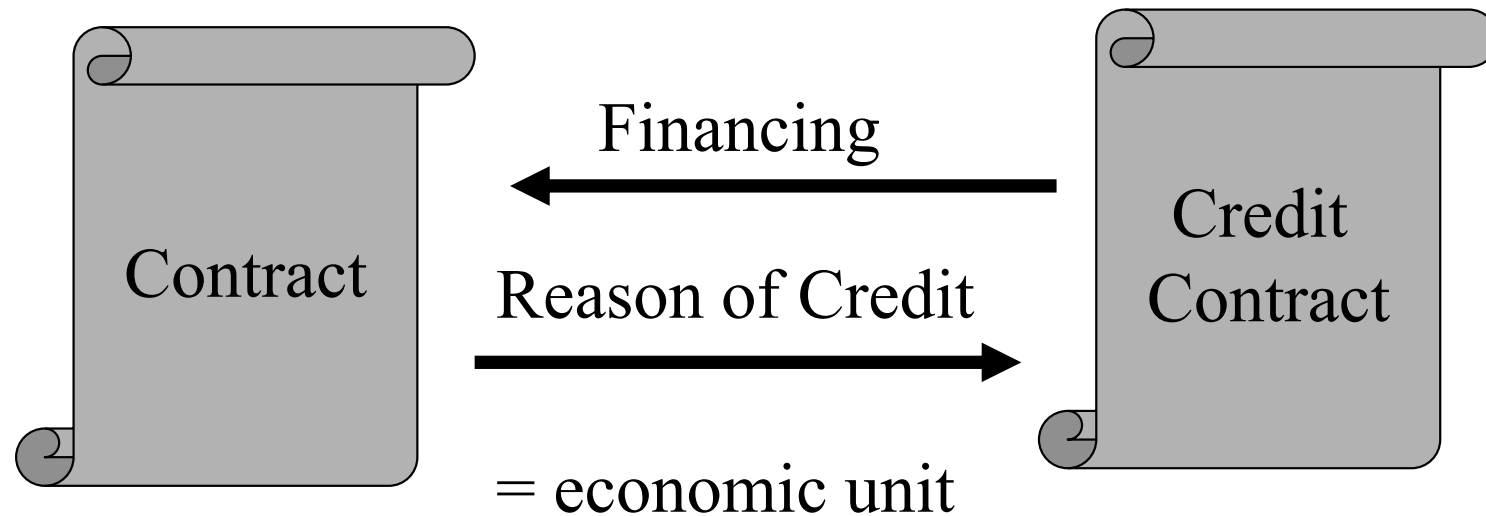


Special rights of action by consumers – Why?

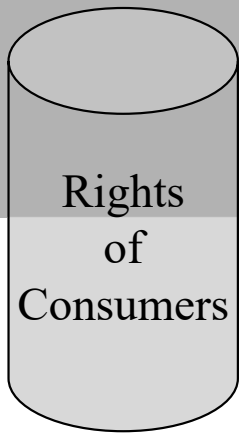
- ❖ Strengthening consumer as weaker part of a credit contract
- ❖ Enabling him/her to avoid financial disadvantages e.g. caused by sticking to a long-term contract
- ❖ = preventing financial damages / insolvency
- ❖ Freedom to pursue ones rights in case of financed contracts

Rights
of
Consumers

Special rights of action by consumers – Rules



Cancelling the Contract cancels the credit contract as well.
Price reduction reduces Credit amount.
Instead of repayment to creditor right to return good.



Special rights of action by consumers – Rules

- ❖ Extraordinary right of cancellation of a mortgage credit contract by consumer in case of special interest, e.g. making use of the securities – Damages (Vorfälligkeitsentschädigung) are to be paid to creditor
- ❖ Right of Withdrawal or Right to Return for 14 days (cooling off)
- ❖ In cases of payment by instalments – right to repay earlier – no costs and interests exceeding 9 months

Sanctions and rule protection

- ❖ Germany (some examples):
 - ❖ Failure of Form → Void, if credit not used
 - ❖ Reduction of interests to legal rate if APR is missing
 - ❖ If APR information is wrong (too low) lower APR will apply
- ❖ Rules may not be altered by contract on behalf of consumers rights

Financial Literacy

- ❖ Important yet not sufficient
- ❖ Independent knowledge to be able to act responsible
- ❖ School, but what about adults today?
- ❖ Not on abstract money flows and probably soon outdated products, yet on concepts of money, time and risk

Debt Counselling and Consumer Insolvency

- ❖ Independent debt counselling
 - ❖ Account duties, check on duties, help tp settling them
→ payment plan
- ❖ Consumer insolvency
 - ❖ (currently under reform)
 - ❖ agreement by court or insolvency
 - ❖ and period of „well-behaving“
 - after 6 years free of debts
(repayment of court fees may start now)

Responsible lending: how it should be

P1: Responsible and affordable credit must be provided for all.

- a. Credit is an essential for full participation in society.
- b. Banks should not discriminate and should provide real access.
- c. Credit to Consumers and Small Businesses must be supervised.

P2: Credit relations have to be transparent and understandable.

- a. Competitive transparency requires a standardized mathematically correct form of “one-price” disclosure (the Annual Percentage Rate of Charge or APRC).
- b. Social transparency requires a standardized pre-contractual payment plan.
- c. Consumers should be provided with adequate time for reflection and with access to independent advice.
- d. Consumers should have access to independent financial, credit and debt advice.
- e. Both parties in the credit markets have to take part in a mutually productive process of financial education.

Responsible lending: how it should be (2)

P3: Lending has at all times to be cautious, responsible and fair.

- a. Credit and its servicing must be productive for the borrower.
- b. Responsible lending requires the provision of all necessary information and advice to consumers and liability for missing and incorrect information.
- c. No lender should be allowed to exploit the weakness, need or naivety of borrowers.
- d. Early repayment, without penalty, must be possible.
- e. The conditions under which consumers can refinance or reschedule their debt should be regulated.

P4: Adaptation should be preferred to credit cancellation and destruction.

- a. There is a need for effective protection against unfair credit cancellation.
- b. Default charges should be adequate to cover losses only.

Responsible lending: how it should be (3)

P5: Protective legislation has to be effective.

- a.** Credit regulation has to cover all non-commercial users.
- b.** Credit regulation has to cover all commercial forms of credit provision.
- c.** Credit regulation has to cover the whole process of credit extension as experienced by its users.
- d.** Credit regulation has to encourage efficient social and economic effects of credit extension.

P6: Overindebtedness should be a public concern.


- a.** Profit-driven systems cannot cope with over-indebtedness.
- b.** Consumers should have a right to discharge.
- c.** Bankruptcy procedures should lead to rehabilitation and not to retorsion.

Responsible lending: how it should be (4)

P7: Borrowers must have adequate means to defend their rights and be free to voice their concerns.

- a.** There should be adequate individual as well as collective legal procedures to enforce borrowers' rights.
- b.** Critical public awareness is crucial for the development a fair and responsible distribution of credit.

<http://www.responsible-credit.net/>



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Responsible Credit

7th International Conference on Financial Services
Brussels, 14th and 15th September 2007

News in **all languages**

04/10/07 **CCD – Meeting at the European Parliament next week where ECRC Partner ULC from Luxemburg will present its key points on the Common Position and Commission legislative approach.**

Following this week's European Parliament meeting where the Committee on the Internal Market and Consumer Protection (IMCO) met on 2 October 2007, 16.00 – 18.30 to discuss: Harmonisation of the Member States' legislation on credit for consumers (repeal of Directive 87/102/EEC) IMCO/6/22866 (The Rapporteur was MEP Kurt Lechner (EPP-ED) and the aim was the Consideration of... [\[more...\]](#)

04/10/07 **"MUTUAL RECOGNITION" - Its unclear and imprecise use in EU-documents makes it unfit for use within consumer policy. Manfred Westphal and Christina Beck (German consumer organisations,...**

PROBLEM Mutual Recognition also addressed as a principle is used by European institutions, associations and politicians. But its meaning differs and although it leads to a seeming consensus, the parties actually using it understand its meaning quite differently. The Green book on consumer protection from February 2007 enumerates three options: full harmonisation... [\[more...\]](#)

01/10/07 **UK "RESPONSIBLE LENDING" LAUNCH** ECRC's UK partners will be launching

- ECRC / GCRC
- Statute
- News
- International Conferences >
- National Conferences >
- Principles >
- ECRC Newsletter >
- Issues [Conference Event No]**
- Topics >
- Regulation [P3] >
- European Social Contracts
- Best-Practice
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<http://www.credit-responsable.net/>

<http://www.credito-responsabile.net/>

<http://www.verantwortliche-kreditvergabe.net/>

Consumer Protection ...

- ❖ ... we are ALL consumers.
- ❖ ... means of quality of a service
- ❖ ... protection against financial hazard not only to consumer but to the market (US mortgage crisis!)