

STUDY

Requested by the ECON committee



Consumer Credit

Mis-selling of Financial Products



Policy Department for Economic, Scientific and Quality of Life Policies

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Mis-selling of Financial Products: Consumer Credit

STUDY

Abstract

This paper is part of a series of five studies on mis-selling of financial products in the EU. Retail financial markets across the EU have been upset by large-scale mis-selling of financial products to consumers. As part of a series of five studies on this topic, this paper examines the problem of mis-selling with a particular focus on consumer credit. It identifies the most problematic products and practices in consumer credit markets that may cause consumer detriment and shows some important limitations of the current EU regulatory framework for consumer credit in providing adequate consumer protection. This document was provided by Policy Department A at the request of the ECON Committee.

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LIST OF ABBREVIATIONS

ADR	Alternative dispute resolution
APRC	Annual percentage rate of charge
EBA	European Banking Authority
BEUC	European Consumer Organisation
CJEU	Court of Justice of the European Union
CMA	Competition and Markets Authority (UK)
EIOPA	European Insurance and Occupational Pensions Authority
ESAs	European Supervisory Authorities
ESMA	European Securities and Markets Authority
FCA	Financial Conduct Authority (UK)
FinCoNet	International Financial Consumer Protection Organisation
OFT	Office of Fair Trading (UK)
P2PL	Peer-to-peer lending
PPI	Payment protection insurance
UK	United Kingdom

EXECUTIVE SUMMARY

While more than a decade has passed since the outbreak of the global financial crisis, retail finance is still among the areas where European consumers are most dissatisfied with the products and services they receive. In particular, **basic consumer credit products**, such as personal loans, credit cards and overdraft facilities, may not only cause **major consumer detriment** but also adversely affect **the functioning of the EU's single market in financial services**.

This paper examines mis-selling of **consumer credit products**, i.e. unsecured credit provided for personal, household or domestic purposes, across the EU. The **aim** of this study is twofold:

- to identify and analyse the **most imminent problems** faced by consumers in **consumer credit markets**; and
- to assess **to what extent the current EU regulatory framework for consumer credit adequately addresses these problems**.

The **key findings** of the study include the following:

- The **most problematic products and practices** in consumer credit markets across the EU that have caused consumer detriment in the past and that are still a source of concern today include: **(1) the provision of high-cost credit**, such as payday loans or credit cards, **(2) cross-selling**, whereby consumer credit products are sold to consumers together with other products, such as payment protection insurance, and **(3) peer-to-peer consumer lending (P2PL)** which connects consumer lenders to consumer borrowers directly by means of an electronic P2PL platform outside the traditional financial sector. In particular, the **growing digitalisation of consumer finance** poses new risks to consumers.
- The **2008 Consumer Credit Directive** adopted before the outbreak of the financial crisis is **not well-equipped to address the consumer problems associated with the provision of high-cost credit, cross-selling, and peer-to-peer lending**. In the absence of a substantial degree of EU harmonisation of these matters, **Member States have a wide room for manoeuvre** to deal with them. The solutions adopted tend to vary greatly, both in relation to consumer protection standards and the way in which they are enforced, and raise questions about their effectiveness. This situation may create **incentives for regulatory arbitrage**, whereby credit providers from Member States with strict regulations engage in cross-border activities in countries with weaker regulations.
- At present, there is **no coherent EU policy agenda in terms of addressing consumer over-indebtedness**. This may result in **unjustified differences in the level of consumer protection** across different segments of consumer credit markets. Notably, the Mortgage Credit Directive adopted post-crisis has departed from the access to credit-oriented approach of the Consumer Credit Directive and introduced much more protective rules designed to prevent consumer over-indebtedness.
- **Further research is needed** to shed more light on the drivers of mis-selling in consumer credit markets and the Member States' responses thereto, and to determine whether the EU should take action and strike **a different balance between access to credit and consumer protection**.

1. INTRODUCTION

Responding to basic financial needs of consumers is a prerequisite for a sustainable financial system that serves the best interests of individual consumers and European societies at large. However, this prerequisite has not been met so far. Retail financial markets across the EU have been troubled by large-scale mis-selling of financial products to consumers¹. After more than a decade since the outbreak of the crisis retail finance is still among the areas where European consumers are most dissatisfied with the products and services they receive². While this is particularly the case when it comes to investment and mortgage products³, **'simple' consumer credit products**, such as personal loans, credit cards and overdraft facilities, may also prove to be problematic. Such basic products may cause unsustainable levels of over-indebtedness resulting in **major consumer detriment**. In addition, they may be **disruptive to the functioning of the EU's single market in financial services**⁴.

The post-crisis lending environment presents new risks to consumers and poses **new challenges for financial regulators** in terms of how to address them. It is notable that in the last few years consumers in most Member States have been increasing their level of debt in terms of both volume and value of consumer credit products⁵. Among the reasons for this trend, according to the European Banking Authority (EBA), are the low interest rate environment, the novel business practices of lenders aimed at finding new revenue sources, such as fees and charges on loans, and the innovative business models emerging on the market, such as peer-to-peer lending⁶. These developments may point to the need for revising the current regulatory framework in order to ensure adequate consumer protection in consumer credit markets.

The central piece of EU legislation governing the provision of consumer credit – **the 2008 Consumer Credit Directive**⁷ – dates back to the pre-crisis period and clearly reflects the **information paradigm of consumer protection**⁸. The idea behind this model is to improve the consumer decision-making process through the rules on information disclosure aimed at redressing information asymmetries between credit institutions and credit intermediaries, on the one hand, and consumers, on the other. A decision as to whether or not to enter into a particular credit agreement is generally left to the choice of the consumer who is presumed to be able to make a rational decision based on the information supplied by the credit institution or credit intermediary. Particularly in the aftermath of the financial crises, however, serious concerns have been raised about the effectiveness of the information model in ensuring adequate consumer protection in retail financial markets and the proper functioning of such markets more generally⁹. Both in the academic and regulatory settings,

¹ See e.g. Better Finance, 'A Major Enforcement Issue: The Mis-Selling of Financial Products', April 2017.

² See e.g. European Commission, *Consumer Markets Scoreboard: Making Markets Work for Consumers*, 2016, p. 18; European Commission, Green Paper on Retail Financial Services *Better Products, More Choice, and Greater Opportunities for Consumers and Businesses*, COM(2015) 630 final, p. 9.

³ European Commission, *Consumer Markets Scoreboard: Making Markets Work for Consumers*, 2016, p. 18. See also Better Finance, 'A Major Enforcement Issue: The Mis-Selling of Financial Products', April 2017.

⁴ European Parliament, *Consumer Protection Aspects of Financial Services: Study*, February 2014.

⁵ European Banking Authority, *EBA Consumer Trends Report 2017*, 28 June 2017, p. 4, 8.

⁶ Ibid.

⁷ Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC, OJEU 2008 L 133/66 (Consumer Credit Directive).

⁸ See e.g. O.O. Cherednychenko, 'Freedom of Contract in the Post-Crisis Era: Quo Vadis?' (2014) 10 *European Review of Contract Law*, p. 390, 408.

⁹ See e.g. E. Avgouleas, 'The Global Financial Crisis and the Disclosure Paradigm in European Financial Regulation: The Case for Reform' (2009) 6 *European Company and Financial Law Review*, p. 440; H.-W. Micklitz, 'The Paradox of Access to Financial Services for Consumers' (2010) *European Journal of Consumer Law*, p. 7; Y.M. Atamer, 'Duty of Responsible Lending: Should the European Union Take Action?', in S. Grundmann & Y.M. Atamer (eds), *Financial Services, Financial Crisis and General European Contract Law: Failure and Challenges of Contracting* (Alphen aan den Rijn: Kluwer Law International, 2011), p. 179; C.I. Garcia Porras & W.H. van Boom, 'Information

increasing attention has been given to the findings of behavioural economics¹⁰. The latter show that, due to their bounded rationality, consumers may systematically err when making financial decisions. As a result, perfectly rational decisions are often not feasible in practice even when consumers have been properly informed about the main features of a particular financial product¹¹.

Against this background, this paper examines mis-selling of **consumer credit products**, i.e. unsecured credit provided for personal, household or domestic purposes, across the EU. The **aim** of this study is twofold:

- to identify and analyse the **most imminent problems** faced by consumers **in consumer credit markets**; and
- to assess **to what extent the current EU regulatory framework for consumer credit adequately addresses these problems**.

For these purposes, the study will first consider relevant **empirical studies** carried out by or for governmental and non-governmental institutions that shed light on the problematic aspects of consumer credit markets across the EU. These include, inter alia, the reports prepared by or for the European Commission, the EBA and the competent authorities of the Member States, International Financial Consumer Protection Organisation (FinCoNet), as well as the European Consumer Organisation (BEUC) and the European Federation of Investors and Financial Services Users (Better Finance). Subsequently, the EU regulatory framework for consumer credit products will be analysed in the light of the findings from the empirical investigation. This **legal assessment** will include relevant EU and national legislative instruments, legislative history, policy documents, administrative practice, case-law of the Court of Justice of the European Union (CJEU) and domestic courts, as well as academic literature.

It is beyond the scope of this study to provide a complete picture of all problematic aspects of consumer credit across the EU. Only the most imminent problems faced by consumers in several Member States will be discussed. Neither does the study aim to provide an exhaustive analysis of national consumer credit laws, regulations or enforcement practices across the EU. Instead, the analysis will focus on the EU legislation currently in force and use the examples from some national legal systems to illustrate the problems faced by the EU legislator in ensuring adequate consumer protection in consumer credit markets.

In the light of the foregoing, the structure of the study will be as follows.

Disclosure in the EU Consumer Credit Directive: Opportunities and Limitations', in J. Devenney & M. Kenny (eds), *Consumer Credit, Debt and Investment in Europe* (Cambridge: Cambridge University Press, 2012), p. 21; I. Ramsay, 'Consumer Credit Regulation after the Fall: International Dimensions' (2012) 1 *Journal of European Consumer and Market Law*, p. 24; S. Nield, 'Mortgage Finance: Who's Responsible?', in J. Devenney & M. Kenny (eds), *Consumer Credit, Debt and Investment in Europe* (Cambridge: Cambridge University Press, 2012), p. 160; N. Moloney, 'The Investor Model Underlying the EU's Investor Protection Regime: Consumers or Investors?' (2012) 13 *European Business Organization Law Review*, p. 169; V. Mak & J. Braspenning, 'Errare humanum est: Financial Literacy in European Consumer Credit Law' (2012) 35 *Journal of Consumer Policy*, p. 307.

¹⁰ See e.g. C.R. Sunstein, 'Homo Economicus, Homo Myopicus, and the Law and Economics of Consumer Choice: Boundedly Rational Borrowing' (2006) 73 *University of Chicago Law Review*, p. 249; S. Block-Lieb & E. Janger, 'The Myth of the Rational Borrower: Rationality, Behavioralism, and the Misguided "Reform" of Bankruptcy Law' (2006) 84 *Texas Law Review*, p. 1481; E. Avgouleas, 'The Global Financial Crisis, Behavioural Finance and Financial Regulation: In Search of a New Orthodoxy' (2009) 9 *Journal of Corporate Law Studies*, p. 23; O. Bargill, 'The Law, Economics and Psychology of Subprime Mortgage Contracts' (2009) 94 *Cornell Law Review*, p. 1073.

¹¹ O.O. Cherednychenko, 'Freedom of Contract in the Post-Crisis Era: Quo Vadis?' (2014) 10 *European Review of Contract Law*, p. 390.

Chapter 2 will identify **major products and practices in consumer credit markets across the EU** that raise **serious consumer protection concerns**. These include: (a) the provision of high-cost credit, (b) cross-selling, and (c) peer-to-peer lending (P2PL).

Chapter 3 will turn to the **EU regulatory framework for consumer credit** and analyse **consumer protection standards** and their **enforcement** within that framework. In particular, this chapter will demonstrate some important **limitations** of the 2008 Consumer Credit Directive as well as the EU's approach to supervision and enforcement in providing adequate consumer protection against the problematic products and practices identified in Chapter 2.

Finally, Chapter 4 will present the main findings of the study.

2. PROBLEMATIC PRODUCTS AND PRACTICES IN CONSUMER CREDIT MARKETS

2.1. General

Products and practices in consumer credit markets can be considered to be problematic when they have caused or may potentially cause consumer detriment. At present, there is no universally accepted definition of the term '*consumer detriment*'. For the purposes of this study **consumer detriment** is understood in a broad sense and refers to a state of personal disadvantage caused by purchasing a credit or related product that does not meet the consumer's reasonable expectations¹². In particular, such detriment may be represented by the financial loss resulting from the purchase of a credit or related product that does not yield any substantial benefit to the consumer and/or seriously impairs the consumer's financial health.

The market for retail financial products, including consumer credit products, is characterised by a number of features which may lead to consumer detriment even in the absence of mis-selling. As has been observed in the 2014 European Parliament study on the consumer protection aspects of financial services: '*The purchase of many types of financial products or services will continue to be challenging for consumers because a) consumers only infrequently purchase such products and services, b) the products and services may be very complex, opaque and their risks may be difficult to assess, especially in the case of long duration financial products and services and c) consumers have no or little bargaining power in retail financial markets*'¹³. These characteristics of the market for retail financial products may lead consumers to buy a product that they do not fully understand. At the same time, these very features make consumers in this market **susceptible to mis-selling** and the resulting detriment. The mis-selling of consumer credit products may result from such products being not designed to satisfy consumer needs but to generate profits for their manufacturers or from unfair selling practices in the distribution process.

A **consumer credit product** is a contract whereby a creditor grants or promises to grant credit to a consumer in the form of a loan or other financial accommodation. Standard contract terms specifying the characteristics of a particular consumer credit product typically form part of such credit agreements. Consumer detriment may thus result from a **contract design** of a particular credit product and, as such a product is embodied in a standard contract, a large number of consumers may be affected.

Consumer credit products can be divided into two broad categories: instalment (closed-end) credit and non-instalment (open-end or revolving) credit. **Instalment credit** requires consumers to repay the principal amount and interest within an agreed period of time in equal periodic payments, usually monthly. Examples of such credit are a car loan and a payday loan¹⁴. **Non-instalment credit** allows the consumer to make irregular payments and to borrow additional funds within the agreed limits and period of time without submitting a new credit application. Examples of this type of credit product are a credit card and an overdraft facility. As will be illustrated below, both instalment and non-instalment credit agreements may give rise to consumer detriment, particularly when they concern high-cost credit products.

¹² Cf. e.g. the definitions of '*consumer detriment*', in particular '*personal detriment*', in Europe Economics, *An Analysis of the Issue of Consumer Detriment and the Most Appropriate Methodologies to Estimate It: Final Report for DG SANCO*, 2007, p. 3 and Civic Consulting, *Study on Measuring Consumer Detriment in the European Union: Final Report for Directorate-General for Justice and Consumers*, February 2017, p. 26.

¹³ European Parliament, *Consumer Protection Aspects of Financial Services: Study*, February 2014, p. 12.

¹⁴ Payday loans are discussed in more detail in section 2.2.1 below.

In addition to the contract design of consumer credit products, consumer detriment can also be caused by **selling practices** to which creditors and credit intermediaries resort in the distribution process. For example, prior to the conclusion of a credit agreement, these entities may fail to perform an adequate assessment of the consumer's creditworthiness or offer additional financial products that are not suitable for the consumer. As a result, even credit products that have been designed with due regard to the consumer interests may end up in the hands of consumers who cannot afford or simply do not need them.

In the following, we will discuss the **most problematic products and practices** in consumer credit markets across the EU that have caused consumer detriment in the past and/or are (still) a source of concern today. In particular, we will focus on the provision of high-cost credit (section 2.2.), cross-selling (section 2.3.), and peer-to-peer lending (P2PL) (section 2.4.).

2.2. The provision of high-cost credit

In an ideal world a consumer would only obtain credit when he or she is able to repay it without undue hardship. Prior to the conclusion of a credit agreement, therefore, creditors are normally required to assess the **consumer's creditworthiness** in order to establish whether the consumer is able to meet his or her obligations under that agreement. Granting credit without performing an adequate creditworthiness check may push the consumer into a **problematic repayment situation** that may result in over-indebtedness. Whether or not the consumer will end up in such a situation generally depends on two factors: (a) the length of the period within which the consumer is able to repay the debt; and/or (b) the impact of the consumer's repayments to service the debt on his or her overall ability to pay. A problematic repayment situation may arise if (a) the consumer is not able to repay the debt within a *reasonable* time and/or b) the consumer is only able to repay it in an *unsustainable* way, for example, by cutting back on essential living expenses or by defaulting on other loans. In these circumstances, the consumer might feel the need to take out more credit in order to meet the existing repayment obligations.

While a proper creditworthiness assessment is thus an important tool for preventing consumer detriment in consumer credit markets, creditors across the EU have not always done a good job in this regard. This is especially the case in those segments of the market where small amounts of credit are at stake and/or the costs of credit are much higher than the average. In particular, **poor creditworthiness checks** across the EU often allowed vulnerable consumers who were already facing a problematic repayment situation to gain access to such risky credit products. The explanation lies in the fact that people on low income, with no prospects and/or existing debt cannot easily obtain a long-term instalment credit or a mortgage loan¹⁵. As a result, they may have little choice but to turn to those market segments where providers of small but expensive loans are '*often more generous with regard to creditworthiness*'¹⁶.

While the above lending practices in themselves may thus lead to consumer detriment, certain credit products as such may also give rise to concern. This is particularly the case when it comes to **high-cost credit products**¹⁷. The high costs of a credit product may result from a variety of sources, including but not limited to the basic interest, costs associated with the conclusion of a credit agreement, charges or penalties triggered by non- or late

¹⁵ Cf. e.g. U. Reifner *et al.*, *Study on interest rate restrictions in the EU: Final Report for the EU Commission DG Internal Market and Services*, Brussels/Hamburg/Mannheim, 2010, p. 129.

¹⁶ *Ibid.*

¹⁷ See also European Parliament, *Consumer Protection Aspects of Financial Services: Study*, February 2014, p. 54.

repayment of loans, and fees for going overdrawn. The consumer problems associated with high-cost credit products are two-fold.

(1) The costs in themselves can be **excessive**. Such costs may undermine the consumer's ability to pay, making the consumer more vulnerable to unexpected financial difficulties. As a result, consumers run a greater risk of getting into a problematic repayment situation.

(2) Once a consumer is not able to repay the agreed amount on time, his or her financial situation is likely to become worse since high-cost credit usually becomes **more expensive over time**.

As a consequence, the consumer may be forced to take out more credit, often at an excessive rate, to repay the initial debt/or to cover his or her essential living expenses. By pushing repayments further into the future, the consumer risks becoming trapped in **a spiral of debt**, which may seriously impair the consumer's financial health. In Estonia, for example, over-indebtedness among consumers reportedly derives for the most part from high-cost credit associated with high interest rates and contractual penalties for non- or late repayment¹⁸. This has caused a situation in which a large number of people, including those outside low-income groups, have become personally bankrupt, surrendered their homes or sold their property¹⁹.

While poor creditworthiness assessments and high-cost credit products can each be seen as a problem in itself, a **combination** of this kind of lending practice with this type of credit product **exacerbates the risk of consumer detriment**. This is especially true once **small amounts of high-cost credit** are at stake, as evidenced by the experiences with **payday loans** and **credit cards** which caused much consumer detriment across the EU. These two credit products, which will be considered in more detail below, are typically quite easy to obtain for consumers and generally involve high costs.

2.2.1. Payday loans

A payday loan is a relatively small, high-cost instalment loan that has to be repaid over a short term, or until '*payday*'. Given these characteristics, it can be categorised as a **high-cost short-term credit**²⁰. For some time, payday loans have been offered in many EU countries and have been associated with quick and easy access to credit. Many consumers tend to prefer payday loans for these very reasons and do not generally consider other credit products to be a close substitute even if they are cheaper²¹. In addition, many payday loan customers are vulnerable consumers who do not have credit alternatives available to them when taking out a payday loan²². Payday loans have raised major concerns about their potential to negatively impact the consumers' financial health.

In the UK, for example, the average amount borrowed in 2013 was between GBP 265 and GBP 270 and the payback period was usually a month²³. On an annual basis the interest rate could, however, go up to 5 853 %²⁴. In the Netherlands, where a payday loan is known as '*flash credit*' (*flitskrediet*), the average amount borrowed in 2011 was EUR 200 and the annual

¹⁸ U. Reifner *et al.*, *Study on interest rate restrictions in the EU: Final Report for the EU Commission DG Internal Market and Services*, Brussels/Hamburg/Mannheim, 2010, p. 124.

¹⁹ *Ibid.*

²⁰ See e.g. A. Fejős, 'Achieving Safety and Affordability in the UK Payday Loans Market' (2015) 38 *Journal of Consumer Policy*, p. 181.

²¹ On the UK, see e.g. Competition and Markets Authority, *Payday Lending Market Investigation: Final Report*, 24 February 2015, p. 10.

²² *Ibid.*

²³ Office of Fair Trading, *Payday Lending: Compliance Review Final Report*, March 2013, p. 9.

²⁴ See A. Fejős, 'Achieving Safety and Affordability in the UK Payday Loans Market' (2015) 38 *Journal of Consumer Policy*, p. 186, who refers to ASA Adjudication on WDFC UK Ltd t/a Wonga, 9 April 2014.

percentage rate of charge (APRC) could go up to several hundred percent²⁵. In Finland, it has been reported that consumers were charged an annual interest of nearly 1 000 % on average²⁶. Similar products with very high interest rates were also offered to consumers in many Central and Eastern European countries, in particular Estonia, Czech Republic, Slovakia, Slovenia, Poland, and Romania²⁷.

Apart from **excessive interest rates** associated with payday loans, a consumer who does not repay the initial debt on time is often confronted with **high additional costs**. In the UK, for example, one lender charged GBP 179 on average in the 35 days after a missed payment, which included an initial missed payment fee, a further non-payment fee after seven days, a default fee after 35 days as well as additional charges for issuing debt collection letters²⁸. This shows that payday loans are best suited for dealing with an unexpected financial setback which asks for a quick solution and that they should therefore be seen as a loan of last resort²⁹. In the absence of proper creditworthiness checks, however, these products, as opposed to most other consumer credit products, are highly accessible for consumers who already find themselves in a problematic repayment situation. Moreover, the **growing digitalisation** in this segment of the market, which makes it possible, for example, to obtain a payday loan over the Internet or via SMS, further facilitates easy access to this type of high-cost credit products³⁰. Notably, in the UK, according to the 2015 report of the Competition and Markets Authority (CMA)³¹, 83 % of payday loan customers have taken out a loan online, while only 29 % of customers have taken a payday loan on the high street³². What is more, the average amount borrowed online (GBP 290) was significantly higher than that borrowed on the high street (GBP 180)³³.

As a result, a consumer who is not able to repay the initial payday loan on time can easily obtain a new one in order to repay the previous one. This makes it possible for a payday loan to **rollover** a number of times. Yet again, the UK provides some telling examples. According to the CMA's 2015 report, consumers' demand for payday loans is typically recurring³⁴. In particular, the CMA's analysis suggests that around three-quarters of consumers take out more than one loan in a year, and that on average a customer takes out around six loans per year³⁵. What is more, in 2013 the UK Office of Fair Trading (OFT)³⁶ even reported a case of a payday loan rolling over 36 times³⁷. The possibility to rollover an existing payday loan thus forms an important feature of this credit product. With every new rollover, new costs are added to the outstanding debt. As a result, the consumer lends more and more money, while the amount of money that ultimately benefits him or her remains relatively small.

²⁵ See also the 2011 statement of the Dutch Authority for the Financial Markets (*Autoriteit Financiële Markten (AFM)*); <https://www.afm.nl/nl-nl/consumenten/nieuws/2014/feb/markt-flitskrediet>.

²⁶ European Parliament, *Consumer Protection Aspects of Financial Services: Study*, February 2014, p. 58.

²⁷ U. Reifner *et al.*, *Study on interest rate restrictions in the EU: Final Report for the EU Commission DG Internal Market and Services*, Brussels/Hamburg/Mannheim, 2010, p. 124.

²⁸ Office of Fair Trading, *Payday Lending: Compliance Review Final Report*, March 2013, p. 24.

²⁹ Cf. e.g. A. Fejős, 'Achieving Safety and Affordability in the UK Payday Loans Market' (2015) 38 *Journal of Consumer Policy* 2015, p. 181, 187.

³⁰ See International Financial Consumer Protection Organisation (FinCoNet), *Report on the Digitalisation of Short-Term, High-Cost Consumer Credit*, November 2017.

³¹ Competition and Markets Authority, *Payday Lending Market Investigation: Final Report*, 24 February 2015, p. 3.

³² There is some overlap, with 12% of consumers having used both channels.

³³ Competition and Markets Authority, *Payday Lending Market Investigation: Final Report*, 24 February 2015, p. 3.

³⁴ *Ibid.*, p. 5.

³⁵ *Ibid.*

³⁶ The OFT had responsibility for consumer credit regulation until 1 April 2014 when the Financial Conduct Authority took it over.

³⁷ Office of Fair Trading, *Payday Lending: Compliance Review Final Report*, March 2013, p. 23.

As rollover practices are **highly profitable** for creditors, the latter have little incentive to perform an adequate assessment of the consumer's creditworthiness before a loan is granted or rolled over. In this context, the OFT concluded in 2013 that rollover practices in the UK provide 50 % of lenders' revenues and that 19 % of revenues comes from the 5 % of loans which are rolled over or refinanced four or more times³⁸. It is therefore not surprising that most payday lenders did not conduct a proper creditworthiness check, and, even worse, that consumers already experiencing repayment problems were advised to take out more loans³⁹. As a result, around one third of the loans were repaid late or not repaid at all, and another 28 % of the loans were rolled over or refinanced at least once⁴⁰.

Similar problems surround the provision of payday loans in many other Member States. The 2014 European Parliament study suggests that many consumers across the EU resort to payday loans when they are already heavily over-indebted and when the only way to escape from their financial trap is to sell some of their assets (such as a car) or enter a formal debt reduction process (such as bankruptcy)⁴¹. For example, in the Czech Republic, Slovakia, Slovenia, Ireland, Romania, and Poland, this type of product was reportedly often used by consumers to cover fees and charges incurred from prior loan default, with a '*spiral of increased over-indebtedness*' as a result⁴². Payday loans can thus be especially harmful to **vulnerable consumers** who often already have serious debt problems. In particular, this type of credit product presents major problems when it is provided to low income groups and young people⁴³.

2.2.2. Credit cards

A credit card is a form of non-instalment credit which allows the consumer to make use of credit reserve within the agreed limits and period of time without having to repay the outstanding amount in a fixed number of payments. The terms of a credit card agreement may require that the consumer repays a certain percentage of the outstanding amount on a regular basis (e.g. each month) or only pays interest throughout the duration of the contract and repays the total amount of borrowed capital upon expiration of the contract. Credit cards are valued by consumers because of their flexibility, which allows consumers to defer payment and spread its costs over a number of months. At the same time, it has been noted in the literature that credit card facilities tend to operate to the disadvantage of consumers, in particular because the providers of such facilities tend to exploit consumers' behavioural biases⁴⁴. Among such biases are overoptimism (overestimating one's ability to maintain a zero balance on one's credit card), myopia (overvaluing the short term-benefits of a credit transaction at the expense of the future) or cumulative cost neglect (neglecting the cumulative effect of a large number of relatively small borrowing choices).

³⁸ Ibid., p. 2.

³⁹ Ibid., p. 10.

⁴⁰ Ibid., p. 2.

⁴¹ European Parliament, *Consumer Protection Aspects of Financial Services: Study*, February 2014, p. 60.

⁴² U. Reifner *et al.*, Study on interest rate restrictions in the EU: Final Report for the EU Commission DG Internal Market and Services, Brussels/Hamburg/Mannheim, 2010, p. 124.

⁴³ European Parliament, *Consumer Protection Aspects of Financial Services: Study*, February 2014, p. 59.

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

In the first place, credit card credit is one of the most **expensive types of credit** in terms of interest rates. In February 2018, for example, on average credit card providers in the Euro area charged an interest rate of 16.86 % to consumers⁴⁵. High interest rates on credit cards have been identified as causing financial distress for consumers in the EU⁴⁶. Moreover, in some countries, such as Italy, in case of a delay in credit card payments, providers often dramatically increased interest rates not only on the payments overdue, but also on the residual credit on the card⁴⁷.

Furthermore, consumer detriment is often associated with the **flexible nature of credit card credit**⁴⁸. As credit card holders are usually allowed to redraw credit after making minimum payments on their credit card debt for an indefinite period, they have continued access to this expensive credit product. As a result, consumers can accumulate and sustain debt over a long period without having to make a significant effort to get out of credit card debt. This may lead to *'persistent debt'* which, following the UK's Financial Conduct Authority (FCA), can be defined as a situation where, over a period of 18 months, a consumer pays more in interest, fees and charges than he or she has repaid of the principal on his or her card balance⁴⁹. For example, in the UK – the main contributor to the number of credit cards issued in the EU⁵⁰ –, in 2014 6.6 % of cardholders (about 2.1 million) were in persistent debt⁵¹ and around 650 000 cardholders have been in this situation for at least three consecutive years⁵². A further 1.6 million cardholders were repeatedly making only minimum payments on their credit card debt, while also incurring interest charges, and 750 000 cardholders have been doing this for at least three consecutive years⁵³. Given that credit cards are suited for short term borrowing, the FCA expressed its concerns about the volume of borrowing behaviour in the UK that does not fit this pattern⁵⁴. According to this authority: *'Using credit cards to service long-term debt (as opposed to benefitting from the flexibility that rolling credit offers in the short term) tends to be expensive and these consumers may be paying more than they need to in debt service costs; struggling under a debt burden; or storing risk that, in case of a life event (e.g. sickness or unemployment) may become problematic'*⁵⁵.

Consumers who have persistent credit card debt or only make systematic minimum repayments on their card without making significant contributions to repaying the outstanding balance tend to be **highly profitable for creditors**. The so called *'sweatbox'* model of credit card lending described by Mann is a case in point. In this model *'the most profitable consumers are sometimes the least likely to ever repay their debts in full'*⁵⁶. Therefore, creditors have an incentive to keep consumers in the *'sweatbox'* rather than intervene to address the consumers' lending behaviour and help them to reduce debt burdens

⁴⁵ European Central Bank, Statistical Data Warehouse; <http://sdw.ecb.europa.eu/reports.do?node=1000005691>.

⁴⁶ European Parliament, *Consumer Protection Aspects of Financial Services: Study*, February 2014, p. 62.

⁴⁷ Ibid., p. 55.

⁴⁸ See Financial Conduct Authority, *Credit Card Market Study: Persistent Debt and Earlier Intervention Remedies – Feedback on CP17/10 and Further Consultation*, December 2017, p. 4.

⁴⁹ Ibid., p. 5.

⁵⁰ European Central Bank, Payments and Settlement Systems Statistics; <https://sdw.ecb.europa.eu/browse.do?node=9689709>.

⁵¹ Financial Conduct Authority, *Credit Card Market Study: Final Findings Report*, July 2016, p. 29.

⁵² Ibid., p. 48.

⁵³ Ibid.

⁵⁴ Ibid.

⁵⁵ Ibid.

⁵⁶ R.J. Mann, 'Bankruptcy Reform and the "Sweatbox" of Credit Card Debt' (2007) *University of Illinois Law Review*, p. 375, 384.

as quickly as they can. As a result, spending on a credit card can easily get out of control and cause consumer detriment.

2.3. Cross-selling

Consumer detriment may also occur when creditors and credit intermediaries resort to cross-selling. In the present context, **cross-selling**, also known as product bundling, refers to the practice of selling a credit product together with another (financial) product, such as an insurance. Cross-selling can take the form of a **tying practice**, meaning that another (financial) product is made mandatory to obtain a loan from a given provider. Alternatively, such a product can be offered to consumers as **an optional extra**⁵⁷. Cross-selling of financial products can result in the purchase of products that consumers do not necessarily want or need and that entail additional fees and charges, and thus in mis-selling. This practice is largely driven by **the lack of consumer understanding of product terms** and **the lack of incentives for firms** – motivated by remuneration arrangements that award volume-based sales – **to act in the interest of consumers** and adequately inform them about such terms⁵⁸.

According to the 2017 EBA report, cross-selling has been identified as a problematic selling practice in a large number of Member States⁵⁹. The examples include the provision of a loan in combination with payment protection insurance (PPI), car insurance or life insurance, where consumers did not need the insurance or were unaware that they were taking it out when concluding a credit agreement⁶⁰. According to the 2014 European Parliament Study, the tying of credit cards to other products has also been an issue. For example, in the Czech Republic many consumers were unknowingly issued a credit card at the moment they were purchasing other products⁶¹. In this example, the consumers might be tempted to use the credit card and, as a consequence, end up in a problematic repayment situation as described in section 2.2.2 above.

Cross-selling of PPI deserves special attention in this context. PPI is an insurance policy that enables consumers to insure repayment of loans if the borrower dies, becomes ill or disabled, or faces other circumstances preventing him or her from meeting the obligations under the credit agreement. As with any other type of insurance, PPI may exclude or impose restrictive conditions on particular types of claimant (e.g. self-employed or contract workers) or claim (e.g. sickness related to pre-existing medical condition) and may be subject to other terms that limit the cover provided.

In the UK, for example, the cross-selling of PPI – mortgage PPI, personal loan PPI and credit card PPI⁶² – has resulted in the largest mis-selling scandal in its financial history⁶³. As of January 2018, around GBP 30 billion were set aside by financial firms for compensation

⁵⁷ Cf. International Financial Consumer Protection Organisation (FinCoNet), *Report on the Digitalisation of Short-Term, High-Cost Consumer Credit*, November 2017, p. 31.

⁵⁸ Cf. European Parliament, *Consumer Protection Aspects of Financial Services: Study*, February 2014, p. 62.

⁵⁹ European Banking Authority, *EBA Consumer Trends Report 2017*, 28 June 2017, p. 22.

⁶⁰ Ibid.

⁶¹ European Parliament, *Consumer Protection Aspects of Financial Services: Study*, February 2014, p. 62.

⁶² Competition Commission, *Market Investigation into Payment Protection Insurance*, 29 January 2009, p. 22.

⁶³ European Parliament, *Consumer Protection Aspects of Financial Services: Study*, February 2014, p. 69. On this mis-selling scandal in more detail, see E. Ferran, 'Regulatory Lessons from the Payment Protection Insurance Mis-selling Scandal in the UK' (2012) 13 *European Business Organization Law Review*, p. 247.

payouts⁶⁴. The scandal has revealed two major problematic aspects of the selling process⁶⁵. First of all, many consumers were provided with **inadequate information** about the benefits, exclusions, limitations and cost of such policies. In addition, while the standard features of such products imply a suitability risk, in many cases **no adequate suitability checks** were performed. As a consequence, many consumers bought products that were wholly unsuitable for them because from the very outset they did not meet eligibility requirements under the product terms to be able to make a claim.

Similar problems with the cross-selling of PPI have been reported in other parts of Europe. In Spain, for example, some consumers who bought PPI were misled to believe that they were protected in case of unemployment or temporary incapacity, whereas this was not always the case as the coverage depended on the specific situation of the insured person⁶⁶. In Ireland, firms gathered insufficient information on consumers in order to ensure the suitability of PPI for each client⁶⁷. As of May 2012, refunds announced by the Irish banks exceeded EUR 4 million⁶⁸. Germany has also been profoundly affected by the mis-selling of PPI. According to the 2017 study prepared by the German Federal Financial Supervisory Authority, while consumers who took out a loan from a given bank were not contractually obliged to purchase PPI, in practice subprime borrowers were led to believe that this was indeed the case⁶⁹. Moreover, borrowers were often charged high insurance premiums, which pushed up the total cost of a loan in practice⁷⁰.

Selling PPI can be a **highly profitable** business⁷¹, in particular as a result of commissions payable to financial firms. In the UK, for example, such commissions were typically between 50 and 80 % of gross written premium for policies sold in connection with a personal loan⁷². Notably, these levels of commission were much higher than those payable for introducing the loan itself, which meant that a large proportion of the profits of loan brokers was derived from selling PPI policies. It is therefore not surprising that many consumers were even pressured into buying such policies⁷³. Likewise, in Germany, the commissions paid by insurance companies to credit institutions for selling PPI together with a personal loan were sometimes extremely high, in some cases amounting to 50 % or more of insurance premium⁷⁴.

2.4. Peer-to-peer lending

As the regulatory grip on the traditional financial sector has tightened post-crisis, novel forms of financial contracting outside it have emerged, such as **crowdfunding**. The latter connects those who give, lend or invest money directly with those who need financing. **Peer-to-peer lending (P2PL)**, also known as debt-based or lending-based crowdfunding, accounts for the

⁶⁴ Financial Conduct Authority, *Monthly PPI Refunds and Compensation* (last updated: 19 April 2018); <https://www.ft.com/content/d9f0050a-739c-11e7-aca6-c6bd07df1a3c>.

⁶⁵ Financial Services Authority, *The Sale of Payment Protection Insurance: Results of Follow-up Thematic Work*, October 2006; Financial Services Authority, *The Sale of Payment Protection Insurance: Thematic Update*, October 2007; Financial Services Authority, *Payment Protection Insurance: A Thematic Update*, October 2008.

⁶⁶ European Parliament, *Consumer Protection Aspects of Financial Services: Study*, February 2014, p. 128.

⁶⁷ Ibid.

⁶⁸ Ibid.

⁶⁹ BaFin, *Ergebnisbericht zur Marktuntersuchung Restschuldversicherungen*, 21 June 2017, p. 31.

⁷⁰ U. Reifner, *Systemischer Kreditwucher am Beispiel der Targobank (Citibank)*, Iff-infobriefe 7-13/2017.

⁷¹ This was the case e.g. in the UK. See Competition Commission, *Market Investigation into Payment Protection Insurance*, 29 January 2009, p. 94 *et seq.*

⁷² Competition Commission, *Market Investigation into Payment Protection Insurance*, 29 January 2009, p. 2.

⁷³ See e.g. the Guardian, 'Liverpool Victoria fined over £840.000 over PPI failings', 30 July 2008.

⁷⁴ BaFin, *Ergebnisbericht zur Marktuntersuchung Restschuldversicherungen*, 21 June 2017, p. 19, 33.

largest share of this emerging market⁷⁵, with peer-to-peer consumer lending being its biggest segment⁷⁶. In general terms, P2PL can be defined as '*the use of an electronic platform that matches lenders/investors with borrowers/issuers in order to provide unsecured loans, including consumer lending, as well as lending against real estate*'⁷⁷. These services are usually provided by new market entrants known for the heavy digitalisation of their processes, including technological support for credit analysis and payments settlements⁷⁸.

The P2PL model poses benefits to consumers in terms of convenience. It also offers improved access to credit for vulnerable consumers who cannot obtain it from conventional lenders. At the same time, P2PL also poses **major risks** to all the parties involved, i.e. consumer lenders, consumer borrowers, and platform operators⁷⁹. In the context of the present study, the risks to consumer lenders and borrowers who use the services of a platform deserve special attention.

Consumer lenders may lose the amount borrowed following either the consumer borrower's or the platform's default⁸⁰. They may also be unaware of such risks, relying on misleading advertisements or unverified information, in particular about the consumer borrower and his or her project. It is notable that current data reveal an increase in defaults and business failures in P2PL markets⁸¹. Importantly, in responding to a sector survey, the platforms have identified their own malpractice and borrowers' defaults/failures as the main current risks in Europe⁸². Consumer borrowers, in turn, may end up in a problematic repayment situation due to the lack of or insufficient assessment of their creditworthiness⁸³.

Therefore, in contrast to the traditional financial sector where mis-selling of credit products may only affect consumer borrowers, in P2PL **both consumer lenders and consumer borrowers can become a victim of mis-selling**. Although the P2PL is presented as a form of democratic, participating and disintermediated finance, consumer lenders and consumer borrowers need a **P2PL platform** in order to reduce information asymmetries between them⁸⁴. The way in which such platforms currently operate, however, raises concerns about their reliability in this respect.

⁷⁵ European Commission, Legislative proposal for an EU framework on crowd and peer to peer finance: Inception impact assessment ((2017)5288649 - 30/10/2017), p. 1.

⁷⁶ B. Zhang *et al.*, *Sustaining Momentum – The 2nd Annual European Alternative Finance Industry Survey*, 2016, p. 20.

⁷⁷ International Financial Consumer Protection Organisation (FinCoNet), *Report on the Digitalisation of Short-Term, High-Cost Consumer Credit*, November 2017, p. 20.

⁷⁸ *Ibid.*

⁷⁹ European Banking Authority, *Opinion of the European Banking Authority on Lending-based Crowdfunding*, 26 February 2015.

⁸⁰ *Ibid.*, p. 12 *et seq.* See also E. Macchiavello, 'Financial-return Crowdfunding and Regulatory Approaches in the Shadow Banking, FinTech and Collaborative Finance Era' (2017) 14 *European Company and Financial Law Review*, p. 662, 669.

⁸¹ B. Zhang *et al.*, *Sustaining Momentum – The 2nd Annual European Alternative Finance Industry Survey*, 2016, p. 21, 47; B. Zhang *et al.*, *Pushing Boundaries: The 2015 UK Alternative Finance Industry Report*, 2016, p. 34.

⁸² *Ibid.*

⁸³ European Banking Authority, *Opinion of the European Banking Authority on Lending-based Crowdfunding*, 26 February 2015, p. 16, 20. See also International Financial Consumer Protection Organisation (FinCoNet), *Report on the Digitalisation of Short-Term, High-Cost Consumer Credit*, November 2017, p. 21.

⁸⁴ Cf. E. Macchiavello, 'Financial-return Crowdfunding and Regulatory Approaches in the Shadow Banking, FinTech and Collaborative Finance Era' (2017) 14 *European Company and Financial Law Review*, p. 662, 673.

3. THE EU REGULATORY FRAMEWORK FOR CONSUMER CREDIT

3.1. General

The primary piece of legislation governing the provision of consumer credit across the EU is the 2008 Consumer Credit Directive⁸⁵. While this EU measure aims to ensure a high level of consumer protection⁸⁶, its ability to attain this objective is restricted in two major respects.

In the first place, the Consumer Credit Directive has a **limited scope of application**. Many types of important loan contracts, which were initially included within its reach in the European Commission's proposal for this directive⁸⁷, ultimately ended up in an extensive list of exceptions thereto. In particular, the Consumer Credit Directive is not applicable to loans involving a total amount of credit less than EUR 200, overdraft facilities where the credit has to be repaid within one month, and loans on a pledge⁸⁸. Narrowing down the scope of this directive was apparently the only way to reach an agreement among Member States on its adoption as a '*full*' harmonisation measure⁸⁹.

Furthermore, it is noteworthy that a number of more protective rules included in the European Commission's proposal⁹⁰ were ultimately dropped during the legislative process. These included the duty of responsible lending⁹¹, specific rules on unfair terms in a consumer credit agreement⁹², and the rights and obligations of the parties in the event of the non-performance of such an agreement⁹³. Furthermore, no new attempt was made to harmonise usury laws at the EU level⁹⁴. More intrusive regulation was considered to be incompatible with the idea of '*consumer credit as lubricant*' and the corresponding need to foster **increased access to credit** for European consumers⁹⁵ which dominated the policy discourse until the outbreak of the global financial crisis.

Instead, as has been mentioned above, the Consumer Credit Directive is based on the **information model of consumer protection**, which is reflected in the extensive

⁸⁵ In addition, the provision of consumer credit is also subject to a number of horizontal EU measures, in particular the Unfair Contract Terms Directive and the Unfair Commercial Practices Directive. See respectively Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, OJ 1993 L 95/29 (Unfair Contract Terms Directive) and Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council, OJEU 2005 L149/22 (Unfair Commercial Practices Directive).

⁸⁶ Consumer Credit Directive, Recital 9.

⁸⁷ Commission of the European Communities, 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, COM(2002) 443 final.

⁸⁸ Consumer Credit Directive, Art. 2(2).

⁸⁹ On this in more detail, see O.O. Cherednychenko, 'Full Harmonisation of Retail Financial Services Contract Law in Europe: A Success or a Failure?', in S. Grundmann & Y.M. Atamer (eds), *Financial Services, Financial Crisis and General European Contract Law* (Alphen aan den Rijn: Kluwer Law International, 2011), p. 221, 235 *et seq.*

⁹⁰ Commission of the European Communities, 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, COM(2002) 443 final.

⁹¹ *Ibid.*, Art. 9.

⁹² *Ibid.*, Ch. VI.

⁹³ *Ibid.*, Ch. X.

⁹⁴ See Commission of the European Communities, *Report on the Operation of Directive 87/102/EEC for the Approximation of the Laws, Regulations and Administrative Provisions of the Member States concerning Consumer Credit*, COM 95(117) final.

⁹⁵ I. Ramsay, 'Changing Policy Paradigms of EU Consumer Credit and Debt Regulation', in D. Leczykiewicz & S. Weatherill (eds), *The Images of the Consumer in EU Law: Legislation, Free Movement and Competition Law*, (Oxford: Hart Publishing), p. 159, 162.

information requirements which should be complied with by the creditor or the credit intermediary at different stages of their relationship with the consumer. Thus, the directive specifies in great detail the information to be mentioned in advertising⁹⁶, the information to be provided to the consumer prior to the conclusion of the credit agreement⁹⁷, the information to be included in the credit agreement⁹⁸, and the information to be provided during the contractual relationship between the creditor and the consumer⁹⁹. In particular, all pre-contractual information should be provided to consumers by means of the Standard European Consumer Credit Information form¹⁰⁰. Creditors and credit intermediaries are also obliged to *'provide adequate explanations to the consumer'* in order to enable him or her to assess whether the proposed credit agreement is adapted to his or her needs and financial situation¹⁰¹.

In the light of this, one may question whether the existing EU regulatory framework for consumer credit is well-equipped to deal with the problematic consumer products and practices identified in Chapter 2. In the following, therefore, we will take a closer look at the 2008 Consumer Directive's approach to harmonisation with respect to the provision of high-cost credit, cross-selling, as well as P2PL, and, where relevant, draw a comparison with the Mortgage Credit Directive¹⁰² adopted in the aftermath of the financial crisis (section 3.2). In addition, we will also discuss some issues related to the enforcement of relevant legislation (section 3.3).

3.2. Consumer protection standards

3.2.1. The provision of high-cost credit

The analysis of the Consumer Credit Directive reveals **several important limitations** of this directive in protecting consumers against the mis-selling of high-cost credit products.

- First of all, as the directive does **not cover loans for less than EUR 200**, it is entirely up to Member States to decide whether, and if so, how they deal with high-cost credit, such as a payday loans, below that amount.
- Second, while interest rate increases may cause consumer detriment, particularly when they come as a surprise, the Consumer Credit Directive does **not oblige creditors to inform consumers about the possible impact of a significant increase** in a variable interest rate on the amounts payable and the risks posed thereby. As an obligation to this effect appears to lie outside the Directive's scope, Member States remain free to introduce it in their national legal systems. To what extent they have done so to date, however, remains unclear. Interestingly, the Mortgage Credit Directive includes an explicit duty of creditors to inform the consumers in similar circumstances¹⁰³.

⁹⁶ Consumer Credit Directive, Art. 4.

⁹⁷ Consumer Credit Directive, Arts 5 and 6.

⁹⁸ Consumer Credit Directive, Art. 10.

⁹⁹ Consumer Credit Directive, Arts 11, 12 and 18.

¹⁰⁰ Consumer Credit Directive, Art. 5(1). Such a standard information sheet contains a detailed list of items on which the creditor or the credit intermediary should provide the consumer with the information grouped around five main issues: the identity and contact details of the creditor/credit intermediary, the description of the main features of the credit product, its costs, other important legal aspects (such as the existence of the right of withdrawal), and additional information in the case of distance marketing of financial services. See also Consumer Credit Directive, Art. 6(1).

¹⁰¹ Consumer Credit Directive, Art. 5 (6).

¹⁰² Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010, *OJEU* 2014 L 60/34 (Mortgage Credit Directive).

¹⁰³ Mortgage Credit Directive, Art. 17 (6).

- Third, while poor creditworthiness checks, particularly when selling high-cost credit products, have been one of the major causes of consumer detriment across the EU, as mentioned above, the **Consumer Credit Directive does not contain a clear duty of responsible lending**. As a result of the compromise among Member States, Article 8 of the directive imposes only a modest obligation on the creditor to assess the consumer's creditworthiness prior to the conclusion of the credit agreement and in case the parties agree to change the total amount of credit after the conclusion of such an agreement. The weaknesses of this provision manifest themselves at each of the three steps of the creditworthiness assessment process: 1) obtaining relevant information about the consumer's financial situation; 2) making a judgment about the consumer's creditworthiness; 3) making a decision on the consumer's credit application.

Step 1: Obtaining relevant information about the consumer's financial situation.

Article 8 of the Consumer Credit Directive makes it clear that the creditworthiness assessment should be based on the '**sufficient information**' obtained from the consumer and/or the relevant database. This provision affords the creditor a **wide margin of discretion** for the purposes of determining which information it must have at its disposal to determine whether the consumer is creditworthy. The existence of such a margin has been confirmed by the CJEU¹⁰⁴. According to the Court, '*the sufficient nature of the information may vary depending on the circumstances in which the credit agreement was concluded, the personal situation of the consumer or the amount covered by the agreement*'¹⁰⁵. In the light of this, the Court also ruled that Article 8 allows the creditor to assess the consumer's creditworthiness solely on the basis of information supplied by the consumer, provided that that information is sufficient and that mere declarations by the consumer are also accompanied by supporting evidence¹⁰⁶. Furthermore, this provision does not require the creditor to systematically verify the information supplied by the consumer¹⁰⁷. The Consumer Credit Directive as interpreted by the CJEU thus leaves **much leeway to the Member States** when it comes to gathering information about the consumer's financial situation. While Member States are likely to impose different requirements to such information, at present we know little about their content and effectiveness in preventing the mis-selling of consumer credit products across the EU.

It is notable that the Mortgage Credit Directive has adopted a more prescriptive approach to information collection for the purposes of the consumer's creditworthiness assessment before concluding a mortgage contract. This directive specifies that such an assessment should be carried out '*on the basis of information on the consumer's income and expenses and other financial and economic circumstances which is necessary, sufficient and proportionate*'¹⁰⁸. Furthermore, the directive requires that the creditor obtains such information '*from relevant internal or external sources, including the consumer, and including information provided to the credit intermediary or appointed representative during the credit application process*' and that it appropriately verifies this information¹⁰⁹. Although these provisions of the Mortgage Credit Directive also leave considerable leeway to the Member States when it comes to regulating information gathering, their room for manoeuvre is more limited compared to the one available to them under the Consumer Credit Directive.

¹⁰⁴ CJEU C-449/13 (*CA Consumer Finance SA v. Ingrid Bakkaus and Others*), ECLI:EU:C:2014:2464, para. 36.

¹⁰⁵ *Ibid.*, para. 37.

¹⁰⁶ *Ibid.*, para. 39.

¹⁰⁷ *Ibid.*, para. 39.

¹⁰⁸ Mortgage Credit Directive, Art. 20 (1).

¹⁰⁹ *Ibid.*

Step 2: Making a judgment about the consumer's creditworthiness.

Once the creditor has collected the necessary data, he makes a judgement about the consumer's creditworthiness. In this context, **a distinction** can be made **between a creditor-focused and a borrower-focused assessment**. The creditor-focused test is based on the premise that there is no problematic repayment situation as long as the consumer is able to repay the credit or otherwise meet his or her obligations under the credit agreement (e.g. making minimum repayments on a credit card). For the purposes of this assessment it is irrelevant whether the consumer is able to do so in a sustainable way, i.e. without having to default on other financial commitments (e.g. energy bills) or having to reduce his or her regular expenditures to a degree which would be harmful to him or her or his or her household (e.g. falling below the minimum living standard). In contrast, the borrower-focused test covers consideration of whether taking on the borrowing is in the consumer's interest. It assumes that there is no problematic repayment situation as long as the consumer is able to repay credit and meet other obligations under the credit agreement in a sustainable way.

The borrower-focused test underlines **a potential conflict of interests between creditors and consumer borrowers**, particularly when it comes to high-cost credit. As our analysis of credit card lending in Chapter 2 above has shown, creditors can engage in a cycle of extending credit and generating profit from consumers who pay interest and penalty charges at a sufficient level to make the loan profitable regardless of whether it is eventually repaid.

However, the wording of Article 8 of the Consumer Credit Directive does not make it clear what kind of creditworthiness test – creditor-focused or borrower-focused – is envisaged by it. As a result, Member States have a **large margin of manoeuvre** as to how to perceive and design the creditworthiness assessment required by the directive. The UK, for example, has explicitly opted for a borrower-focused test¹¹⁰. The Consumer Credit Sourcebook currently in force explicitly requires that, in making the creditworthiness assessment, financial firms '*take into account more than assessing the customer's ability to repay the credit*'¹¹¹ and take reasonable steps '*to assess the customer's ability to meet repayments under a regulated credit agreement in a sustainable manner without the customer incurring financial difficulties or experiencing significant adverse consequences*'¹¹². Absent a complete set of data on the implementation and application of Article 8 across the EU, however, it is unclear which approach has been adopted in other Member States.

In contrast, the Mortgage Credit Directive appears to suggest a borrower-focused test. In particular, the directive explicitly states that the creditworthiness test cannot rely predominantly on the fact that the value of the property exceeds the amount of the credit or the assumption that the property will increase in value, unless the purpose of the credit agreement is to construct or renovate the property¹¹³. In addition, when making the judgment about the creditworthiness, the creditor '*should make reasonable allowances for committed and other non-discretionary expenditures such as the consumers' actual obligations, including appropriate substantiation and consideration of the living expenses of the consumer*'¹¹⁴. What is more, the creditor should even '*make prudent allowances for potential negative scenarios in the future, including for example, a reduced income in retirement; an increase in benchmark interest rates in the case of variable rate mortgages;*

¹¹⁰ See e.g. Financial Conduct Authority, *Assessing Creditworthiness in Consumer Credit: Proposed Changes to Our Rules and Guidance*, Consultation Paper CP17/27, July 2017.

¹¹¹ Consumer Credit Sourcebook, para. 5.3.1 (1).

¹¹² Consumer Credit Sourcebook, para. 5.3.1 (2).

¹¹³ Mortgage Credit Directive, Art. 18 (3) and Recital 55.

¹¹⁴ European Banking Authority, *Guidelines on Creditworthiness Assessment: Final Report*, June 2015, Guideline 5.1.

*negative amortisation; balloon payments, or deferred payments of principal or interest*¹¹⁵. The EBA's guidelines on creditworthiness assessment provide further detail on how Member States should give effect to these provisions¹¹⁶.

Step 3: Making a decision on the consumer's credit application.

Once the creditor has made a judgment about the consumer's creditworthiness, he can make a decision on the consumer's credit application. The key issue to be addressed at this stage is what to do in case of the **negative outcome of the creditworthiness test**. Article 8 of the Consumer Credit Directive **does not address this issue**. In particular, it does not oblige the creditor to refuse granting credit to the consumer in such a case. In the light of the case law of the CJEU, the only duty which may rest upon the creditor in such a situation under EU law is an obligation to provide the consumer with an adequate explanation in good time before signing the credit agreement¹¹⁷. Article 8 of the Consumer Credit Directive thus leaves Member States **a wide margin of discretion** as to the consequences of the negative outcome of the creditworthiness test. It is therefore not surprising that the solutions adopted at the national level differ across the EU. While some Member States, such as the Netherlands¹¹⁸, have introduced an explicit statutory prohibition on granting credit in such a case, other Member States, such as the UK, have not gone that far in the area of unsecured consumer credit. At present, however, no comprehensive data are available from all Member States.

In contrast, in case of the negative result of the creditworthiness test, the Mortgage Credit Directive explicitly obliges the creditor to refuse granting credit to the consumer. This duty follows from the positively formulated provision of this directive under which *'the creditor only makes the credit available to the consumer where the result of the creditworthiness assessment indicates that the obligations resulting from the credit agreement are likely to be met in the manner required under that agreement'*¹¹⁹.

Last but not least, the Consumer Credit Directive **does not provide any substantive safeguards against excessively high interest rates or other potentially dangerous features of high-cost credit products** that may adversely affect the consumer's financial health. In particular, the directive does not require that Member States regulate product contract terms in the form of price caps or rollover restrictions. Nor does it lay down any rules designed to prevent financial institutions developing financial products that may cause consumer detriment. In the absence of EU harmonisation on such sensitive issues, it is up to Member States how to deal with them and the adopted solutions vary greatly¹²⁰.

Yet again, a comparison between Consumer Credit Directive and the Mortgage Credit Directive reveals a striking difference between the two. Article 7 (1) of the Mortgage Credit Directive makes it clear that when manufacturing or distributing products, creditors and credit intermediaries must act *'honestly, fairly, transparently and professionally, taking account of the rights and interests of the consumers'*. The meaning of this open-ended duty has been specified in the EBA's guidelines on product oversight and governance

¹¹⁵ Ibid., Guideline 6.1.

¹¹⁶ European Banking Authority, *Guidelines on Creditworthiness Assessment: Final Report*, 1 June 2015.

¹¹⁷ CJEU C-449/13 (*CA Consumer Finance SA v. Ingrid Bakkaus and Others*), ECLI:EU:C:2014:2464, para. 49.

¹¹⁸ Financial Supervision Act 2006 (*Wet financieel toezicht 2006*), Art. 4:34 (2).

¹¹⁹ Mortgage Credit Directive, Art. 18 (5) (a).

¹²⁰ See e.g. U. Reifner *et al.*, *Study on interest rate restrictions in the EU: Final Report for the EU Commission DG Internal Market and Services*, Brussels/Hamburg/Mannheim, 2010; O.O. Cherednychenko, 'Freedom of Contract in the Post-Crisis Era: Quo Vadis?' (2014) 10 *European Review of Contract Law*, p. 390, 413.

arrangements for both manufacturers and distributors¹²¹. In particular, such arrangements should be designed to ensure that the interests, objectives and characteristics of consumers are appropriately taken into account, to avoid potential consumer detriment, and to minimise conflicts of interest¹²². However, in the absence of the respective legal basis in the Consumer Credit Directive, at present, the **EBA has no competence** to develop similar guidelines for consumer credit products.

3.2.2. Cross-selling

While **cross-selling**, whereby a consumer credit product is sold together with payment protection insurance or another financial product, has been identified as one of the major causes of consumer detriment in European consumer credit markets, the 2008 Consumer Credit Directive **does not comprehensively deal with this practice**. The directive only requires that, where the consumer is obliged to purchase an insurance policy in order to obtain the credit, the cost of such a policy should be included in the APRC designed to help consumers compare different offers¹²³. However, the Consumer Credit Directive does not impose any restrictions on making the provision of credit conditional on payment protection insurance or another financial product, also known as tying. Nor does it contain rules designed to ensure the suitability of credit-related products for individual consumers. Given a lack of harmonisation of these matters, Member States are free to decide whether to regulate consumer credit-related cross-selling, and if so, how.

By way of comparison, the Mortgage Credit Directive lays down specific rules designed to restrict some cross-selling practices. Importantly, the directive distinguishes between product bundling and product tying. The latter is understood as *'the offering or the selling of a credit agreement in a package with other distinct financial products or services where the credit agreement is not made available to the consumer separately'*¹²⁴. Whereas bundling practices are allowed, tying practices are generally prohibited¹²⁵. The idea behind this rule is *'to prevent practices such as tying of certain products which may induce consumers to enter into credit agreements which are not in their best interest, without however restricting product bundling which can be beneficial to consumers'*¹²⁶.

In the absence of sector-specific EU rules on unfair cross-selling practices related to consumer credit, consumers could derive some protection from the **2005 Unfair Commercial Practices Directive**. While this horizontal EU measure does not contain a general prohibition of tying practices, such practices might be considered unfair and hence prohibited following a case-by-case assessment¹²⁷. In addition, national rules implementing the Unfair Commercial Practices Directive could potentially play a role in combatting misleading and aggressive cross-selling practices even in those cases where no tying is involved¹²⁸. Yet, given the large-scale mis-selling of consumer credit-related PPI across the EU over the past decade, it is questionable whether the general provisions of the Unfair Commercial Practices

¹²¹ European Banking Authority, *Guidelines on Product Oversight and Governance Arrangements for Retail Banking Products*, 22 March 2016.

¹²² Ibid., Guidelines 1.1 and 9.1.

¹²³ Consumer Credit Directive, Art. 19 and Annex II, para. 3.

¹²⁴ Mortgage Credit Directive, Art. 4 (26).

¹²⁵ Mortgage Credit Directive, Art. 12 (1). At the same time, the general prohibition of tying practices has been weakened by allowing Member States to introduce exemptions from this rule in a number of situations (Art. 12 (2-4)).

¹²⁶ Mortgage Credit Directive, Recital 24.

¹²⁷ European Commission, *Guidance on the Implementation / Application of Directive 2005/29/EC on Unfair Commercial Practices Directive*, SWD(2016) 163 final, p. 14.

¹²⁸ Unfair Commercial Practices Directive, Arts 6-8.

Directive suffice to ensure adequate consumer protection against unfair cross-selling in consumer credit markets.

It is also notable that in 2014 the Joint Committee of the three European Supervisory Authorities (ESAs) – the EBA, the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities and Markets Authority (ESMA) – made an attempt to develop a coherent regulatory approach to cross-selling across the three sectors of banking, insurance and investments, respectively, in order to ensure consumer protection¹²⁹. However, this attempt proved to be unsuccessful due to major inconsistencies across existing legislative instruments¹³⁰.

3.2.3. Peer-to-peer lending

The drafters of the Consumer Credit Directive designed this legislative instrument with the conventional borrowing model in mind. It applies to credit agreements in which a creditor, i.e. a natural or legal person acting in the course of his trade, business or profession, grants or promises to grant credit to a consumer, i.e. a natural person who is acting for purposes which are outside his trade, business or profession¹³¹. **The P2PL model**, which connects those who lend money directly to those who need financing by means of an electronic P2PL platform, does not fit into this legal framework and thus **falls outside the directive's scope of application**. In particular, the Consumer Credit Directive would not apply to P2PL platforms given that they typically do not act as lenders or borrowers¹³². Nor would the directive apply to consumer lenders as they normally do not grant credit to consumers in the course of their trade, business or profession. The existing EU legislation thus does not harmonise consumer protection standards in the area of P2PL and leaves their development entirely up to Member States. While there are significant differences in legal regimes for P2PL across the EU¹³³, consumer P2PL falls outside the scope of the European Commission's recent proposal for a regulation on European crowdfunding service providers¹³⁴.

3.3. Enforcement

The foregoing analysis has shown that the EU regulatory framework, in particular the Consumer Credit Directive, **does not tackle the most imminent problems faced by consumers in consumer credit markets across the EU**. The degree of consumer protection against problematic consumer credit products and practices in such markets thus largely depends on the national laws of the Member States. Given many instances of mis-selling in European consumer credit markets, however, it is questionable to what extent domestic legal systems ensure adequate consumer protection. The lack of such protection appears to result from the lack of appropriate consumer protection standards or non-compliance therewith at the Member State level. While it is beyond the scope of this paper to discuss these aspects in more detail, a few observations concerning the EU's approach to enforcement should nevertheless be made in the present context.

¹²⁹ Joint Committee of the European Supervisory Authorities, *Joint Committee Consultation Paper on Guidelines for Cross-Selling Practices*, 22 December 2014.

¹³⁰ European Banking Authority, *EBA Consumer Trends Report 2017*, 28 June 2017, p. 22.

¹³¹ See Consumer Credit Directive, Art. 3 (a)-(c).

¹³² Cf. European Banking Authority, *Opinion of the European Banking Authority on Lending-based Crowdfunding*, 26 February 2015, p. 31.

¹³³ E.g. *ibid.*, p. 36 *et seq.*

¹³⁴ European Commission, Regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business, COM(2018) 113. Cf. European Commission, Legislative Proposal for an EU Framework on Crowd and Peer to Peer Finance: Inception Impact Assessment, 30 October 2017.

There is general agreement that **effective enforcement** in terms of reducing the incidence of harmful behaviour and doing so at least cost for both the regulators and the regulated is vital to the ability of legal norms of European or national origin to attain desired outcomes. Efforts expended on setting consumer protection standards, therefore, must be allied to effective enforcement strategies.

Particularly in the wake of the global financial crisis, ensuring effective enforcement of the rules governing the relationship between financial institutions and their (potential) clients ranks high on the EU political agenda¹³⁵. Traditionally, such rules were enforced by civil courts at the initiative of one of the parties to a dispute through the means available within national private laws. **Private enforcement** in this sense makes it possible for the aggrieved party, for example, to obtain compensation for loss caused by the violation of consumer protection standards. Over the past three decades or more, however, it has been increasingly recognised that private enforcement alone is insufficient for the realisation of important public goals, such as the proper functioning of financial markets or a high level of financial consumer protection, and that it needs to be supplemented by **public enforcement**. The latter implies that the state and its agencies monitor the financial institutions' compliance with their obligations towards the clients and, in case of non-compliance, enforce these rules through administrative law means, such as penalties. It is the **combination of public and private enforcement** that is needed for achieving desired results. Many questions, however, still exist concerning the modalities of such a combination in a multi-level system of governance in the EU.

In the field of European financial (consumer) law, including consumer credit law, the EU legislator has predominantly relied on public enforcement through administrative agencies and private enforcement through alternative dispute resolution (ADR). In particular, the Consumer Protection Cooperation Regulation required Member States to set up public authorities for the enforcement of the Consumer Credit Directive¹³⁶. The latter in turn obliged Member States to establish adequate and effective ADR procedures for the settlement of consumer disputes concerning credit agreements¹³⁷. Notably, in the UK, the Financial Ombudsman Services (FOS) played an important role in providing redress to consumers in the aftermath of the PPI mis-selling¹³⁸. Yet the rise of public enforcement and ADR in the field of financial consumer protection poses **many new challenges** in terms of their ability to ensure compliance with consumer protection standards.

In particular, it is **questionable to what extent financial supervisory authorities across the EU are well-equipped to effectively address consumer protection issues** given considerable differences among Member States in the relative importance of financial consumer protection within a specific framework for financial supervision¹³⁹. For example, a critical issue for the German Federal Financial Supervisory Authority is how to integrate financial consumer protection into its supervisory activities given that, traditionally, this authority focused on prudential supervision and received the consumer protection mandate

¹³⁵ On this in more detail, see O.O. Cherednychenko, 'Public and Private Enforcement of European Private Law in the Financial Services Sector' (2015) 23 *European Review of Private Law* 23, p. 621.

¹³⁶ Regulation (EC) No. 2006/2004 of the European Parliament and of the Council of 27 October 2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws, *OJEU* 2004 L364/1, as subsequently amended (see consolidated text in EUR-Lex).

¹³⁷ Consumer Credit Directive, Art. 24.

¹³⁸ See e.g. E. Ferran, 'Regulatory Lessons from the Payment Protection Insurance Mis-selling Scandal in the UK' (2012) 13 *European Business Organization Law Review*, p. 247.

¹³⁹ See e.g. U. Reifner & S. Clerk-Renaud, *Financial Supervision in the EU: A Consumer Perspective* (Study for the BEUC), February 2011. See also U. Reifner, 'Financial Services and Consumer Protection – From Private Law to Bank Supervision', in E. Buttigieg (ed.), *Rights and Remedies for the Consumer in the European Union* (Gutenberg Press: Malta, 2012), p. 99, 104.

only in 2015¹⁴⁰. A similar concern can be raised in relation to the EBA and other two ESAs which are also based on the single financial regulator model (prudential supervision and conduct of business supervision (financial consumer protection) under one roof). Notably, according to the 2014 European Commission's report on the operation of the ESAs, the general view among stakeholders was that consumer protection had not been given sufficient priority in the work of these European agencies¹⁴¹. It remains to be seen whether the current reform of the European system of financial supervision, which does not envisage a clear separation between prudential supervision and conduct of business supervision, will bring about a major improvement in terms of financial consumer protection.

In addition, the **traditional divide between public law** (in particular, financial supervision law) **and private law** (in particular, contract and tort law) at the Member State level may create **obstacles for consumers to invoke consumer protection standards in private actions against financial institutions**¹⁴². In Germany, for example, the creditor's duty to assess the consumer's creditworthiness enshrined in Article 8 of the 2008 Consumer Credit Directive was initially implemented in financial supervision legislation alone, which for a long time precluded consumers from invoking private law remedies, such as damages, in case of its violation¹⁴³. Only the 2014 ruling of the CJEU in *LCL Le Crédit Lyonnais*, in which the Court explicitly stated that Article 8 of the Consumer Credit Directive '*is intended to protect consumers against the risks of over-indebtedness and bankruptcy*'¹⁴⁴, prompted a change in the legislator's approach and led to the introduction of detailed rules on the creditor's duty to assess the consumer's creditworthiness into the German civil code (*Bürgerliches Gesetzbuch (BGB)*)¹⁴⁵.

Last but not least, while **private enforcement by means of ADR** has the potential to significantly improve the procedural position of consumers by providing them with low-cost, simple, and fast procedures, it is **not entirely unproblematic**. In particular, neither the Consumer Credit Directive nor Directive on Consumer ADR¹⁴⁶ require the participation of creditors or credit intermediaries in ADR procedures to be mandatory or the outcome of such procedures to be binding on them¹⁴⁷. In addition, the rise of ADR raises concerns in terms of legal certainty. The involvement of ADR entities in resolving disputes between financial institutions and consumers leads to another layer of rules in an already complex legal matrix for financial services – one consisting of contract-related financial supervision rules, on the one hand, and traditional private law rules, on the other. Further, ADR bodies are not always clear and consistent as to the standards they apply when resolving consumer disputes. A good illustration of the problem is provided by the case law of the dispute resolution bodies of the Dutch Financial Services Complaints Institute (*Klachteninstituut Financiële Dienstverlening*) – the Financial Services Complaints Commission (*Geschillencommissie Financiële Dienstverlening*) and the Commission of Appeal (*Commissie van Beroep*) in cases

¹⁴⁰ A. Ottow & Y. Svetiev, 'Financial Supervision in the Interstices Between Private and Public Law' (2014) 10 *European Review of Contract Law*, p. 496, 529.

¹⁴¹ European Commission, *Report from the Commission to the European Parliament and the Council on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (ESFS)*, SWD(2014) 261 final, p. 14.

¹⁴² O.O. Cherednychenko, 'Public and Private Enforcement of European Private Law in the Financial Services Sector' (2015) 23 *European Review of Private Law* 23, p. 621, 634 *et seq.*

¹⁴³ P. Rott, 'Insufficient Prevention of Over-indebtedness – Legal and Policy Failures', in F. Ferretti (ed.), *Comparative Perspectives of Consumer Over-indebtedness: A View from the UK, Germany, Greece, and Italy* (The Hague: Eleven International Publishing, 2016), p. 189, 191.

¹⁴⁴ Case C-565/12 (*LCL Le Crédit Lyonnais SA v Fesih Kalhan*), ECLI:EU:2014:190.

¹⁴⁵ See new § 505d BGB.

¹⁴⁶ Directive 2013/11/EU of the European Parliament and of the Council of 21 May 2013 on alternative dispute resolution for consumer disputes and amending Regulation (EC) No. 2006/2004 and Directive 2009/22/EC, *OJEU* 2013 L 165/63 (Directive on Consumer ADR).

¹⁴⁷ *Ibid.*, Recital 49.

concerning consumer credit¹⁴⁸. While some cases were resolved based on the contract-related supervision rules and/or relevant industry self-regulation¹⁴⁹, in other cases traditional private law duties of care and loyalty played a crucial role, either alone¹⁵⁰ or in combination with the self-regulation¹⁵¹. In addition, there are cases in which it is not clear at all what sets of norms were actually applied¹⁵². Such divergent and contradictory approaches by ADR entities to extra-judicial private enforcement significantly undermine legal certainty for both financial institutions and consumers in the financial services field.

¹⁴⁸ On this in more detail, see O.O. Cherednychenko & J.-M. Meinderstma, 'Verantwoorde kredietverstrekking aan consumenten in een multilevel governancestelsel' (2014) 13 *Tijdschrift voor Consumentenrecht & Handelspraktijken*, p. 181, 189 *et seq.*

¹⁴⁹ For example, Geschillencommissie Financiële Dienstverlening, nr. 212, 5 September 2011; Geschillencommissie Financiële Dienstverlening, nr. 2012-199, 4 July 2012; Geschillencommissie Financiële Dienstverlening, nr. 2013-17, 14 January 2013; Commissie van Beroep, nr. 2013-10, 11 March 2013; Geschillencommissie Financiële Dienstverlening, nr. 2013-219, 10 July 2013.

¹⁵⁰ For example, Geschillencommissie Financiële Dienstverlening, nr. 189, 10 August 2011; Geschillencommissie Financiële Dienstverlening, nr. 68, 1 April 2011; Commissie van Beroep, nr. 2012-14, 21 June 2012.

¹⁵¹ For example, Geschillencommissie Financiële Dienstverlening, nr. 2012-308, 31 October 2012.

¹⁵² For example, Geschillencommissie Financiële Dienstverlening, nr. 2012-155, 16 May 2012.

4. CONCLUSIONS

The preceding analysis has shown that **consumer credit products** can be **dangerous for consumers**. The purchase of such products may not only yield no substantial benefits to the consumer but also seriously impair the consumer's financial health.

The **most problematic products and practices** in consumer credit markets across the EU that have caused consumer detriment in the past and that are still a source of concern today include: **(1) the provision of high-cost credit**, such as payday loans or credit cards, **(2) cross-selling**, whereby consumer credit products are sold to consumers together with other products, such as payment protection insurance, and **(3) peer-to-peer consumer lending (P2PL)** which connects consumer lenders to consumer borrowers directly by means of an electronic P2PL platform outside the traditional financial sector. In particular, the **growing digitalisation of consumer finance** poses new risks to consumers by facilitating a quick and easy access to credit for vulnerable consumers who cannot obtain it from conventional lenders, such as banks.

The **2008 Consumer Credit Directive** adopted before the outbreak of the financial crisis is **not well equipped to address these issues** in post-crisis consumer credit markets. Reflecting the **information paradigm** of consumer protection, this directive fosters increased access to consumer credit. In particular, the Consumer Credit Directive does not cover small loans for less than EUR 200 and does not oblige creditors to inform consumers about the possible risks involved in interest rate increases. Nor does this directive impose a clear duty of responsible lending or provide any substantive safeguards against excessively high interest rates or other potentially dangerous features of high-cost credit products. In addition, neither the Consumer Credit Directive nor other EU measures adequately address the problem of cross-selling in consumer credit markets and the new risks involved in P2PL.

In the absence of a substantial degree of EU harmonisation of these matters, **Member States have a wide room for manoeuvre**, and the solutions adopted tend to vary greatly. Given many instances of mis-selling in European consumer credit markets, it is questionable to what extent national legal systems provide for **adequate consumer protection standards**. In addition, given the limitations of the EU's enforcement architecture, the **effectiveness of public and private enforcement mechanisms** in the field of European consumer credit law is likely to differ considerably across the EU. This situation may create **incentives for regulatory arbitrage**, whereby credit providers from Member States with strict regulations engage in cross-border activities in countries with weaker regulations.

While the European Commission aims to achieve a deeper and safer single market for consumer credit¹⁵³, at present, there is **no coherent EU policy agenda in terms of addressing consumer over-indebtedness**¹⁵⁴. This may result in **unjustified differences in the level of consumer protection** across different segments of consumer credit markets. Notably, the Mortgage Credit Directive adopted post-crisis has departed from the access to credit-oriented approach of the Consumer Credit Directive and introduced much more protective rules designed to prevent consumer over-indebtedness. In particular, this directive has introduced a clear duty of responsible lending and imposed limitations on certain cross-selling practices. One may question, however, to what extent the fundamental differences in the level of consumer protection between the two directives are justified, given

¹⁵³ European Commission, Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions *Action Plan: Better Products, More Choice*, COM(2017) 139 final, para. 2.6.

¹⁵⁴ Cf. European Parliament, Resolution of 14 November 2017 on the Action Plan on Retail Financial Services, P8_TA(2017)0428, para. 25.

that problems of irresponsible lending exist not only in secured but also unsecured credit markets, particularly those associated with high-cost credit.

In order to determine whether the EU should take action and, if so, of what kind, **further research is needed** to shed more light on the drivers of mis-selling in consumer credit markets (such as potential market failures and regulatory failures resulting from the lack of appropriate consumer protection standards or their underenforcement), as well as the Member States' responses thereto, including best practices. Perhaps the time is now ripe for striking a **different balance between access to credit and consumer protection in the post-crisis EU regulatory framework for consumer protection.**

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This paper is part of a series of five studies on mis-selling of financial products in the EU. Retail financial markets across the EU have been upset by large-scale mis-selling of financial products to consumers. As part of a series of five studies on this topic, this paper examines the problem of mis-selling with a particular focus on consumer credit. It identifies the most problematic products and practices in consumer credit markets that may cause consumer detriment and shows some important limitations of the current EU regulatory framework for consumer credit in providing adequate consumer protection. This document was provided by Policy Department A at the request of the ECON Committee.

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