

“READ BEFORE YOU SIGN!” (EUROPEAN WAYS TO CONSUMER CREDIT)**Regional Consumer Law Conference, Malta, 16-17 March 2006
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In the year 2004 the **Czech Consumer Association (CCA)** developed and launched consumer campaign called **“Read before you sign!”**, warning, informing and educating consumers to be aware, cautious and vigilant before they conclude any consumer contract - particularly when signing up for credits, financial loans, mortgage etc.

In the frame of this campaign CCA have issued booklets and newspapers, which we prepared exclusively for this event. We organized a seminar in the Czech Parliament and others in various regions. Awareness raising spots were broadcasted on TV and radios and advertisements were published in newspapers.

The integral part of the preparation for the campaign was analysis of the situation on the market of consumer credit, loans, mortgage etc. in the Czech Republic.

In this paper we would like to give short information about this campaign. During the campaign CCA gained some experience in the area of financial services. It helped us to adopt some opinions and attitudes towards the proposals prepared by the European Commission concerning consumer credit. The summary of our views is presented in the part 3 of this paper. The following 4 parts are the basic structure of this paper:

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0. WHO ARE WE?

The **Czech Consumer Association (CCA)** was established in 1990 to promote justified interests and rights of consumers. Its priorities it set in the development of activities, which focus on supporting a preventive approach and developing system tools in the field of consumer protection. These activities aim at enhancing relations between service providers and consumers. The objectives of CCA are among others (indicative list):

- To participate as an expert organisation and defender of consumer interests and rights on the internal market of EU and CR and to develop consumer protection on the basis of prevention (approval process of laws, development of standards etc.);

- To develop activities in regions with the aim to gather instigations and suggestions for the type of work CCA can do; the work in regions is done via regional contact sites; in several regions CCA have established Regional Commissions for Consumer Protection, with representatives of counterparts from the region (regional self-government, municipalities, market surveillance, professional associations, NGO);
- To develop assistance and advisory activities in the sphere of consumer protection especially on on-line basis (see www.regio.cz/spotrebitel) and with special attention paid to the disabled, elderly people etc.;
- To provide educational and training activities in the sphere of consumer protection (accredited by the Ministry of Education);
- To collect information about the market, to build information and technical background, to cooperate with ministries, the Czech Parliament, profession associations, the Czech Ethic Forum, market surveillance bodies, standardization body etc.

CCA have long-term experience in delivering training sessions, workshops, seminars and conferences on national, European and international level. Together with the European Commission (TAIEX) two international workshops on alternative dispute resolutions and on product safety it organized in 2003. In 2004, a seminar aimed at issues of consumer contracts and particular consumer credit was organized; while in 2005, the relation of consumer and metrology was the main topic.

CCA realized several projects supported by the Czech Ministry of Industry and Trade, or by EC (Transition Facilitation). CCA is also engaged in some European projects providing technical assistance to West Balkan countries.

1. ANALYSIS OF THE SITUATION IN THE CZECH REPUBLIC

At the beginning of this decade a new phenomenon appeared on the Czech market. The situation of bank houses had been stabilized, and while at the beginning of 90th of the last century it was not easy to get a loan from a creditor, now the providers of loans and credits commenced to compete for catching costumer. And people do not object.

The situation may become alarming. People do not care very much how they will pay in instalments their debts, how their family allowance will be effected.

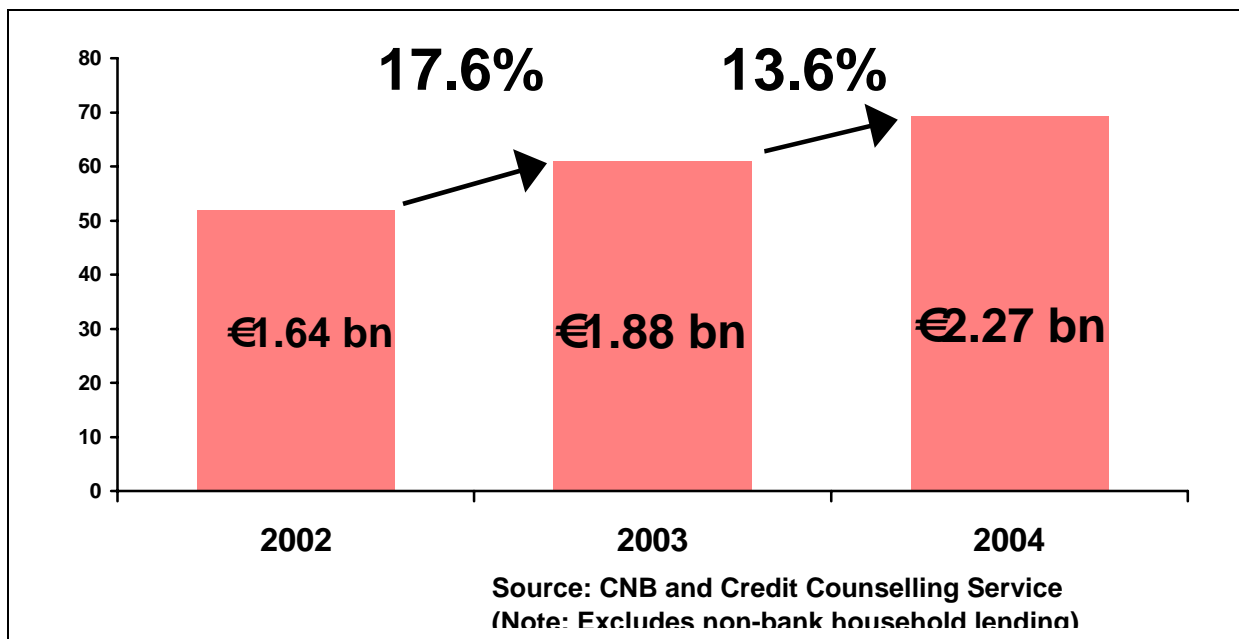
These circumstances lead our association to develop in the year 2004 and perform in the year 2005 a consumer campaign called “**Read before you sign!**”. The objective was to try to warn, inform and educate consumers to be well cautious and vigilant before they conclude and sign any consumer contract - particularly credits, financial loans, mortgage etc. Our experience proved that most of problems that consumer have with their creditors are closely connected with the fact, they practically did not read the contract which they signed.

In the frame of this campaign CCA have issued booklets and newspapers, which we prepared exclusively for this event, we organized a seminar in the Czech Parliament and some others in regions; warning spots were broadcasted on TV and radios and advertisements were printed in newspapers.

As mentioned above, the integral part of the campaign, particularly in the phase of preparation was analysis of the situation in the Czech Republic on the market of consumer credit, loans, mortgage etc. The description of this analysis follows.

Inter-annual growth of consumer credit

Analysis showed, that the inter-annual growth of consumer credit was about 15 %, in the years 2002 to 2004.



Increase of mortgage

During the years 2002 – 2004 the mortgage concluded in the CzR increased 2.5 times; from 51 bn CzK to 120 bn CzK (from ə 1.7 to 4 bn).

Household lending in context (2004)

- Growth in loans to non-financial corporations: +7.5%
- Growth in loans to households: +34.4%, of which
 - Mortgages: +52.8%
 - Building society loans: +32.4%
 - Consumer credit: +13.7%
- Loans to households: 28.0% of bank loans at end 2004 compared with 22.2% at end 2003

Concerns over indebtedness

The uncertainties and potential risks include fast growth in lending to households, which is leading to a gradual increase in their indebtedness. Growth in mortgage loans is particularly sharp. The interest burden on households is also rising. (National Bank 2004)

Consumer loan credit quality

In the case of consumer credit, households' discipline as regards repaying loans on time and in full is significantly worse ... Their quality has steadily deteriorated, and the share of classified consumer loans in total consumer loans exceeded 12% in mid-2004. (National Bank 2004)

Assessment based on domestic data

- Grounds for concern:
 - High growth rate relative to wages & salaries / GDP
 - High growth relative to other types of lending
 - Consumer inexperience with credit / risk of debt?
- Grounds for reassurance:
 - Growth from a very low base
 - Strongest growth - mortgages
 - Main lenders - Int'l banks & finance companies with significant experience from home markets
 - Improving infrastructure (e.g. credit registers)
 - **INFORMATION AND EDUCATIONAL CAMPAIGNS**

2. CAMPAIGN ON CONSUMER CREDIT (AND OTHER LOANS)

The campaign aimed at warning, informing and educating consumers in respect to concluding any consumer contract - particularly credits, financial loans, mortgage etc.

What was (is) the present situation in the Czech Republic? (See also the chapter above):

- More and more citizens in the country use credits, financial loans, mortgages etc.;
- Some of these services (consumer credits, financial loans) are preferably used by such social groups of citizens whose households incomes and budgets are relatively low, or at least lower than the national average income level;
- Consumer is generally a weaker party in the contractual relation; they do not have necessary theoretical knowledge or practical experience for concluding contracts;
- Consumers are not vigilant and cautious enough; they do not read attentively the contractual conditions. Afterwards they are surprised what they signed. But they blame the creditor.

With reference to the short description of the mission of CCA above, we were searching how to cope with the situation and to try to contribute to solve it. We decided:

- Issue printed documents (information, education) - brochures/ booklets and newspaper/ leaflets;
- Organize seminars and round tables;
- Launch a “medial” campaign in newspapers, TVs and radios.

Particular examples are presented:

- What we explained to consumers in the brochure and newspapers?
 - Principles of EU legislation and the Czech legal framework concerning consumer contract generally, financial loans and consumer credit, mortgages
 - What role does the Czech Financial Ombudsman (Arbiter) play in the system?
- Seminar in the Parliament
- Seminars in various regions
- Newspapers, TV spots



Advertisement in newspapers



During the campaign, CCA have gained deeper knowledge in the sphere of consumer credits. We could enhance our service for consumers and we also now can more effectively cooperate in the public discussions over new tendencies in relevant laws.

The position of the Czech Consumer Association concerning new EU drafts is explained bellow.

3. NEW CONSUMER CREDIT DIRECTIVE – LOOKING FOR THE POSITION OF THE CZECH CONSUMER ASSOCIATION

Directive 87/102/EEC and its two revisions have been transposed into the Czech legal order before May 2004 when the Czech Republic (CzR) accessed together with nine other European countries into European Union.

Our consumer association - CCA appreciated implementation of the said Directive, as an important contribution to introduce clear rules for consumer protection in this area concerning consumer credit in the national framework. Sure we understand also the significant role of this act to contribute to the creation of the common market in the area of financial services and to support the European frontier-free market in consumer credit. We also understand that facilitation of service provision has an impact in quality of services offered to consumers. But

for the time being our expectations were mainly aimed at creating more transparent national rules from which the consumer would benefit.

However the experience with implementation of the national law transposing the Directive is rather short, the gained experience is quite positive; we are of the opinion that the situation on the Czech market has been significantly improved since 2004.

On the other side, the sector of loans, mortgage and credits is accompanied with a lot of problems. We are of the opinion that many of them are caused by the consumers themselves, which we tried to conceive in the campaign described before.

At the same time, we can see some lacks in the Directive, which is the reason that the act may not fulfil all the expectations. That is why we appreciated the initiatives of the Commission that prepared several analyses and studies. They offered conclusions and recommendations saying where regulation in this area should be further developed in years to come.

We shared the feeling that the level of protection was inadequate, an observation of which resulted on the one hand in a clear resolve to improve consumer information and protection and, on the other, consideration of the types of credit and/or new forms of credit contracts, which were not covered by current Directives. We must also admit that the Czech lawmakers have not utilized the possibility, that the Directives gave rise to a broad application of the minimum clause.

Anyway, we appreciated announcing intentions several years ago, to formulate a new directive and to develop a more transparent, more effective market offering a high degree of consumer protection and the opportunity for professionals to better appreciate the risks involved.

We were informed that the Commission accordingly feels that the revision of the current Directive should be conducted in accordance with the following six guidelines:

- Redefinition of the Directive's scope in order to adapt it to the new market situation in this area and better tracking of the demarcation line between consumer credit and real estate credit;
- Inclusion of new arrangements taking into account not only of the creditors but also of credit intermediaries;
- Introduction of a structured information framework for the credit grantor in order to allow him to better appreciate the risks involved;
- More comprehensive information for the consumer and any guarantors;
- More equitable sharing of responsibilities between the consumer and the professional;
- Improvement of the arrangements and practices for processing payment incidents by the professionals, both for the consumer and for the credit grantor.

Lastly, the achievement of these objectives would involve moving on from minimum harmonisation to maximum harmonisation, which would guarantee a high level of consumer protection across the whole of the European Union.

After several years of legal process, the drafts of new act were several times significantly changed, and some of the said approaches have not been followed any more. Some of such changes we appreciate, in other cases we understand such a development as retreat from the reasonable objectives. One of the latest summaries of the situation described the achievements like this (November 2005):

- Restricting the scope to consumer credit of up to €50,000 to cover the most common consumer credit contracts; Applying a specific regime based on pre-contractual and contractual information to credit contracts of up to €300;
- Mortgage credit will be addressed separately following the consultations triggered by the Green Paper on Mortgage Credit launched in July (2005);
- Giving Member States more flexibility to adapt the rules to their national situation in certain clearly specified areas, while insisting on a mutual recognition clause in a limited number of cases to protect the single market;
- Making it easier to compare consumer credit contracts through a harmonised method of calculating the cost of credit;
- A list of information that consumers must be given;
- A right of withdrawal of up to 14 days;
- The right to repay a loan early; and
- The right to break a credit contract if the related purchase is cancelled.

But negotiations in the Commission continue, and agreement is rather “out of sight”. In following, I want to touch some areas of the consumer credit rules, which are in the focus of our (CCA) interest, and I will quite briefly present the attitude of our consumer association.

Credit contracts covered by the Directive

Article 2 of Directive 87/102/EEC has listed a series of exemptions, which today appear to be no longer justified. It was, therefore, presumed that the new Directive would apply to all forms of credit granted to natural persons for mainly private purposes, irrespective of the amount, irrespective of the security required, and irrespective of the purpose of the credit (with the exception of that intended to finance the purchase or renovation of buildings).

CCA fully supported such approach. We believe that the difference between the “consumer credit” market and the market in “real estate credit” and “mortgage-backed credit” is becoming increasingly small. The financial techniques used have become virtually identical: fixed or variable rate, the option of one or several instalments, regular periods or reimbursement at the end of the contract, straight loan or opening of a credit line, mortgage registration, guarantee, etc. We also agree, that the mortgage was being increasingly used thanks to mortgage techniques which cover all types of credit in the area of funding of the purchase of consumer goods. This trend involves serious potential risks for the consumers whenever they use their home as collateral to guarantee consumer requirements. There would therefore seem to be no longer any reason to maintain an artificial distinction between “consumer credit” and “mortgage credit”.

What is the present situation? Present modified proposals have excluded again credit agreements concluded for housing purposes. Mortgage credit agreements are said to be in general very specific instruments with particular features, which require to be addressed separately, irrespective of the purpose of the loan. Therefore, the Commission has excluded equity release from the scope. This is said to correspond to an EP amendment strongly supported by industry.

CCA regrets of this development. We can just believe that mortgage credit will really be addressed separately following the consultations triggered by the Green Paper on Mortgage Credit launched in July. But even if a separate regulation will be adopted for mortgage, it means again more complicated, intricate, non-transparent legislation for users. Our credo is different: Preferably more general, simple and friendly usable legislation than more pieces of detailed, badly understandable legislation.

The annual percentage rate of charge (APR)

The annual percentage rate of charge (APR) is that rate which “on an annual basis, ... equalises the present value of all commitments (loans, repayments and charges, future or existing, agreed by the creditor and the borrower” (Article (1)(a) of the Directive). In theory, the APR must include all credit costs. Directives 90/88/EEC as amended provides for a negative list of costs which should be excluded from this basis of calculation. If the APR is to be fully reliable and usable throughout the European Union, ideally it should be calculated by the Member States in a uniform manner incorporating in the same way all the cost elements linked to the credit contract. Yet this is not always the case despite the amendments.

Generally speaking, the inclusion or exclusion of certain costs should be re-evaluated, so as to arrive at a minimum of exclusion of credit cost elements from the basis for calculation. This should bring about a genuine approximation of the national “bases of calculation” and a higher uniformity of calculation, thus enhancing transparency and comparability.

Directive 98/7/EC leaves the choice between different time parameters, which leads to genuine imprecision in calculating the APR. Moreover, there are no hard and fast rules as regards mixed financial products containing simultaneously a credit element and a savings or insurance element (life/mixed).

In the CzR there is a very low experience with using APR. Providers proceed more or less according to the law, for consumers it not easy to understand this tool, additionally taking into account the aspect mentioned above. It seems that at this time consumers do not use APR when they take decision on different credit alternatives.

CCA tackled this instrument in the information and educative materials in the campaign described above. We also appreciate the progress as done in proposals concerning this issue. Despite the Czech experience with APR as noted above, we still believe that in order that consumers can make their decisions in full knowledge of the facts, they should receive adequate information, prior to the conclusion of the credit agreement, on the conditions and cost of the credit and on their obligations. To ensure the fullest possible transparency and comparability of offers, such information should, in particular, include APR (applicable to the

credit) and determined throughout the Community in the same way. As APR of charge can at this stage only be indicated through an example, such example should be representative. Consumers should be informed of any additional costs that are compulsory for obtaining the credit before the conclusion of the credit agreement. Even if the amount of such costs cannot be determined in advance, consumers should receive adequate information both in advertising and at a pre-contractual stage.

Improving Information to the Consumers

Transparency with regard to the conditions of credit supply is an essential element for better comparability of products on the market, including those originating in other Member States. It is the precondition for real free circulation of supply. Financial techniques nevertheless prevail over the typology of the credit agreement and it is therefore important to have provisions to supply first and foremost appropriate information for the consumer as a function of the techniques used.

This information as planned several years ago, should cover amongst other things:

- The interest rate: the consumer must be informed at least of the conditions under which this rate can vary, on how the rate is calculated, on the periods during which it will be applied, etc.;
- Repayment arrangements: is the consumer to repay on a regular basis, in one go, by paying limited instalments for a certain period and a large sum at the end, in cash or in kind?
- Withdrawing arrangements: can he/she draw on the sums made available once or several times, in a staggered or a repetitive way, is there a clean-up requirement, etc.?
- Amortisation table: this should be given to the consumer for all contracts for which interest and charges are fixed and calculated beforehand.

Concerning advertising the new Directive will be rather “reserved”, which is understandable as advertising is already dealt with by the Directive on Unfair Commercial Practices (2005/9EC). Now the Commission only proposes a list of mandatory information elements to be mentioned in advertising containing financial information on credit. General advertising on a given credit service is not concerned, which avoids unnecessary burden on businesses. Our association does not have any problem with such an approach.

Pre-contractual information allows consumers to compare offers. Some pre-contractual information requirements, proposed in previous proposal, have later been deleted. The reason is that various stakeholders in the consultation process were concerned that an excess of information may be confusing. Generally, our association prefer provision of just clear, simple, just “appropriate” package of information (on products, as well as from providers of services). We do not support efforts (so common in legislative processes in last years) aiming at providing bigger and bigger, and more and more detailed information. We think that the effect is then contra-productive. Consumer is lost or even drowned in “both hands full” of information.

We are not, however, quite sure concerning the development in this case of new Directive. We would like to discuss the experience and opinions of others partners on the appropriateness of pre-contractual information in the present drafts.

Maximum rates and usurious rates

Under the Commission information, several Member States have introduced a system of maximum rates and/or usurious rates. The report on the implementation of the Directive revealed major differences of approach across the Member States and expressed the Commission's hope that the debate on usury could be addressed at the Community level.

In fact, there are really complaints of the Czech consumers, which may implicate the same requirement – to incorporate maximum rates and usurious rates directly and unambiguously into the law. In the Czech law such measures have not been incorporated. CCA have remained reserved concerning this question. The issue is very sensitive. We slightly prefer the current development when maximum rates are not suggested to be in the draft Directive.

Right of withdrawal

The present proposal foresees a possibility for consumers to withdraw from the credit agreement within 14 days. The right of withdrawal is established in Article 13. This delay allows consumers to shop around after conclusion of the agreement and possibly to find a better offer. Commission says this provision is intended to enhance competition. It corresponds to existing practice in most Member States, although the length of the period may vary. The length of the withdrawal period corresponds to the Distance Marketing Financial Services Directive (2002/65/EC). As a consequence, at least for consumer credit agreements, which are also marketed by distance means, it will not involve additional costs for creditors.

Paragraph 1 of the proposed provision is straightforward and does not open any flexibility. On the contrary, its language is mandatory and does not contain any leeway. In this context, the Council Legal Service emphasises the fact that it would not follow from Article 21 (2) that a Member State could, for example, extend or shorten the duration of the withdrawal period of fourteen days.

CCA appreciate and support this provision in the present proposal.

Early repayment

The present proposal grants the consumer a right to repay his credit earlier than initially agreed. However, early repayment has a cost for creditors. We understand therefore, following consultations with stakeholders and Member States, the proposal foresees that creditors may charge fair and objective fees to compensate the loss. Since the calculation of the compensation should be made on an objective basis, it is expected that this provision would only entail marginal costs for creditors. CCA takes into account that there are discussions on some formulations concerning early repayment. We strongly support the provision to be incorporated and we prefer clear fully understandable wording. We have very bad experience concerning the words like “fair and objective fees to compensate the loss”.

Harmonisation

CCA follows with interest and rather with concern the debates on harmonization of Internal Market rules among the Commission and the Member States. In general, both harmonisation and mutual recognition have contributed to EU market integration, while ensuring that consumer interests are taken into account. The policy mix chosen in a given area invariably depends on the characteristics of that area and should be decided on a case-by-case basis. Finding the right mix requires an application of the proportionality principal in designing a solution, combining where appropriate harmonisation with mutual recognition.

CCA fully agree with suggestions to maintain the full harmonisation approach, with a degree of flexibility for Member States in certain areas (e.g. safety of some sensitive products). We are not so sure, that this tool should be used inappropriately, for example in services. Therefore, we share the feelings that this total harmonization should relate just “core issues”, and as much as possible, the appropriate measures should be left to competency of Member States to take them at national levels.

The proposal now clarifies that only those elements explicitly dealt with in the text are fully harmonised whereas issues such as joint and several liability are left to the national legal systems. In some cases, the proposal gives leeway to national implementation, mainly due to existing heterogeneity as regards national markets or national legislation. This is the case, for instance, in the context of early repayment or overrunning.

In practice, Article 21 (2) would mean that a Member State may apply its implementing measures taken on issues expressly listed (within the flexibility provided by the Directive) to the creditors established in its territory, but cannot impose them on other creditors. Those creditors would have to comply with the rules of the Member State where they are established, without prejudice to the possibility for the Member State where the consumer resides to take necessary and proportionate measures on grounds of public policy.

The consequence of Article 21 (2) would be that local implementation measures, taken in areas expressly listed and within the flexibility provided by the Directive, cannot be imposed on foreign creditors. For these issues, the creditor will be subject only to the law of the Member State where it is established. The recipient Member State shall not be able to restrict its activities on the basis of its own national implementation rules. These provisions can therefore only apply to internal situations and in respect of local creditors. Yet the foreign creditor will not be obliged to offer its home country regime. The creditor will be able to freely decide, for commercial reasons, whether or not to align its contracts on the rules or regime in force in the country of the consumer.

CCA are aware that the system as described may be in practice rather confusing for users and particularly for consumers.

4. CONCLUSIONS, SUMMARY

Czech Consumers Association (CCA) is an oldest consumer NGO in the CzR, with a broad scope of activities aiming at protection of justified interests and rights of consumers.

CCA developed and performed a consumer campaign called “**Read before you sign!**”, warning, informing and educating consumers to be well cautious and vigilant before they conclude any consumer contract - particularly credits, financial loans, mortgage etc.

In the frame of this campaign CCA have issued booklets and newspapers, organized a seminar in the Czech Parliament and others in regions; awareness arising spots were broadcasted on TV and radios and advertisements were published in newspapers.

The integral part of the preparation of the campaign was analysis of the situation in the Czech Republic about financial services. It proved that more and more citizens in the country use credits, financial loans, mortgages etc.; the situation may be dangerous because of these services are preferably used by such social groups of citizens whose households incomes and budgets are relatively low. Additionally consumer is generally a weaker party in the contractual relation; they do not have necessary theoretical knowledge or practical experience for concluding contracts. Consumers are not vigilant and aware enough; they do not read attentively the contractual conditions. On these conclusions, the campaign was built and developed.

During the campaign, CCA have gained deeper knowledge in the sphere of consumer credits. It has formulated priorities and attitude for participation in public discussions over new tendencies in relevant laws. CCA would prefer mortgage to be directly covered by the new Act; If the APR is to be fully reliable and usable throughout the European Union, ideally it should be calculated by the Member States in a uniform manner incorporating in the same way all the cost elements linked to the credit contract; Appropriate pre-contractual information should be provided; We slightly prefer the current development when maximum rates are not suggested to be in the draft Directive; CCA strongly support the present proposal which foresees a possibility for consumers to withdraw from the credit agreement within 14 days as well as a consumer right to repay his credit earlier than initially agreed; here we rather afraid of unclear wording concerning compensation to the creditor; we also share the feelings that the total harmonization should relate just “core issues”, and as much as possible, the appropriate measures should be left to competency of Member States to take them at national levels.

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