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***Information disclosure in the EU
Consumer Credit Directive:
Opportunities and limitations***

Catherine I. Garcia Porras &

Willem H. van Boom

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Abstract:

Any system of consumer credit regulation is based both on conceptions of the legitimate function of credit in society and on assumptions pertaining to how creditors and debtors think, decide and operate. For instance, information disclosure duties in consumer regulation are predominantly based on the assumption that consumers are able to read and understand mandatorily disclosed information and that they are thus empowered to make better (rational) choices after having received information on the benefits and dangers of particular transactions.

However, the concept of the well-informed, average consumer who only needs full information to choose alludes to a mythical figure. This seems especially true in the area of financial services because there the legislative framework hardly ever takes into account outright irrational consumer behaviour. Furthermore, where consumers face difficulties in processing information on credit or interest cost and terms, the complexities of credit products may provoke commercially profitable but dubious and deceptive practices.

The provisions of the Directive 2008/48/EC on Credit agreements for consumers and repealing Council Directive 87/102/EEC (hereafter: EU Consumer Credit Directive) predominantly follow the abovementioned information paradigm. It promotes consumer autonomy by aiming at enabling consumers to make informed decisions. To this end, it imposes information duties on the creditor and credit intermediaries by means disclosure of information to be included in advertising with figures relating to the cost of credit and disclosure of information to be included in the credit agreements. Moreover, by using a Standard European Consumer Credit Information (hereafter: SECCI) it also regulates the form in which specific information must be conveyed to consumers in the pre-contractual stage. Such standardization of information appears to aim at avoiding information overload and at maintaining or allowing the comparability of different offers.

Against this background, we will look into both the opportunities and the limitations of information disclosure duties encapsulated in the EU Consumer Credit Directive. Moreover, focusing on less-than-rational and cognitively distorted thinking and deciding involved in consumer borrowing behaviour, we draw attention to the question whether and to what extent information disclosure duties can actually improve the quality of contractual choice and lead to responsible borrowing. As the Directive aims at full harmonization, it leaves little room for manoeuvring at member state level. This may be at odds with the need felt by domestic policymakers for a more interventionist approach.

Keywords: EU consumer credit directive, mandatory disclosure, standardization of credit information, predatory lending, consumer borrowing behaviour.

JEL Classifications: D18, K12, K39

[♦] Catherine Garcia Porras (garcia@law.eur.nl) is PhD student and [Willem van Boom](#) (vanboom@law.eur.nl) is professor at the [Rotterdam Institute of Private Law](#), Erasmus School of Law, Rotterdam, The Netherlands. This paper was concluded in December 2009. Later developments were not included.

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1 Introduction

For the most part the EU Consumer Credit Directive had favoured the *disclosure paradigm* to remedy information asymmetry and to improve the quality of contractual choice. The basic assumption is that consumers are able to read and understand mandatorily disclosed information and that they are thus empowered to make better (rational and informed) choices after having received information on the benefits and dangers of particular transactions. However, the European consumer credit market, which encompasses a heterogeneous mass of consumers, barriers of varying nature (e.g. legal, linguistic, geographical and cultural differences¹, different levels of information asymmetry between lender, financial intermediary and consumer, and predominant local credit cultures), cast doubts on the effectiveness of this policy tool. In this paper, we focus on the actual opportunities created by disclosure duties in consumer credit regulation and on the limitations of such duties.

This paper has the following set-up. First, in order to explain the core ideas underlying the provisions of the European consumer credit regulation, we will provide a background of its rationales (sections 2 and 3). Then we briefly review the informational principles and provisions on information duties, embodied in the EU Consumer Credit Directive (sections 4 and 5). Next, aiming at presenting a more realistic picture of consumer decision making we will focus on the opportunities and the limitations of disclosure duties, by appraising some of the empirical research that is available on consumer thinking and deciding with regard to credit transactions (section 6). Finally we touch upon the question to what extent information disclosure is sufficient and whether a more interventionist approach is perhaps warranted, by analysing the relevance of the insights generated by this line of research for consumer credit policymaking and by drawing conclusions (sections 7 and 8).

A preliminary observation is that in this paper, we focus on information disclosure in the EU Consumer Credit Directive and we do not touch upon over-indebtedness issues tackled by the creditworthiness test laid down in article 8 of the EU Consumer Credit Directive. By necessity, this narrows down our object of research and filters out some of the most pressing problems of consumer credit. That does not imply, however, that we overlook the information disclosure's potential value and its opportunities. Rather, we emphasize the intrinsic value of standardized credit information, provided such information takes into account the types of information needed, the timing and the ease of use and the different levels of consumer sophistication.

¹ Lannoo and Mata-Munoz(2004).

2 Consumer credit regulation rationales

Strategies employed in the various European legal systems have included interest rate caps, bans of usury, stimulating co-operative lending and more recently information disclosure regulation.² Thus, consumer credit law increasingly developed into a combination of private and public regulation, attributable to the fact that through mandatory law it combines economic (transparent, competitive market) and social concerns (such as social consequences of over-indebtedness³) in a private law setting. Consequently, it has developed into a balancing act between stimulating financial services and safeguarding economic interests of consumers.⁴

In Europe, two main strands of regulatory strategies can be distinguished.⁵ The first strand is a neoliberal approach and relies on empowerment of the consumer, who is assumed to be a rational maximizer of his own utility by making optimal resource allocation decisions when provided with sufficient information. In this model, regulating information disclosure and installing some controls on unfair terms in credit contracts is considered to be an adequate condition for markets to police credit provision, to foster responsible lending and borrowing and to sustain the development of financial capability.⁶

The second strand is more interventionist and paternalistic in operation and it is typified here as the social market approach to consumer credit. It is not primarily concerned with economic grounds and includes compulsory interest rate ceilings, lender liability for irresponsible lending, controls on termination and default penalties and restrictions on debt recovery from consumers.⁷ These non-economic rationales may express social values such as distributive justice and 'access to credit', may draw on human rights and constitutional principles and

² Franken, S;(2009).

³See Ramsay(2004). Differing opinion Micklitz, H-W et al(2009; 45) .

⁴ See, e.g., Commission of the European Communities, White Paper: Financial Services Policy 2005-2010 (2005) "The Commission will deploy the most open, transparent, evidence based policymaking based on a dual commitment to open consultation and impact assessments, so to ensure sound rules are drawn up, adding value to the EU's financial services sector and consumers". See also Bradley(2008).

⁵ Ramsay(2009), see also Westphal, M.(2008), Wilhelmsson (2005), Micklitz, H-W(2008).

⁶ On the role of information disclosure duty in the neoliberal pro-market approach, see, e.g., Wilson, Howell and Sheehan (2009); Cartwright (2004)62; Weatherill (2005)84 ff. Cf. Gozzo (2005).

⁷ Furthermore, where regulation is aimed at protecting the consumer a distinction can be made between *prudential regulation*(based upon the idea of information asymmetry and concerned with soundness, solvency, safety and of banks and may apply even if there is not systemic risk) and *conduct of business regulation*(that focuses on how banks conduct business and self regulation with their customers) which also raise questions related to the legal status and binding character of this codes. For an overview see Cartwright, P.(2004)

may aim at both redistribution of wealth, mitigation of cultural exclusion and marginalization and at increasing autonomy and self-reliance.⁸

To some extent, both strategies can be applied simultaneously and a certain degree of overlap between them may exist. From an early stage, rationales of consumer credit regulation at a European level were twofold: protecting vulnerable consumers against unfair credit terms and promoting cross-border credit and the free movement of goods and services financed by credit, by means of the harmonization of the information to be provided to the consumer.

Currently, the EU consumer policy seems to be leaning towards the neoliberal approach by gradually moving away from a conception of consumers as *objects* of European law towards a notion of consumers as regulatory subjects⁹ by substituting “consumer protection”¹⁰ with a broader notion of “consumer policy” in which consumers are empowered with tools that support their role as accountable and active actors¹¹, rather than as passive subjects that need to be protected against themselves.¹² Consequently, in EU policy the following regulatory objectives dominate in the area of financial services for consumers:¹³

- Stimulating the quality of products that meet consumer needs, through regulation of open markets and strong competition for the provision of products, offering choice and value
- Increasing consumer confidence in financial services, ensuring that on one hand consumers can make the right choices, properly protected, and on the other hand providers are financially sound and trustworthy,

⁸ Cartwright(2004), European Commission(2008), Howells,G(1999), Ramsay, I;(1999).

⁹ Based on the speech of Mr. Ducoulombier, Deputy Head of Unit for Retail Issues, Consumer Policy and Payment systems, DG Internal Market and Services at the Workshop on “Good practices of consumer protection in financial services” organized by the European Credit Research Institute at the Centre for European Policy Studies, in cooperation with the World Bank. See also EU Consumer Policy strategy 2007-2013: Empowering consumers, enhancing their welfare, effectively protecting them, and European Commission(2007)

¹⁰ Critical discussion thereof in Reifner (2006) who argues that the word *protection* should be abolished instead should be seen as *consumer empowerment*.

¹¹ This could be understood as a way to promote party autonomy by secondary EC legislation, which is even more a general characteristic of European contract law. See for an overview, Grundmann(2002). Accordingly, the consumer is viewed as a market player whose action(or inaction) is vital in constructing the single market(Wihelmsson, T; 2004)

¹² See fn. 9. Worth noting is that consumers and their organizations are being actively involved in the EU decision making process to promote consumer representation in the field of financial services.

¹³ Green paper Retail Financial Services (April 2007), also see *infra* note 11.

- Enhancing the quality of information and advice, thus empowering consumers to make the right decisions in seeking out the best deals (through financial literacy, clear, appropriate and timely information provision, and high quality advice).

While this list is not meant to be exhaustive, it highlights some of the core aspects as regards to consumer policy and the ‘framework of rights’ discourse (i.e. substantive economic rights such as the right to exercise choice, on the demand side, or the right to carry out trading activity, on the supply side). In this discourse, reference to the prototypical *financial citizen* is made: an active, informed, and responsible market participant who embraces market risk, albeit with advice.¹⁴ This seems to represent a shift towards a concept of citizenship that posits social responsibilities, rights to information and fair dealing far beyond the concept of the consumer, borrower, shopper, and buyer. Moreover, it converges with the neoliberal approach referred to earlier. Information disclosure duties fit in this approach to the extent that such duties are propagated as strengthening the consumer autonomy in contrast to mandatory substantive rules which may overly restrict autonomy and therefore amount to overzealous paternalism.¹⁵

3 The regulatory challenge of information disclosure duties

One of the characteristics of a perfect market is that economic agents have perfect information about both their preferences and the nature and value of the goods and services needed to maximize their utility. In reality, however, markets do not deliver efficient allocation of resources due to market failures such as imperfect information (knowing less than would be ideal) and information asymmetry (knowing less than another person)¹⁶. Information asymmetry is the most acknowledged rationale for regulation in the field of consumer credit¹⁷, alongside other potential market failures.¹⁸ Broadly speaking, informational problems reflect the characteristics of financial products and services which are technically complex, barely knowable and may produce operational risk. Consumers may experience problems in information processing due to the complexity of contracts and may have difficulties judging the financial soundness.¹⁹ Furthermore, they may have a poor understanding of their

¹⁴ See Pearson, G.(2009), Pearson, G(2008), Condon, M and Philipps, L; (2005), Cartwright, P. (2001),

¹⁵On this debate: Grundmann, (2002); Wilhelmsson, (1995); generally: Ogus (2006)31; p. 227-228, p. 252.

¹⁶ Cartwright(2004)

¹⁷ Cooter and Ulen (2008); Cf. Ebers(2004). Hadfield, Howse and Trebilcock (1998)141 argue that this is an outdated paradigm.

¹⁸ For a discussion of market failures: Benston,J.B. (2000), Akerlof, G.A.(1970), Ramsay,I; (2007), Cartwright(2004), UK’s Secretary of State for Business, Innovation and Skills(2009).

¹⁹ For an overview Rutledge,S. (2008).

preferences and needs for credit and are likely to act predictably irrational rather than perfectly rational.

Regulation aimed at tackling information asymmetry fits the neoliberal paradigm in the sense that it pays respect to consumer choice as the cornerstone of proper competition. In this regard there are many tools designed to create enhanced consumer confidence in financial products and services: increasing transparency by generating clear and comparable information about prices, terms and conditions, all written in plain language, mitigating coercive and deceptive practices as well as stimulating reasonable practices in selling, contract performance and debt collection, introducing credible as well as speedy mechanisms for addressing complaints and resolving disputes.

That said, the process of consumer decision making is certainly different from the one anticipated in a perfect market scenario if it is unfairly distorted by deliberate commercial practices of lenders and their intermediaries. Moreover, what use is a theoretical informational equilibrium if consumers do not use the available information, do not carry out an appropriate search for information, are likely to misread relevant and available information or are deceived by businesses interfering with the consumers' search for information? Against this background two observations can be made. First, it seems inevitable that a policy aimed at informational equilibrium is in need of ancillary measures to avoid misleading framing and omission of information and the spread of useless and unskilled advice. Secondly, information equilibrium comes at a cost and may not be practically attainable. For instance, should non-searchers or infra-marginal searching consumers be taken into account when designing information disclosure duties?²⁰ Thus, in any legal system it is as much a challenge for policymakers to respect the financial citizen's autonomy by designing strategies against 'use-pattern mistakes' such as overconfident borrowing patterns²¹, as it is for the consumer to be aware of the risks related to them, and apply self protection in the course of its decision making and for the supply side to act as responsible lenders and assess creditworthiness and eligibility.

4 The informational principles underlying the Directive

What is the approach of the European consumer credit Directive in this regard? Chronologically, European consumer credit regulation was preceded and indirectly influenced by the U.S.A. Truth in Lending Act 1970. It may be helpful to briefly review the basic principles embodied in the information disclosure provisions in the Truth in Lending Act (TILA), since these principles seem to have been influential in shaping the European

²⁰ On typology of consumers' search efforts in credit markets see Bertrand et al (2005).

²¹ Bar-Gill, O. (2007).

approach. The 1970 TILA aimed to solve two types of problems: first, the problem that lenders will not spontaneously reveal all the information that borrowers should examine to make an informed choice – which implies consumer awareness and understanding – before taking the loan. Secondly, lenders will not voluntarily reveal information in such a way to facilitate comparability across products needed for efficient consumer decision making. The ‘truth in lending’ principle solved these issues by introducing mandatory disclosure and coordination of terms and conditions.²²

Further, a key feature of this principle is the credit cost disclosure. Here, the fundamental rationale is that by providing information on the costs of credit to consumers, borrowers -or potential borrowers- they will have a better opportunity than they otherwise would have had to advance their own interests by making rational, well-informed credit purchasing decisions. Accordingly, the disclosure, for instance, of an annual percentage rate of charge is meant, not merely to furnish the consumer with information on the total cost of credit, but also to alert him with a reliable signal of the cost of borrowing, to enable him to compare different credit products, to assist him in the choice between using credit or paying in cash for purchase, and, last but not least, to enable the consumer to be aware of his credit needs before taking out credit.²³ Indirectly, the ‘truth in lending’ principle encompasses a variety of intermediate goals²⁴ such as enhancing competition and quality in consumer credit markets, improving consumer understanding of the relationship among credit cost terms and simplifying consumer information processing, improving consumer confidence and ability to compare and match products and needs.

The current approach to the information paradigm of EU consumer policy in general and the EU consumer credit Directive in particular is twofold. On the one hand, it aims at correcting the information imbalance between consumers and suppliers, by ensuring that the ‘average consumer’ receives adequate information that is easy to understand and readily comparable, in order to enable consumers to make an informed choice. By doing so, it relies on ‘reasonably well informed and reasonably observant and circumspect’ consumers acting as fully rational agents.²⁵ In particular, information rules are the preferred policy instrument since 1979, when the ECJ ruled in *Cassis de Dijon*²⁶. Mandatory substantive rules are thought only to be justified when an information rule cannot remedy the market failure.²⁷ On the other hand, as will become apparent in the following sections, to some extent the consumer credit Directive

²² See for an overview Barr et al(2008); Renuart and Thompson (2008).

²³ See for an overview Alberta Law Reform Institute(2000)

²⁴ See for a in deep analysis of these goals: Durking,T.; Stalen, M; (2002)

²⁵ ECJ 16-07-1998, case C-210/96, ECR 1998, p. I-4657 (Gut Springenheide); ECJ 16-09-1999, case C-220/98, ECR 2000, p. I-117, (Estée Lauder). Cf. Incardona and Poncibò (2007)22 ff.

²⁶Case 120/78, *Cassis de Dijon*, [1979], ECR 649.

²⁷ Critical of this line of reasoning: Reich, N;(2004).

seems to acknowledge that even ‘average consumers’ have their cognitive limitations and that there is a need to cautiously structure interventions to ensure that it is compatible with the manner in which consumers actually process information.

The duties of disclosure embedded as part of the vocabulary of community law and named under different labels²⁸ such as *duties to disclose*, *rights to information*, *information duties* and *information requirements*, constitutes a list of obligations imposed on parties providing goods and services. In the context of the Directive the definition used is that of the legal obligation to provide information.²⁹ A closer look reveals that there is some vagueness surrounding the semantic connotation of duties of disclosure that might have implications in connection to legal certainty in the field of consumer credit. Firstly, there is a difference between *disclosure* and *information*, since the latter has a wider scope than the former.³⁰ Disclosure denotes that the information is hidden or somehow exclusively available to the one possessing the information. Secondly, the *duty to inform* and *duty to advise* seem to overlap, given the fact that sometimes it is not always clear where informing ends and advising begins³¹.

‘Truth in lending’ is not the sole consideration under the Directive. Whereas in the previous consumer credit Directive (87/102/EEC) the principle of truth in lending gained considerable momentum, in the 2008 Directive the principle of responsible lending is being advanced.³² Transparency in the provision of information by creditor and intermediary is an important cornerstone of the Directive. Information duties include borrowing rate, annual percentage rate, total cost of credit (including costs, interest, commissions, taxes, fees for credit intermediaries).³³ Another cornerstone of responsible lending concerns professional diligence in assessing creditworthiness³⁴ and supporting the education of consumers, warnings about the risk related to default of payment and over-indebtedness.³⁵ Overall, the concept of responsible lending in the Directive is aimed at tailoring credit products to consumers’ needs

²⁸ And its correspondingly translation, as *L’obligation d’information* in French law, *contratto informato* in Italian law.

²⁹ Directive 2008/48/EC, Recital 24.

³⁰ Which is linked to the issue of how much information is necessary for a contracting party to exercise an autonomous choice. See Sefton-Green, R; (2005:174).

³¹ Ebers (2004) suggests that giving information is a process where there is no need for an individual consultation given the fact that the client must evaluate the information he receives himself, and that advice does not only mean the information *per se*, but also its professional assessment and recommendation, taking into consideration the customer’s life circumstances and interests. See also Sefton-Green, R; (2005)

³² The foundations of this principle has antecedents in EU COM(1995)117, as well as, existing national legislation and case law in EU, cited in Ramsay(2005; 12)

³³ Directive 2008/48/EC, Recital 20, 32, Articles 5, 6,8,10

³⁴ Directive 2008/48/EC Article 8, 9

³⁵ Directive 2008/48/EC Recital 19, 26, 31, 32

and their ability to repay. This has implications for evaluating the suitability of the product design as such³⁶ and the suitability of the product for a particular borrower. The latter includes consumers' understanding of the product and its risks³⁷ and lenders' understanding of the creditworthiness.

The Directive's dedication to responsible lending does not imply that the Directive is a comprehensive regulatory instrument for responsible consumer credit, notwithstanding the fact that the Directive purports maximum harmonization³⁸-. General aspects of unfair commercial practices are left to the 2005 UCP Directive, and general contract terms are covered by the 1993 Directive.³⁹ Furthermore, issues such as long-term affordability of credit are not dealt with. More importantly, the role of bonus driven intermediaries as fuelling consumer credit is hardly considered in the Directive.

5 A closer look at the information duties under the Directive

In the previous sections, we have reviewed the ends of European consumer credit regulation by looking at rationales for regulation. Moreover, we have assessed some of the main characteristics, limitations and opportunities of information disclosure as a policy tool. In this section, we present a functional approach of the information disclosure provisions embedded in the EU Consumer Credit Directive by looking into three key components: *What* specific information should be conveyed to consumers through disclosure? *When* must creditors and credit intermediaries disclose information to consumers? In which *form* should this information be framed?

³⁶ As far as product design is concerned the European Commission(2009) point that there has been a credit market product innovation in recent years, with products such as buy-to-let, interest-only and self-certification mortgages and revolving credit taking a significant market share in some European Member States

³⁷ In this regard, Jan Molenaar from Rabobank mentioned in the Public Hearing on Responsible Lending and Borrowing(Brussels, September 2009) that The Netherlands have a product information protocol(provided in the pre-contractual phase), which implies information on risk, cost and all other aspects of the product.

³⁸Directive 2008/48/EC, Article 22(1). However, there are several provisions in the Directive to which full harmonization does not apply and Member States are given discretion as to whether and how to apply these provisions.

³⁹ Dir. 2005/29/EC concerning unfair business-to-consumer commercial practices in the internal market, OJ L 149/22; Directive 93/13/EEC (unfair terms in consumer contracts), OJ L.

5.1 Information in advertising

At the stage prior to the conclusion of the credit agreement, specifically in relation with the standard information to be included in advertising⁴⁰, there are basically two main categories and sub-categories of content that are subject of information disclosure: the cost of the credit (the total amount payable by the consumer⁴¹ and the amount of its instalments, the annual percentage rate of charge⁴², the borrowing rate⁴³ (with particulars of any charges), terms of the potential consumer credit contract (the total amount of credit⁴⁴, duration of the credit agreement⁴⁵, and the obligation, if any, to enter into an ancillary service contract relating to the credit agreement⁴⁶). Moreover, in order to enable consumers, to compare different offers, such information should be given in a clear, concise and prominent way by means of a representative example. Furthermore, when the conclusion of an insurance contract (in relation to the credit agreement) is 'compulsory', this obligation should be stated in a clear and prominent manner. Although this provision seeks for transparency and is an interesting initiative, it has been criticized by reason of its wording, given the fact that it set specific criteria (which could be misused as well).⁴⁷

5.2 The Standard European Consumer Credit Information

The goals of simplification and standardization of information and thus enhancing the comparability of different offers have been the main triggers for developing the SECCI⁴⁸ (Annex II of the Directive). The SECCI displays the content and format of the information to

⁴⁰The application of the provisions of the Article 4 are specifically meant for advertisement with figures related to the cost of credit, where no figures are given. Unfair Commercial Practices Directive apply. See Directive 2008/48/EC, Article 4.

⁴¹ Which means the sum of the total of the credit, and the total cost of the credit to the consumer. See Directive 2008/48/EC, Article 3(h).

⁴² Expressed as an annual percentage of the Total amount of credit. See Directive 2008/48/EC, Article 3 (i)

⁴³ Interest rate See Directive 2008/48/EC, Article 3 (j)

⁴⁴ Which means ceiling or total sums made available under the credit agreement. See Directive 2008/48/EC, Article 3(l)

⁴⁵ See Directive 2008/48/EC, Article 4(2)(d)

⁴⁶ See Directive 2008/48/EC, Article 2(3)

⁴⁷ See Directive 2008/48/EC, Article 4(3). See for remarks on this article Micklitz (2009).

⁴⁸ This is a clear sign of the standardization trend of credit information at the pre-contractual stage. A similar initiative at the EU level is the European Standardised Information Sheet for Mortgage Credit (ESIS) that forms part of the Code of Conduct for Home Loans. In the USA, the Truth in Lending Act requires that for credit card applications and solicitations sent through mail, any annual, periodic or membership fees be disclosed in tabular format named as the 'Schumer Box'. The box terms are intended to enable consumers to compare credit offerings. Dubel, J-H;(2008) argues that ESIS in comparison to the other two avoids the mistake of providing excessive and thereby confusing information to consumers.

be provided to credit recipient of consumer credit, on paper or another durable medium⁴⁹, by its credit grantor and, when applicable, the credit intermediary, in good time before the consumer is bound by any credit agreement.

At the stage prior to the conclusion of the credit agreement there are basically six main pieces of information that need to be disclosed in the SECCI: costs, terms of the potential consumer credit contract, essential characteristics of the credit product, information concerning the creditor, credit intermediary, and rights and obligations of the contracting parties and a warning regarding the consequences of missing payments.

There is no obligation to provide information in the SECCI on product attributes, potential risks and use, on the identity and geographical address of creditor/ credit intermediary, on the name and address of the competent supervisory authority⁵⁰, or on redress mechanisms. There are no specific rules on adding qualification restrictions when advertising low rates (a common practice in marketing).

An EU-wide study⁵¹ has shown that the vast majority of respondents thought that the SECCI was a good initiative but that it had several faults, for example the difference between the borrowing rate and the APR was thought to be unclear, as well as the costs in case of late payments, and the procedures for early repayment. Furthermore, there was widespread agreement for a shorter and more summary-style document.

5.3 *Information to be included in the credit agreement*

At the conclusion of the credit agreement, there are basically seven main categories of information disclosure: costs, terms of the consumer credit contract, essential characteristics of the credit products, information concerning the creditor, credit intermediary, rights and obligations of the contracting parties, the risk of missing payments and finally redress mechanisms. There is no information duty concerning the lender / intermediary relationship (tied agent, independent broker, commission structure, etc.), nor is there a specific duty on

⁴⁹ Also if the credit agreement has been prepared and concluded at the consumer's request by means of distance communication. See Directive 2008/48/EC, Article 5(3). However, in the case of voice telephony communications as referred to in Article 3(3) of Directive 2002/65/EC (Directive on Distance Marketing for Financial Services) the description of the main characteristics of the financial service shall include at least the items referred to in points of (c), (d), (e), (f) and (h) of paragraph (1) together with the annual percentage rate of charge illustrated by means of a representative example and the total amount payable by the consumer. See Article 5 of the Directive 2008/48/EC

⁵⁰ World Bank has recently documented this one, as good practice of consumer protection in financial services with reference to disclosure and sale practices. See Rutledge(2008), European Commission(2009).

⁵¹ Optem(2008) .

the potential fees payable by the borrower to the credit intermediary for the provision of the services.

5.4 Information: When and how?

The Directive regulates the when and how of information to some extent. In the following table we summarize the timing and form requirements:

INFORMATION DUTIES IN DIRECTIVE 2008/48/EC		
Timing	Form requirement	Provision
Prior to the conclusion of the credit agreement (specifically in advertising)	<ul style="list-style-type: none"> Standard information (with figures related to the cost of credit) Clear, concise prominent way 	Article 4 without prejudice to Directive 2005/29/EC(Unfair Commercial Practices Directive)
Prior to the conclusion of the credit agreement (specifically before the consumer is bound by any credit agreement)	Standard European Consumer Credit Information (on paper or another durable medium, with information needed to compare offers and conclude the credit agreement)	Article 5 & Annex II of the Directive Article 3, paragraphs (1)(2) of Directive 2002/65/EC(Directive on Distance marketing for Financial Services)
Prior to the conclusion of the credit agreement (specifically before the consumer is bound by any credit agreement)	Voice telephone communications, as referred to in Article 3(3) of Directive 2002/65/EC the description of the main characteristics of the financial service shall include at least the items referred to in points of (c), (d), (e), (f) and (h) of paragraph (1) of Article 5 of the EU Consumer Credit Directive, together with the annual percentage rate of charge illustrated by means of a representative example and the total amount payable by the consumer	Article 3(3)(b) of Directive 2002/65/EC(Directive on Distance marketing for Financial Services) Article 5 (c), (d), (e), (f) and (h) of paragraph (1) of Directive 2008/48/EC(EU Consumer Credit Directive)
Prior to the conclusion of the credit agreement (specifically before the consumer is bound by any credit agreement)	Adequate explanation: "Member States shall ensure that creditors and, where applicable, credit intermediaries provide adequate explanations to the consumer, in order to place the consumer in a position enabling him to assess whether the proposed credit agreement is adapted to his needs and to his financial situation, where appropriate by explaining the pre-contractual information to be provided in accordance with paragraph 1, the essential characteristics of the products proposed and the specific effects they may have on the consumer, including the consequences of default in payment by the consumer. Member States may adapt the manner by which and the extent to which such assistance is given, as well as by whom it is given, to the particular circumstances of the situation in which the credit agreement is offered, the person to whom it is offered and the type of credit offered."	Article 5(6)
Prior to the conclusion of the credit agreement	Explanation in personalized manner, namely duty to assist (pre-contractual information and essential characteristics of the product)	Flexible element of the Directive, is an option of the MS to implemented (Recital 27)

Of particular interest is article 5(6), which apparently aims at enhancing contractual fairness between contracting parties. At the same moment, the article may provide an opportunity to empower consumers in their contracting position. On balance, however, the duty to 'adequately explain' – apart from the fact that member states have ample room for choosing the method and intensity of implementation – may cause blurred interpretation given the fact that the Directive does not spell out what adequate explanation exactly means. Finally, a positive assessment of this provision is that, as it has been introduced as flexible element in the EU Consumer Credit Directive, it will provide a range of possible options for a Member States regarding implementation, the negative side is that it is a missed opportunity to firmly introduce the principle of responsible lending by adding a duty to give financial advice to the creditworthiness test.

6 Opportunities and limitations of disclosure duties

6.1 *The diverse use of credit*

As Van Raaij asserts that money is one of the basic resources of consumers and the allocation of money is the basis of financial behaviour.⁵² Therefore, the possible forms of allocations are: spending, saving, investing, and borrowing. A broad range of functions for consumer credit has been acknowledged⁵³. Keynes⁵⁴ mainly focused on motives within the credit user without going into details such as enjoyment, extravagance, short-sightedness, miscalculation, ostentation and generosity. Whilst Norton⁵⁵ suggested two broad reasons that are closely related to the concrete use of credit, namely: maintenance and improvement of lifestyle, hence resemblance an income substitute.

Driving forces of consumer behaviour in Western societies are hedonic values⁵⁶, promoting credit use for the acquisition of consumer goods. Consequently, credit use no longer means

⁵² Van Raaij, F.(2007). Seminar on Budget Information and Prevention(Utrecht 2007), cited in European Consumer Debt Network(2007). Money matters Financial well-being. No2, 12pp.

⁵³By doing an extensive literature review Kamleitner and Kirchler (2007: 270-271) provide a comprehensive description of the processes before, during and after actual credit take up by doing an overview of empirical findings on consumer credit use from a consumer perspective.

⁵⁴ See Keynes(1936/1997), cited in Kamleitner and Kirchler (2007; 271).

⁵⁵ See Norton(1993), cited in Chien and Devaney (2001)

⁵⁶ However it is important to consider cultural differences in credit use, due to the fact that most research on credit use comes from the United States where use and availability of consumer credit are more extensive than in other parts of the world. A closer look to the use of credit in Europe indicates clear differences between European countries due to different degrees of familiarity with different forms of credit (Huls;1993).

investing in one's personal future, but rather has made it acceptable and accessible for acquiring luxury goods, cars, vacations, and other services⁵⁷. Devaney⁵⁸ asserts that consumers with different demographic and economic characteristics might develop different attitudes toward credit use. For example, instead of a simple preference for borrowing, those who are in the early stages of their career might have even more favourable attitudes towards borrowing because they expect to have more future resources to pay off their debts. Also, high-income consumers might have more favourable attitudes toward credit use because they are less likely to be credit constrained and have more ability to pay off their debts than low-income consumers.⁵⁹

Literature suggests that there are several key variables explaining the motives of credit use. Kamleitner and Kirchler⁶⁰ argue that a decision to borrow money does not necessarily lead to the signing of a credit contract immediately. Moreover, depending on various personal and situational factors (e.g. financial situation and various personal characteristics such as attitude towards credit and financial advice, etc.) it is possible that entering into a credit contract may result from a spontaneous decision (e.g. purchases on credit card, or implicit credit use by late payment) or a more or less extensive decision process (e.g. taking up a bank credit). In such cases information can be searched more intensively, credit alternatives can be evaluated, and a choice can be made accordingly.

It may well be that the factual circumstances in which credit is made available, triggers different decision strategies. Therefore, the inattentive use of store card credit in case of impulsive buying behaviour raises different issues than deliberate application for hire-purchase credit for home improvement. In terms of patterns, sometimes a cautious or intelligent pattern (e.g., committing to an instalment plan with fixed rates provides a means of self-control and leaves acquired savings untouched) is used while in other cases there is an optimistic pattern to translate expectations into effective demand (e.g., students borrow money because they expect higher future incomes). Different patterns may call for different policymaking. Furthermore, the impact of the use of credit by private households has various dimensions: legal, social, psychological, economic and political levels. Some of its broader social aspects are cemented into what we could name as the *paradox of credit*. On the one hand, the issue of access to credit and its disciplinary force in modern society which portrays credit as a positive force in society, aiming at broad availability and promoting financial inclusion, whereas on the other hand the widely felt need for use of credit not to cause societal

⁵⁷ See Kamleitner and Kirchler;(2007: 268).

⁵⁸ Chien and Devaney (2001)

⁵⁹ See *infra* note 59.

⁶⁰ Kamleitner and Kirchler (2007).

difficulties – e.g. over-commitment and consumer default, indebtedness and bankruptcy – portrays the downside of credit.⁶¹

Given the differences in the use of consumer credit observed across EU countries⁶² and consumer deviations that affect borrowing behaviour, the one-dimensional European financial citizen with typical credit behaviour does not exist.⁶³ Analyses of consumer credit and its use in Europe reveal specific national characteristics of this sector of household credit. Among the differences are those concerning to the weight of consumer borrowing in the economy and the use of credit to finance consumption. These differences may be explained by structural factors such as differences in tax, legal and regulatory framework but also by differences in cultural preferences.⁶⁴

6.2 *Reading and understanding*

Ideally, the financial citizen has command of the three levels of literacy: the ability to read and write, the capacity to extract information from different places in different documents and the understanding of information conveyed in numbers. In reality, financial literacy in consumers is shockingly bad. Some of the research done in the USA reveals the following.

- Most credit contracts require literacy at 15th grade level (three years of college). Consumers do not live up to that standard.⁶⁵ 96% of US consumers cannot extract and compute credit cost information from contract and disclosure documents.⁶⁶
- A third of consumers surveyed could not find the default rate in a credit card contract.⁶⁷ Moreover, if information on charges is scattered throughout the contract half of the consumers will fail to identify at least one item of information. Unsurprisingly, they will be more likely to find all fees and charges if these are grouped and totalled.⁶⁸

⁶¹ Ramsay, I;2004: 524-527.

⁶² European Commission Report on the retail banking sector inquiry (2007; 13, 18, 21); European Credit Research Institute 2009 (www.ecri.be/new/node/168).

⁶³ Stuyck, J; Van Dyck, T.; (2006).

⁶⁴ For example McKinnon and Schröder (2006). This also goes a long way in explaining barriers for cross-border borrowing. Lannoo and Mata-Munoz(2004) argue that these barriers are often based on habits, tradition and feelings of trust and confidence. In this regard, the Eurobarometer 298(2008) identified among the main barriers to signing-up to financial services in another EU Member State: difficulty to communicate in another language(37%), followed by the incomprehensible information(29%), insufficient information(26%) and misleading or deceptive information(18%).

⁶⁵ Renuart and Thompson (2008)207. See also the Australian experience of illiterate consumers, as reported by Wilson, Howell and Sheehan (2009).

⁶⁶ White and Lesser Mansfield (2002)237-238.

⁶⁷ Renuart and Thompson (2008)208.

⁶⁸ Ibid.208.

- When USA consumers were given a credit advertisement stating the monthly payment, the term, the borrowed amount and the APR, and were then asked to explain how they would calculate the total amount in interest, only 22% were able to describe the method (such as subtracting the borrowed amount from the payments over the term of the loan).⁶⁹
- When asked how much interest one would pay if the borrowed sum is USD 200, the interest is 10% annually and the term 24 months, less than 18% of consumers between 51 and 56 could calculate this sum.
- When asked to estimate the amount of periodical payments for a given borrowed sum, they state payments that reflect a considerable overestimation of the interest rate and when asked to estimate the interest rate encapsulated in that payment they grossly underestimate the interest rate. Wealth and education reduced but not eliminated these inaccuracies in estimating.⁷⁰
- Using standardized information sheets disclosing information in such a way as to simplify presentation and facilitate comparison has proved successful in the USA.⁷¹

In Europe, the overall literacy rate may be higher but nevertheless the level of financial literacy is not encouraging either.⁷² When given an example of a standard information sheet (amount borrowed € 3000, APR 10,4%, monthly payments € 263,66 with 12 months term, total price of the credit € 3163.92), only 27% of Dutch consumers in a group of consumers 'prone to irresponsible borrowing' were able to indicate that the total cost of the credit was € 163.92. The average consumer from the sample did perform much better. 36% of the remaining consumers (i.e., those not at risk) succeeded in the task.⁷³

Obviously, reading is no guarantee for understanding. O'Shea (2008) reports an empirical study on whether or not the disclosure provisions embedded in of Australian Consumer Credit Code actually improves consumers' understanding of their credit contract. He points out that quite a poor understanding of important provisions of the relevant transactions did not improve when consumers read a contract which complied with the disclosure requirements of the Code, as compared to consumers who read contracts which did not comply.⁷⁴

⁶⁹ Ibid.210.

⁷⁰ Stango and Zinman (2006)5.

⁷¹ Renuart and Thompson (2008)217-218.

⁷² The United Nations Educational, Scientific, and Cultural Organization (UNESCO)-Institute for Statistics reports for adults older than 15 years old a literacy rates of 98.8% in Europe and 95.6% in North America (period 2000-2004). See for details: www.uis.unesco.org

⁷³ EIM (2007). Cf. generally on financial (il)literacy in The Netherlands: Hart and Perron (2006)104 ff.

⁷⁴ O'Shea (2008).

This may be an indication that the mere statutory duty to disclose certain items of information may not be sufficient to ensure that consumers actually understand what they are supposed to read. If competitors have no incentive for uniformity in their presentation of key information, consumers that compare credit offers may have a hard time doing so. A recent Dutch survey indicated that 40% of consumers who compared credit offers experienced difficulties in making a sound comparison.⁷⁵

Not reading at all may pose problems as well. Information disclosure duties assume reading. However, findings in the field on standard form contracts support the assumption that most of consumers do not read most of standard contract terms in their entirety at the time of contracting. The cost of doing so and inability to change the terms anyway are perceived as obstacles. The small portion of those who do read the standard forms beyond the price and description of the goods or services, pay attention primarily to warranties and product information warnings, and an even smaller portion of those readers actually read the forms when the value of the contract is high.⁷⁶

6.3 Searching and comparing efforts

A Dutch study showed that the majority of consumers buying credit omitted to compare the accepted credit offer with other offers.⁷⁷ Are they just lazy or rationally apathetic? It seems that there is something complex going on. Different consumers have different strategies in reaching their decisions on transactions and in some respects the properties of credit and how consumers respond to these properties influence their search efforts. There are at least three perspectives worth noting: the cognitivist approach (also known as the planned process), the behavioural approach (the automatic process),⁷⁸ and the dual mechanism which combines the experiential mode of thinking and the analytical mode of thinking.⁷⁹ Switching from one strategy to another in the dual mechanism may depend on value attached by the consumer to the decision itself since consumers devote more time to gathering and processing information for decisions that are important to them.⁸⁰ It may also depend on the factual setting in which the demand for credit is elicited.

⁷⁵ EIM (2007), cited in Franken(2009).

⁷⁶ See, e.g., Becher, S. and Unger-Aviram, E.; (2009), Hillman, R; (2005), Korobkin, R; (2003); Pogrud Stark and Choplin (2009).

⁷⁷ EIM, Overkreditering aan banden: onderzoek naar de effectiviteit van beleid om overkreditering tegen te gaan, Zoetermeer: 2007 (research report delivered by the Dutch Ministry of Finance), cited in Franken(2009).

⁷⁸ Caratelli(2008).

⁷⁹ See Slovic et al(2002). Thaler and Sunstein(2008) call it an automatic system and reflective system.

⁸⁰ Piacentini et al (2007), *supra* note 79

Another complicating factor in the search process is the cost. To the extent that credit is a search good, the cost of searching and comparing may be prohibitive. As mentioned, lack of uniform presentation of key information obfuscates the consumer and heightens thresholds for searching. Consumer testing undertaken by the European Commission showed that it is very important for consumers to obtain pre-contractual information in a structured form that allows for comparison between offers; the results indicate that the information should be comprehensive and employ simple wording with limited use of technical jargon.⁸¹

Some consumer credit products are credence goods⁸², meaning that consumers are unable to assess their characteristics, quality, the entire risk of a contract, and the effects of their long term use even after entering into the contract.⁸³ Consumers will then need to rely on advice provided by the lender, financial advisor, intermediaries and third parties. In absence of information, there is no point in searching, comparing and deliberating, which in turn may cause the market for certain consumer credit products to float on heuristics, marketing influence and aggressive intermediaries' strategy rather than intrinsic value.⁸⁴

If information is available but not readily available, to what lengths will consumers go to gather information? A good example can be gathered from a Dutch survey. According to Dutch credit regulation, the standard sheet has to be *at the disposal of* the consumer (e.g., downloadable) rather than physically handed over to the consumer. Most lenders refer to their websites. Less than 50% of Dutch consumers seeking credit reported that they 'received' the Dutch standard information sheet.⁸⁵ Such an outcome may well prompt policymakers to consider making actual delivery of the standard sheet compulsory. The bad news is, however, that the same survey showed that out of the group of consumers who did report to have had the sheet at their disposal, 50% did not read it. Moreover, the sheet was hardly ever used to compare credit offers. Another qualitative study was similarly telling.⁸⁶ In this study on

⁸¹ European Commission (2009:5)

⁸² Also in the case of other financial products such as home loans, pensions, mutual funds, long term investments. See for an overview on consumer credit as credence goods: Micklitz, H-W. et al (2009), European Parliament's committee on Internal Market and Consumer Protection(2006:xi), Cartwright(2004:16), Emons(2001); Ramsay(2008). Generally, on the nature of goods (search, experience, credence), e.g., Cartwright (2001)21 ff.; Hadfield, Howse and Trebilcock (1998)142 ff.; (OFT) (1997). Cf. Ramsay (2008).

⁸³This leads to a distortion of the "normal" market efficiency, where prices fully reveal information, quality and risk. As a result a consumer may buy products at a higher price than if he or she had had better knowledge. See European Parliament's committee on Internal Market and Consumer Protection(2006:xi).

⁸⁴ Cf.Engelmann, Capra, Noussair and Berns (2009) for recent neurobiological research on the intense influence of expert advice on financial decision making under stress.

⁸⁵ EIM (2007).

⁸⁶ Optem(2008). The study was based on stated attitudes rather than observed behaviour. Many studies in social psychology have found that attitude and behaviour are not always compatible, see Ajzen, Icek and Martin Fishbein. 1977. Attitude-Behavior Relations: A Theoretical Analysis and Review of Empirical Research. Psychological Bulletin, 84 888-918. , cited in Devaney, S.; (2001).

attitudes in consumers on search efforts concerning pre-contractual information for financial services, three groups of consumers were queried: *consumers of credit products*⁸⁷, *consumers owning financial investment products* and *inexperienced consumers*⁸⁸. The study found that with regard to the pre-contractual information sought by both consumers of credit products and inexperienced respondents,⁸⁹ the type of information sought included the total amount to be paid; details of monthly repayments; and the overall rate (rather than the nominal rate). The vast majority of respondents seemed to find the size of the monthly repayments to be the most important information. In regard to pre-contractual information sought by consumers of credit products, the following categories were mentioned: The total amount to pay, size of the monthly repayments, and size of the monthly repayments. The inexperienced consumers focused on total cost of the loan, the size of the monthly repayments, provisions in the event of difficulties and conditions for early repayment. Furthermore, some respondents mentioned that they paid less attention than they should to pre-contractual information because their main aim was to obtain the loan enabling them to make the desired purchase. Overall, with regard to the form of the information, all respondents agreed that they needed direct information in the shape of a face-to-face discussion, as well as a written document.

6.4 *Heuristics, biases, impulse and compulsion*

It is a well-known fact that informed consumers do not necessarily make the best choices.⁹⁰ Consumers may apply simplified decisions by using heuristics or rules of thumb which may make the decision-making process prone to error.⁹¹ We do not need to report extensively on the strands of behavioural research showing optimism bias in future financial planning ('In future, I will spend less and earn more'),⁹² the phenomenon that the smaller the borrowed sum and the shorter the term, the more likely consumers will err in assessing the true costs of the contract,⁹³ and the tendency to replace full attentive information gathering strategies with

⁸⁷ Namely who do not have any consumer credit running for at least 2 years or home loans,

⁸⁸ Namely, having a bank (or postal) account, but no consumer credit running for at least 2 years, no home loans and no intention to buy any in the next 2 years.

⁸⁹ Respondents in the "credit user" and "inexperienced consumer" groups were interviewed on this point.

⁹⁰ E.g., Wilson, Howell and Sheehan (2009); Howells (2005). Generally Korobkin and Ulen (2000); Schwartz (2004).

⁹¹ Simon, H. A. (1957)(1978).

⁹² Consumers prone to irresponsible borrowing typically are overly optimistic about their ability to repay debts and experience more problems in reading and understanding credit contracts. See EIM (2007).

⁹³ Renuart and Thompson (2008)213-214.

heuristics in case of information overload or in case of stress and pressure, as well as biases causing selective reading, perception and memory.⁹⁴

A commonly applied heuristic applied by consumers in deciding on credit offers is focusing on the monthly payment advertised or quoted as an anchor for gauging the cost of credit.⁹⁵ Focusing attention on periodical payments may have the following implications. Mental accounting causes consumers sometimes to think of their finances as separate budgets.⁹⁶ The classic example is the consumer having a savings account with a 5% interest and a current accounts overdraft facility at an APR of 12%. The rational thing to do is to make sure that any money on the savings account is transferred to the current account in case of overdraft. However, consumers tend to separate the two accounts and they may be inclined to suffer the 12% rate rather than part with their money on the savings account.⁹⁷ This tendency to think of finances as separate budgets may have other effects as well. If a consumer in comparing credit focuses on the monthly payments, he may overlook, ignore or downplay any additional costs charged by lenders. If lender A offers credit at a 6% rate and lender B at a 7% rate, a consumer might be tempted to accept offer A even if lender A charges a € 49 'start-up fee', 'administration cost charge' or whatever the fancy title he chooses. A consumer might not include in his calculation the € 49 in the total cost of the credit. If indeed consumers operate in this manner there may be a strong incentive for credit marketing to increase complexity of contracts and to unbundle the costs of the credit to the extent possible since consumers may allocate different fees to different budgets.⁹⁸

What seems equally important to underline here is that some consumers suffer from impulsive or even compulsive buying behaviour to satisfy their hedonic cravings.⁹⁹ There is some evidence that such behaviour is fuelled by low threshold access to credit card credit and store card credit.¹⁰⁰ In particular, there is some evidence that irresponsible borrowing can be linked to other individual propensities and characteristics. For instance, there is also some evidence that in (USA) students the propensity for developing into compulsive buyer is positively associated with drinking, having unprotected sex and smoking, and with individuals' perceptions of money as sign of power and prestige, while negatively associated with parents' income (i.e., students with poorer parents are more likely to become compulsive

⁹⁴ Incardona and Poncibò (2007)32 ff. Generally Gigerenzer and Engel (2006).

⁹⁵ Renuart and Thompson (2008)212. Generally on anchoring in risk evaluation Kahneman, Slovic and Tversky (1982), Sunstein (2000), Sunstein (2002), and related to consumer decision making Arnould, Price and Zinkhan (2004)648.

⁹⁶ Baron (2000)288 ff.

⁹⁷ Thaler (1999). Cf. Scholnick, Massoud and Saunders (2008) for a discussion of the relationship between wealth and inattention in this respect.

⁹⁸ Renuart and Thompson (2008)215; 220.

⁹⁹ Generally Evans, Jamal and Foxall (2006)87 ff.

¹⁰⁰ Erasmus and Lebani (2008); Norum (2008); Wang and Xiao (2009).

buyers).¹⁰¹ Such personal characteristics can be used in marketing (by developing credit scoring techniques to single out good and bad debtors) but also in policymaking.

6.5 *Advertising, marketing, framing*

Obviously, the information provided and framed in advertising and marketing may influence consumer decision making. For example, the context or the way in which the information is framed (i.e. terms of trade, time, identity, intuition) may influence the consumer¹⁰².

Whether advertising as such causes consumers to develop wants and needs for credit is debatable. It seems primarily to be the other way around: his wants and needs (whether they are utilitarian or hedonic) elicit a demand for credit.¹⁰³ In any event, Dutch research showed that advertising does not cause consumers to develop a demand for credit but rather helps to create a favourable image and reputation of trustworthiness of the advertising lender.¹⁰⁴ In this respect, repeated advertising has a habituating effect on specific consumers, namely those prone to irresponsible borrowing.

As far as marketing is concerned, there is some evidence that consumers prone to irresponsible borrowing typically prefer taking out credit through an anonymous channel (internet, telephone) to avoid the embarrassment of rejection in a face-to-face conversation with lenders.¹⁰⁵ Other research showed that disclosure of information was immaterial in face of a sleek sales pitch. In an experiment on the influence of information disclosure in insurance sales talks, De Meza et al. found that despite consumers declared that they valued having information on the salesmen' bonus incentives in the selling process and on the payout ratio of the insurance (i.e., on the quality of the product), the actual disclosure of this information did not affect their choice.¹⁰⁶ The same research showed, however, that persuasive extravert salespersons were able to raise the consumer's willingness to pay for insurance.

¹⁰¹ Norum (2008).

¹⁰² See Shafir(2008).

¹⁰³ From a psychological perspective motivation occurs when a need is aroused that the consumer wishes to satisfy. Often a person's values, his or her priorities and beliefs, influence this choice. See Salomon et al (2006).

¹⁰⁴ EIM (2007).

¹⁰⁵ Ibid.

¹⁰⁶ De Meza et al. (2007).

7 Is information disclosure sufficient or is a more interventionist approach warranted?

What does the previous teach us? Information duties embedded in the Directive are aimed at influencing the consumer's decision making at the pre-contractual stage. Accordingly, the ability of consumers to act in an informed and empowered way relies on three groups of cognitive attributes: the capacities or skills of consumers to read, understand and process the information available to them, the willingness of consumers to proactively seek information and to assert their rights. By disclosing information in the way prescribed by the Directive, consumers are thought to be better informed and hence better empowered to seek out the best deals. Reality is more complex. There is evidence that consumers may 'err' in their decision making processes – they may not always read, search and compare, they may follow rules of thumb rather than educate themselves of all the details of the intended transaction, they may have a fogged view of their preferences, they may take out credit in the spur of the moment. However, are the problems this may cause serious enough to warrant a more interventionist approach beyond the information disclosure duties currently laid down in the Directive? Naturally, we are careful in drawing firm conclusions. It must be stressed that we have not developed a theory of effective or efficient information disclosure in consumer credit transactions. Having said that, we would like to point at some points that merit consideration.

A first observation is that the empirical evidence reviewed in this paper has its inherent limitations both from a methodological and jurisdictional point of view. Therefore, it would be unwise to infer from it that there is a pan-European pandemic of consumer ignorance, laziness and gullibility, claiming for fierce intervention. The extent and gravity of the problems¹⁰⁷ faced by consumers with the credit¹⁰⁸ contracting process is difficult to measure – at least, we are not aware of a reliable and uncontested methodology – and the cost of remedying these problems with a more interventionist approach may be considerable. Moreover, even if there was a 'pandemic' the relevant policy question would still be whether intervention is warranted (and if so, what kind of intervention). It seems appropriate to heed Hadfield's warning, based on the modern theory of information, against the paradox of treating problems relating to information, such as informational asymmetries, by regulating information and failing to take into account the costs of such regulation.¹⁰⁹ Likewise,

¹⁰⁷ Individuals and households in the UK and in Central and Eastern European countries proved to be as capable of crippling over-indebtedness as their US counterparts. See Avgouleas, E; (2009)

¹⁰⁸ Conclusions drawn from the analysis of European consumer credit statistics, show that by 2008 the use of consumer credit reaches comparatively high levels in Denmark, Cyprus, Spain and Portugal and an intermediate level in Belgium, Finland, Luxemburg and France. See ECRI(2009). According to Eurofinas, which represents 16 members associations in European 15 countries and more than 1000 finance houses, (56%) of consumer credit loans in 2006 were granted for personal consumption, (31%) were for vehicle finance and (13%) mortgage. More details at facts and figures www.eurofinas.org

¹⁰⁹ Hadfield, G.K. et al (1998), the OECD Reference Checklist for Regulatory-Decision Making provides regulatory policy tools that can be used to address informational problems in consumer transactions.

literature written from this perspective¹¹⁰ emphasizes the importance of identifying a consumer protection policy, the level of competition, and whether there is a structural or informational problem, and only then decide if state regulation or market based solution should take place, and finally, decide on appropriate regulatory instruments (e.g., minimize information acquisition and processing costs for consumers, and whether proactive or reactive policy solutions should take place). In reality, however, such a three-step approach boils down to an iterative process. If policymakers can identify relatively mild instruments of soft paternalism¹¹¹ - such as framing information disclosure, setting of defaults rules, provision of wealth warnings, cooling off periods, debiasing through law - and implementing such instruments is rather straightforward and cheap for the consumer credit industry, then issues such as effectiveness may well be less relevant and more invasive measures will be less likely to come to the fore. In other words, if in a given case soft paternalism is cheap and a more interventionist measure would be disproportionate, then the effectiveness of the soft intervention may well be less relevant. The symbolic value of the intervention may then be a policy value in itself; the use of compulsory warnings in consumer credit advertising ('wealth warnings') may be a case in point.

A second observation is that exposure of consumers to financial risks as such is neither fundamentally nor necessarily bad. Unless a consumer is particularly vulnerable or the product can be particularly harmful, it is important to bear in mind that given the chance consumers may learn *market skills* and self-control. Hence, there is power in the argument that it is best is to let consumers develop their own imperfect rules of thumb to defend themselves in the credit markets¹¹² and educate the supplier side to adapt to his or her needs and social risks while learning how to influence product policies¹¹³. In this regard several authors find that policymakers have rightly embraced financial education as a necessary corollary to the disclosure model regulation. Indeed, it has been argued that financial education both in families and schools and from an early age on is a crucial element in any government policy to prevent unnecessary debts and even overindebtedness later in life.¹¹⁴ However, for some consumers financial education appears to increase confidence *without* improving ability¹¹⁵. Moreover, education seems an easy solution but in practice it may prove to be more difficult to design financial capability education programs (which is the best way to deliver these

See <http://www.oecd.org/dataoecd/20/10/35220214.pdf> (last time visited: 20/10/09), UK's Beter Regulation Executive and National Consumer Council(2007).

¹¹⁰ Ibid at 53, Armstrong, M.(2008)

¹¹¹ These strategies have also been called "asymmetric paternalism", "libertarian paternalism", see, eg. Sunstein, C. R. and Thaler, R. H. (2003), Camerer, et al(2003), Sunstein(2006).

¹¹² See Armstrong (2008).

¹¹³ Reifner, U (2009).

¹¹⁴ E.g., Office of Fair Trade (2004); Autio, Wilska, Kaartinen and Lähteenmaa (2009); Wang and Xiao (2009); Norum (2008); Townley-Jones, Griffiths and Bryant (2008); Schröder and McKinnon (2007). Willis, L.(2008).

¹¹⁵ Willis, L..(2008)

programs, how effective are these initiatives, and which groups of people should be targeted?).¹¹⁶

A third issue of concern is that information disclosure usually focuses on the content of the information while neglecting the importance of form and timing. To the extent that the *form* and *timing* of information disclosure is left to lenders, one can expect that lenders make choices commensurate with their own interests. For instance, if regulation compels lenders to disclose APR but at the same time allows them to dissect the credit charge and unbundle costs into costs that can be more or less hidden in the contract (e.g., annual fees, start-up fees, administrative costs), then disclosure misses the point.¹¹⁷

Moreover, consumers do not only need information but clear and preferably uniformly presented information. The suggestion to focus on duties to disclose a summary or short-form contract in plain language, highlighting rather than hiding key terms (Wilson et al., 2009) seems less meddlesome than one might suspect. In this regard, we feel that the SECCI is a step in the right direction although one can debate whether consumers effectively use it and whether the right items of information are on the sheet¹¹⁸.

The idea of promoting a standardization of information will help to measure in a better way the impact of information policies as such. In this regard, a good policy response to misleading advertisement in the field of consumer credit can be found in the provisions of the UK's Consumer Credit (Advertisements) Regulations 2004. This piece of regulation tackles common practices in credit card advertising such as '*APR from 3%*' by providing that the advertisement must also specify the *typical APR*, which is an indication of the calculation of this figure on real time at the date of publication. This regulation has also placed restrictions on certain expressions in credit advertisement as '*pre-approved*', '*interest free*' or '*bad credit no problem*'.¹¹⁹ Another good approach might be that in the case of low-borrowing-rates ads (a common practice in advertisement and marketing), basic information about qualification criteria should be provided. Examples of misleading practices include the advertising of a low interest rate while failing to mention the fact that (stringent) criteria of qualification for such a low rate apply, and intermediaries inducing potential borrowers to believe that they can authorize loans while only lenders are allowed to do so.¹²⁰ As Bertrand et al. (2005) found in their field experiment in consumer credit markets is that offer letters displaying a small

¹¹⁶ Kempson (2008).

¹¹⁷ Cf. Renuart and Thompson (2008) 188 ff.

¹¹⁸ Kozup *et al*(2008) argue that standardization may need to be carried out within product categories, rather than across the entire mix of financial products One common element seems to be risk (e.g. the risk of interest rates, the risk of principal value, and the risk of future payments), bearing in mind that open-end credit(e.g. credit cards and overdrafts) may present a different set of risk than those related to closed-end credit(e.g. vehicle loans and instalment loans).

¹¹⁹ See for a detailed overview of this regulation Ramsay (2008).

¹²⁰ European Commission, (2009).

interest rate and monthly repayment table generated a higher take-up rate than offer letters displaying a large table and detailed information about repayment. In other words, consumers were more likely to take up a loan if the description of the offer was minimal, rather than if many examples, plain language, or detailed information about the terms of the loan were provided.

Admittedly, there is a general framework in the Unfair Commercial Practices Directive that should be taken into account when evaluating marketing strategies. Therefore, information duties are to be seconded by duties not to give misleading information, to present information in misleading ways or to omit material information and, if necessary, by positive duties regarding form and timing. A further point that might be relevant for policymakers to consider (and which is dealt with specifically neither by the UCP¹²¹ Directive nor by the EU Consumer Credit Directive) is that there may be a valid reason for not merely regulating the content of information disclosure duties but also the *form* and *timing*. In this respect, the full harmonization character¹²² of the Directive (article 22 (1)) may turn out to be an obstacle for member states to respond with specific domestic legislative intervention in credit marketing to specific dubious practices and predatory lending associated with poorly informed and unsophisticated borrowers (e.g. In the UK, people tend to report problems in credit sale practices;¹²³ in France, the average annual rate of interest of loans is 15.6% due to particular low promotional rates at the beginning of the loan period but the effective rates are often 20%¹²⁴).

A fourth point of concern is the *adding-on* of secondary products such as insurance to credit. Currently, lenders have every incentive to cloak their tariff structure by making their products difficult to understand. They can do so by breaking information on fees and additional charges into little parts and by scattering them throughout the contract. If information disclosure duties leave room for inventive complicating of the contract, there could be a bonus in doing so. A case in point is the Payment Protection Insurance (PPI). In some countries, PPI is added on by sellers to consumer credit contracts. UK evidence shows that there is a problem of misselling of PPI, fuelled by generous commissions for salespersons

¹²¹ Which have failed to blacklist specific financial services' misleading and aggressive practices.

¹²² Copenhagen Economics (2009) assert that the EU Credit Directive is split into 'core elements' and 'flexible elements'. The Member States have no choice regarding the implementation of 'core elements' included in Article 4, 5(except 5.6), 10,14, 16 and 21. Before the contract, both the content and the form of pre-contractual information will be standardized by means of SECCI(Article 5), whereas only content but not form of the contractual information will be standardized(Article 10). Concerning 'flexible elements' Member States have a range of possible implementation options available to them. These flexible elements include the idea of 'adequate explanation' (Article 5.6) and creditworthiness test (Article 8).

¹²³ Citizens Advice, National Consumer Council and Which?(2005)

¹²⁴ France: Consumer Credit Reforms benefit finance, trading groups. World Socialist Web site(2009).

selling PPI with the credit.¹²⁵ This is especially problematic if it is true – as some research indicates – that the primary anchor of consumers buying credit is on the monthly payments¹²⁶, of which the PPI is merely a (cloaked) part. One intervention that policymakers, faced with problematic PPI practices, could consider is restricting the sale of PPI as an add-on to credit. Obviously, this is a highly interventionist and intrusive measure but there may be good reasons for taking such a measure in specific markets under specific conditions.¹²⁷ The hurdle that domestic policymakers in the EU would have to overcome is the full harmonization clause in article 22 (1) of the Directive. We are not entirely confident that restricting certain add-ons is allowed under the Directive.

A fifth and final point that we would like to briefly touch upon – slightly outside the ambit of this paper – concerns intermediaries, salespersons and their commission. The business practice in the context of lending transactions engages the participation of a variety of key agents besides the creditor such as credit intermediaries¹²⁸, classed as tied agents and independent broker intermediaries. It seems important to assess to what extent *fee structures* may be considered to be main drivers for sales, rather than the needs of the consumer. Accordingly, more attention should be paid on remuneration structures (fees and commissions) and adequate supervision of financial advice provided by credit intermediaries (tied agent or independent broker) and the quality of advice (needs assessment in general, know your customer requirements, in particular) and professional standards.¹²⁹ A first step towards regulation of this issue seems to be implied in article 5 (6) of the Directive, which gently nudges both lenders and the intermediary in the direction of testing suitability of the credit and therefore knowing their clients' needs, preferences and abilities. However, article 5 (6) is evidently the product of compromise as it takes off the rough edges of the suitability test and seems to be difficult to enforce stringently.

¹²⁵ On PPI, see, e.g., OFT (2006)1 ff. and the commissioned market studies by London Economics.

¹²⁶ Optem (2008:40).

¹²⁷ On the problem with add-on insurance, see, e.g., Van Boom (2008).

¹²⁸ Directive 2008/48/EC, Article 3(f): (i) presents or offers credit agreements to consumers; (ii) assists consumers by undertaking preparatory work in respect of credit agreements other than referred to in (i); or (iii) concludes credit agreements with consumers on behalf of the creditor. The Directive assigns only certain information obligations for credit intermediaries (Articles 5, 6 and 21, recital 16 and 17). However, when suppliers of goods and services may be deemed act as credit intermediaries in an ancillary capacity it is not appropriate to burden them with the legal obligation to provide pre-contractual information in accordance with the Directive (Directive 2008/48/EC, Recital 24).

¹²⁹ See (FIN-USE, 2008).

8 Conclusion

The previous has not generated a new theory on information disclosure duties in European consumer credit regulation. What it has done, we hope, is to show that the 2008 Directive generates general rules pertaining to all consumer credit contracts entered into by average consumers while seemingly neglecting the fact that there may be differences in the way various groups within a given society think and decide on their preferences and motives and in their decisions how and when to take out credit. We are not claiming there is a pressing need for an overhaul of the Directive's framework. Surely, the Directive is to be applauded for following the path of *standardization* of information in the SECCI. What we do claim, however, is that the full harmonization character of the Directive as laid down in article 22 may restrain member states from addressing specific information needs concerning specific types of credit and from introducing further regulation on form, timing and presentation of information that may be considered beneficial in their specific markets or in regard of problems experienced in their particular jurisdictions. Moreover, a functional assessment of the information disclosure reveals, on one hand, tensions between *transparency* goals and *simplification* of the information available for consumer, and, on the other hand, a clear trend towards a paradigm of *standardization* of information disclosure in Europe. Standardization in itself is a valuable policy instrument to stimulate accessibility and comparability of information but it may not always help consumers directly if the information is left unused or misunderstood. The laudable goal of transparency may cause an increase in information not necessarily corresponding with goals of accessibility and simplicity. In any event, it remains debatable to what extent the concept of the average consumer reflects real-life thinking and deciding in consumers and allows special treatment of vulnerable consumers. Special cases may deserve special rules and it is clear that full harmonization leaves little room for tailor-made solutions to specific problems at member state level. In that respect, the 'one-size fits all' approach in the Directive may turn out to be an obstacle rather than a comfortable starting point for empowerment of the financial citizen.

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