



Finance Watch

Tackling causes of over-indebtedness in the EU consumer credit market

An in-depth study of the key topics that need to be
addressed by the Consumer Credit Directive Review

Finance Watch Policy Brief



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Contents

I. Key conclusions of the study findings	4
II. Policy recommendations	6
III. Introduction and context	7
IV. Methodology	8
V. Key findings	9
1. Scope: Concerns regarding credit products currently not in the scope of the CCD	9
1.1. Interest free credit	9
• Buy-now-pay-later (BNPL) schemes	9
• Deferred debit cards	12
1.2. Payday loans	13
1.3. Peer-to-peer lending	14
1.4. Leasing	17
1.5. Overdrafts and overrunning	19
2. Creditworthiness assessment practices (CWAs)	20
3. Advertising practices	22
4. Forbearance measures	24
VI. Annex: Country-specific data	25

I. Key conclusions of the study findings

1. Scope: Concerns regarding credit products currently not in the scope of the CCD

- **Credit products that are currently not in the scope of the Consumer Credit Directive (CCD), despite being largely low in value, are high risk and can present a huge financial burden, leading to over-indebtedness for the types of consumers who typically purchase such products.** These loans are mainly purchased by vulnerable (lower income) consumers. The size of a loan is always proportionate to a consumer's overall budget. Since the budget of these consumers is rather low, **these small-value loans are *not* low in value from the financial perspective of the consumers purchasing them. In addition, high costs are associated with these products.** High APRs as well as high late payment and default fees are commonplace with these products. As a result, consumers are at high risk of becoming over-indebted when taking out these loans and often have to take out multiple loans to finance their original loan.
- **Credit providers offering consumer credit products that are currently not in the scope of the CCD exhibit a high degree of sales malpractice when offering these types of loans, leading to mis-selling and over-indebtedness.** Providers of these products offer poor pre-contractual information, in particular regarding costs and consequences in the case of default and/or late payments. This prevents consumers from being able to make informed choices when purchasing these products. Moreover, the sales processes for these types of loans are marred by poor and at times even completely lacking creditworthiness assessments (CWAs). Finally, misleading and poor advertising, particularly regarding the disclosure of key information about the loan such as costs and risks, is widespread.
- **In some member states, overrunning poses a risk for consumers, especially vulnerable ones, to become over-indebted and/or face a high financial burden. In Italy, for example, for this type of credit, the pre-contractual information is poor, the costs are high, and CWAs are not conducted before their sale. These products are largely purchased by lower-income consumers.**

2. Creditworthiness assessment practices (CWAs)

- **CWAs are poor for all types of loans. As CWAs are important in determining a consumer's ability to repay a loan, the high number of poor CWAs on the market likely leads to the significant mis-selling of loans to consumers who are not able to afford them.** An adequate CWA assesses a consumer's household budget, which is based on data of the consumer's income and essential expenditures, as well as ongoing credits/debts. However, in 62% of the cases a proper analysis of a household's budget is not performed. Moreover, in 58% of cases, no supporting documents are requested to verify the information/data provided by the consumer for the CWA.

3. Advertising practices

- **Consumer credit advertising is often misleading and does not provide any information about the key features such as costs and risks of a loan. This contributes to mis-selling and over-indebtedness.** In a stunning 95% of cases, information about the consequences in case of default or late payment is not communicated. Information on costs is not prominently displayed in 51% of cases, and the quality of the information on key characteristics of the loans is poor in 57% of cases.

4. Forbearance measures

- **Forbearance measures vary widely across member states and are in some instances very weak.**

II. Policy recommendations

1. There is a need to **expand the scope of the CCD to all of the credit products that the European Commission proposes to bring into scope in its legislative proposal on the CCD**. In our view also, the regulation of the borrower side of peer-to-peer lending cannot wait for a potential future standalone regulation on consumer crowdfunding as sales malpractices are currently too significant.
2. **The full regime of the CCD needs to be applied to the products the European Commission proposes to bring into the scope of the CCD. A ‘light regime’ for these products, meaning that not all CCD rules would be applied to these products, is not proportionate given these products’ high levels of risk for the consumers who typically purchase them.**
3. **More of the CCD regulatory requirements should be applied to overrunning** than is currently the case. The CCD CWA, cost cap, and pre-contractual information requirements should also apply to these products to avoid mis-selling and over-indebtedness.
4. **There is a need for mandatory cost caps that are applied to the Annual Percentage Rate (APR) of Charge for loans. The calculation method for these cost caps should be harmonised at EU level to ensure an equal level of protection for consumers and a level playing field for credit providers.** In addition, the CCD must specify that the APR should also include the cost of any insurance or other financial product purchased along with the credit.
5. **More prescriptive rules are needed in the CCD specifying what kind of data should be used for a CWA to ensure that an adequate assessment of a consumer’s ability to afford credit is performed.** An adequate CWA assesses the current financial capacity of the borrower’s budget based on the consumer’s income and expenditures, as well as their credit and debt instalments as laid down in the Guidelines of the European Banking Authority (EBA) on loan origination and monitoring¹. **The CWA requirements of the EBA Guidelines should be introduced in the Level 1 text of the CCD to make sure that all credit providers apply them.**
6. **More prescriptive rules are needed in the CCD on the content and format of advertising** to ensure that advertising is not misleading and that consumers are informed about the essential features of a credit product. **Key information about the loan such as costs and risks must be included and clearly and prominently displayed in the advertisement.**
7. **There is a need for the introduction of strong and harmonised forbearance measures in the CCD.** In addition, there is a need to oblige creditors to have monitoring processes in place allowing them to detect consumers’ financial difficulties early so that forbearance measures can be put in place before the situation becomes too aggravated.

¹ ‘EBA Guidelines on Loan Origination and Monitoring,’ <https://www.eba.europa.eu/regulation-and-policy/credit-risk/guidelines-on-loan-origination-and-monitoring>, May 2020.

III. Introduction and context

The mis-selling of consumer loans can have dire consequences for consumers, especially the most vulnerable ones. Vulnerable consumers who have been mis-sold a loan often find themselves in a situation where they are forced to take out additional credit and face high default and/or late payment fees if they are unable to repay their original loan. This, in turn, often leads to over-indebtedness, and with it a financial situation for debtors that does not allow them to lead a decent life. Over-indebtedness often results in social exclusion and psychological and health issues for consumers.² The mental and physical health repercussions of over-indebtedness also have a detrimental effect on a country's economic growth and its social benefit system, since they lead to large costs for medical care services, a decline in production, and high costs of the social insurance/unemployment benefit systems.³ Hence, it is crucial to address this issue and its root causes in the EU.

One of the key causes of the mis-selling of loans and therefore over-indebtedness is the malpractice of lenders in the consumer credit market. Consumers of credit are faced with questionable and misleading advertising material, unreasonably high and usurious costs and fees, problematic creditworthiness assessments, and misleading pre-contractual information. All these prevalent issues cause dire problems for consumers, especially regarding risky new products that are currently not in the scope of the CCD and are mostly popular with vulnerable consumers—such as payday loans, free interest rate credit (buy-now-pay-later schemes [BNPL] and deferred debit cards), peer-to-peer lending, and overdraft facilities. In the last decade, the market has seen the emergence and increased use of these new credit products and services. Peer-to-peer lending, for example, has emerged as part of the ongoing digitisation trend of the consumer credit market. Furthermore, BNPL schemes, payday loans, and overdrafts have grown in popularity and size.

The Consumer Credit Directive (CCD) of 2008, the current regulatory framework for the EU consumer credit market, contains regulatory gaps and flaws in key consumer protection areas. For example, it is incompatible with the increasingly digitised market and does not regulate the aforementioned relatively new and risky consumer credit products. Therefore, it is crucial that the ongoing review of this directive addresses these shortcomings.

The European Commission's legislative proposal on revising the CCD from June 2021 includes many important amendments to improve consumer rights, such as widening the scope of the CCD, improving pre-contractual information, banning product tying and unsolicited credit sales, and expanding supervision to include non-credit institutions. Nevertheless, there is still a need for further improvements in some key areas of the European Commission's proposal. Now that the directive is being reviewed by the European Parliament and Council, it is important that the key improvements proposed by the European Commission are upheld and not diluted. Moreover, it is important that key issues that are not adequately addressed in the European Commission's

2 Finance Watch, 'From Debtor Prisons to Being Prisoners of Debt,' <https://www.finance-watch.org/wp-content/uploads/2022/01/Personal-insolvency-paper-january-2022.pdf>

3 Ahlström, R., Edström, S., & Savemark M., 'The Swedish Consumer Agency Report,' 2014:15, <https://www.finance-watch.org/wp-content/uploads/2018/12/Is-debt-relief-rehabilitative-R-Alstrom.pdf>

proposal relating to advertising, creditworthiness assessments, the introduction of cost caps, and improving forbearance measures are adequately tackled.

To identify the key policy proposals that are needed in the final legislative text of the revised CCD to avoid mis-selling and over-indebtedness, Finance Watch conducted a quantitative and qualitative study of the EU consumer credit market. The focus of the study was on issues that are currently deemed controversial by policymakers, are intensely debated, and for which there is currently a lack of data available to support the policy debate. These issues are risky credit products that are currently not in the scope of the directive, the cost of credit, advertising rules, and creditworthiness assessment rules.

This policy brief highlights the findings of our study, draws a number of conclusions regarding the study findings, and provides evidence-based recommendations for the necessary revisions of the CCD on the specific key issues of focus.

IV. Methodology

For the purposes of identifying the main factors leading to the mis-selling of consumer credit and over-indebtedness, Finance Watch commissioned a mystery shopping exercise in the EU consumer credit market. The focus of the study was on controversial issues that are currently being widely debated and for which there is currently a lack of data available, including new and risky credit products that are currently not in the scope of the directive, the cost of credit, advertising rules, and creditworthiness assessment rules.

As part of this exercise, Finance Watch collected 126 real case studies from four different EU Member States: France, Italy, Denmark, and the Czech Republic. The data was collected by several consultants for each country, and the mystery shopping exercise was complemented by qualitative questionnaires filled out by experts in the field from Italy, Germany, Denmark, the Czech Republic, and the Netherlands. The qualitative questionnaire provided more information on some important topics that could not be fully captured by the mystery shopping exercise. Furthermore, discussions with experts who have direct contact with consumers in the field refined the main findings of the analysis.

The information utilised in this study was gathered between December 2021 and February 2022. Assigned consultants were asked to provide information regarding lending practices and customer experiences for the following consumer credit products:

- Payday loans below €200;
- Car loans and car leasing up to €15,000;
- Personal loans, revolving credit, and peer-to-peer lending up to the amount roughly equivalent to one month's salary;
- BNPL below €500 and deferred debit cards (in the French market).

Data regarding overdrafts from Italy and deferred debit cards from France was also gathered. The study covered the online and offline markets and banks and non-banks as credit providers.

Within the limits of its scope, the findings of the study provide reliable insights into the current state of the consumer credit market in the European Union as a whole.

V. Key findings

1. Scope: Concerns regarding credit products currently not in the scope of the CCD

1.1. Interest free credit

Buy-now-pay-later (BNPL) schemes

BNPL is a form of unregulated interest free credit that allows customers to defer payment to a later date or pay in instalments when purchasing a good via certain retailers. The BNPL market has grown rapidly in recent years, and there are reasons to anticipate that this growth will continue.⁴ Our qualitative data indicates that users of BNPLs are often consumers who cannot borrow via regular channels and/or consumers with no financial savings nor planning ability. Furthermore, research from Citizens Advice in the UK shows that 41% of BNPL consumers struggle to meet BNPL repayment.⁵

As evidenced by our study, suppliers of BNPLs often provide consumers, especially the most vulnerable ones, with a false sense of security and impression of increased purchasing power. This type of product is often advertised as a zero-cost product. However, it is far from being 'zero-cost', and by being unregulated, this product has many loopholes that are being exploited by credit suppliers. While BNPL suppliers praise their 'zero-cost' product, high late-payment fees and other hidden costs are a structural part of their business model. For example, BNPL provider Clearpay charges €6 after seven days for products under €24 and 25% for products over €24.⁶

Despite this, our study shows that consumers are not adequately informed about the high costs and risks of BNPLs. To avoid mis-selling to consumers, which can eventually lead to over-indebtedness, it is crucial that the information consumers receive about a credit product at the pre-contractual phase - product information contained in the pre-contractual information sheet and advertising - display full and non-misleading information to allow the consumers to make informed decisions. As shown in Graph 1 below, however, many consumers struggle to obtain any information about BNPLs before making use of them. In only 10% of cases in our mystery

4 'The Woolard Review: A Review of Change and Innovation in the Unsecured Credit Market,' Financial Conduct Authority (FCA), <https://www.fca.org.uk/publication/corporate/woolard-review-report.pdf>, February 2021.

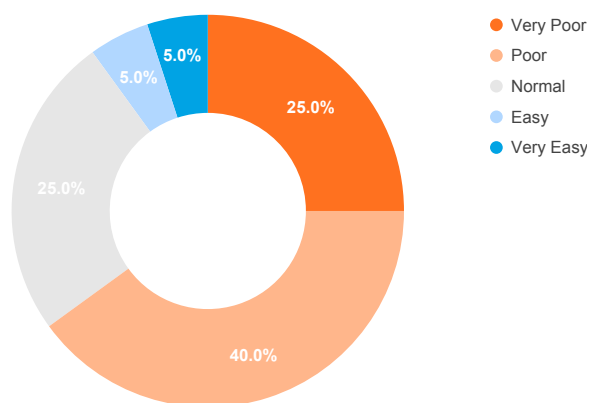
5 [https://www.citizensadvice.org.uk/Global/CitizensAdvice/Debt%20and%20Money%20Publications/BNPL%20Debt%20Collection%20\(1\).pdf](https://www.citizensadvice.org.uk/Global/CitizensAdvice/Debt%20and%20Money%20Publications/BNPL%20Debt%20Collection%20(1).pdf)

6 https://www.beuc.eu/publications/beuc-x-2022-017_buy_now_pay_later_products.pdf

shopping exercise, access to information⁷ regarding BNPL schemes was deemed easy (Graph 1). Moreover, in 65% of the cases, the information on costs provided to consumers in the product information document prior to concluding the credit contract was not clear (Graph 2). In addition, in a stunning 90% of cases, the pre-contractual information was not clear regarding consequences (e.g., fees) in the case of late payments or default (Graph 3). Given that, as elaborated earlier, the late payment fees for BNPLs are quite high and many BNPL consumers struggle to repay their BNPLs, this is a serious problem leading to not only mis-selling but also over-indebtedness. Our study findings show that BNPL advertisements do not fare better, as they lack clear information about the costs and risks of BNPLs and are often misleading. In 94% of cases, consequences in the case of default and late payments are not prominently⁸ displayed in the advertising material. Moreover, in 94% of cases, the quality of the information on the key characteristics of BNPL schemes communicated in advertisements was deemed low quality (Graph 4).

In addition to poor and misleading information at the pre-contractual phase, we can infer from the findings of our mystery shopping exercise that another key reason for the mis-selling of BNPLs is a lack of proper creditworthiness assessments being performed when consumers sign up for the product. Retailers often encourage consumers to turn to BNPLs for the sole purpose of higher conversion rates without enforcing proper creditworthiness assessment practices. This malpractice likely results in these products being sold to vulnerable consumers who cannot afford this type of credit. Our study showed that in 57% of the cases, creditworthiness assessments were not performed when applying for BNPL products (Graph 5). While BNPL providers might claim that conducting full creditworthiness assessments is time-consuming and costly for these low value products, there are innovative ways to conduct cheap and fast full creditworthiness assessments. For example, prospective consumers' budget balances can be assessed in a low-cost way using Open Banking with adequate safeguards for data protection.⁹

Graph 1: Ease of access to information on BNPLs – Question: Rate the ease of access to information (1 = Very Poor, 5 = Very Easy).

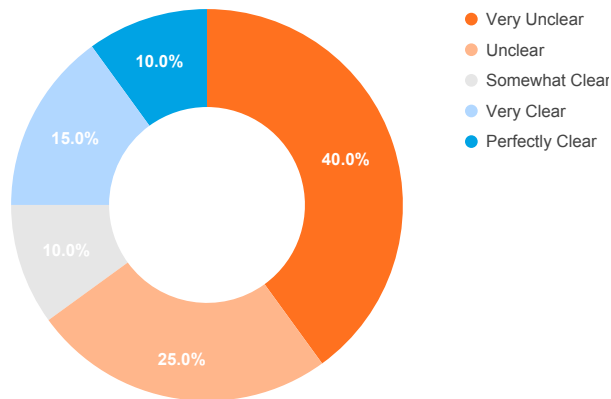


7 Ease of access to information is when it is not difficult to find the information on the provider's website, i.e., for example, when it does not take several clicks or a lot of effort to find it.

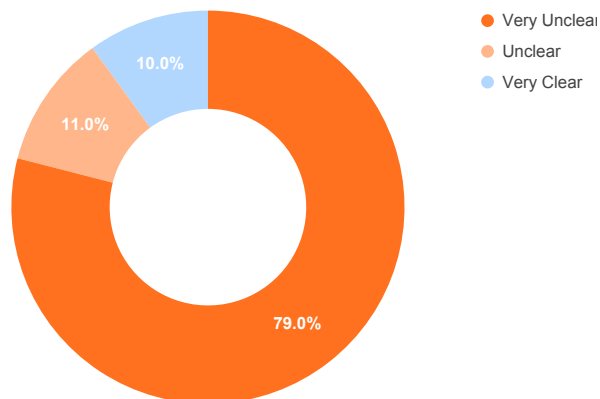
8 Prominently displayed: displayed in an easily identifiable manner; for example, not displayed in a smaller font size than the rest of the disclosure making the information difficult to find and/or notice.

9 'Responsible Lending and Privacy Protection: A Consumer Perspective,' Finance Watch, <https://www.finance-watch.org/publication/responsible-lending-and-privacy-protection-a-consumer-perspective/>, October 2020.

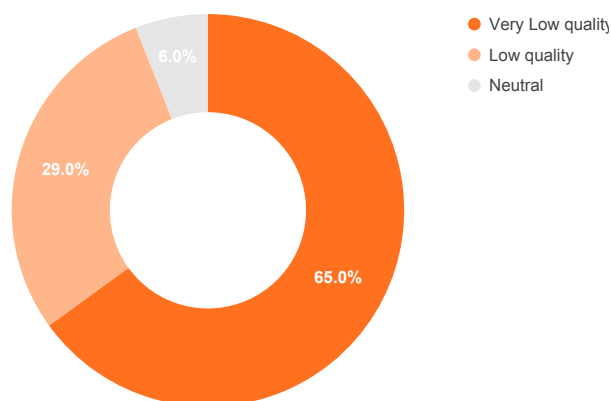
Graph 2: Clarity of the pre-contractual information on costs in BNPL schemes – Question: Rate the clarity of the pre-contractual information on costs (1 = Very Unclear, 5 = Perfectly Clear).



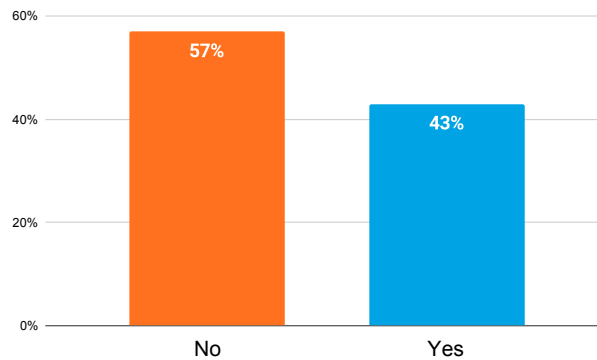
Graph 3: Clarity of pre-contractual information on the consequences in the case of default and late payments for BNPL schemes – Question: Rate the clarity of pre-contractual information on the consequences in case of default and late payments (1 = Very Unclear, 5 = Perfectly Clear).



Graph 4: Quality of information on BNPLs in advertisements – Question: Rate the quality of the information on the key characteristics of the loan communicated in the advertisement (1 = Very Low Quality, 5 = Very High Quality).



Graph 5 : Creditworthiness assessment prevalence in BNPL schemes – Question: Has the credit provider assessed your creditworthiness?



Deferred debit cards

Deferred debit cards are a type of credit product that is widespread in France. Unlike a traditional bank debit card, purchases using a French deferred debit card are not debited from the bank account immediately. Instead, all card purchases are consolidated and payment is set for a single date in the month. Therefore, expenses are not debited upon purchase but grouped into a single direct debit per month. With a deferred debit card, consumers can continue to spend even if their payment account is not sufficiently funded. However, they need to have sufficient funds in their payment account on the date when they have to make the monthly card payments; otherwise, the account will be overdrawn and they will have to pay fees to the bank.

Hence, this type of product in France is very similar to a BNPL scheme and is in fact (even though it is not officially referred to as such) a zero interest rate credit product. The risks associated with this product are very similar to the risks linked to BNPL schemes. It encourages impulse purchases, since consumers do not see the balance of their account decrease as they spend and thus, they could have the false impression that their financial situation allows them to spend more and more. Moreover, consumers face indebtedness and high fees if they are unable to cover payments. This can lead to over-indebtedness, in particular for vulnerable consumers.

Our mystery shopping exercise revealed that consumers are not adequately informed about the costs and risks of these products. Our data from the French market revealed that these products are not advertised as a 'credit product' but as a regular debit card. Moreover, consumers are often not given pre-contractual information on costs, late payment fees, or any other information regarding consequences of not being able to repay their card purchases on time. Hence, consumers are unaware that they can become indebted if they miss payments.

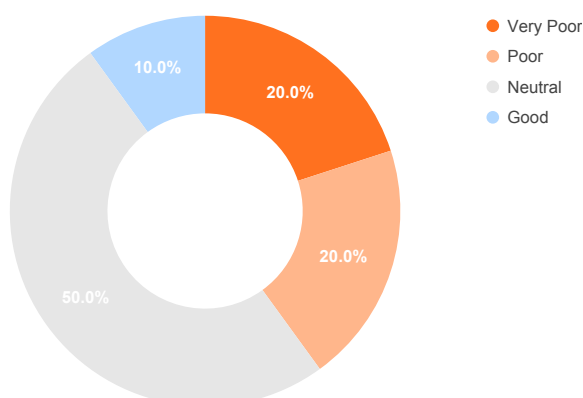
In light of the above, it is key that deferred debit cards are also explicitly brought into the scope of the CCD. Consumers need to be fully informed about the costs and possible risks (consequences) of using these cards via pre-contractual information, explanations by deferred debit card providers, and advertising. Moreover, it is crucial that a creditworthiness assessment is performed before consumers are offered these products. Finally, a spending limit, to ensure that the monthly expenses do not exceed the account balance, should be determined before a consumer is offered the card based on their creditworthiness assessments.

1.2. Payday loans

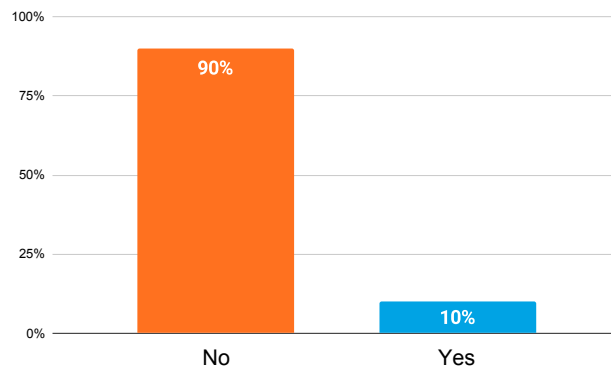
A payday loan, also known as a salary loan or cash advance loan, is a low-value, high-cost loan designed to be repaid within less than thirty days, usually on the date of the borrower's next paycheque. These loans are available both in-person and online. Our data suggests that payday loans are typically acquired by lower-income consumers that take out these types of loans as their last resort. These consumers often take out payday loans to repay other existing loans and/or to cover late payment fees or interest payments on other existing debt. For example, our qualitative data shows that around 80% of low-income payday loan consumers in the Czech Republic tend to roll over or take out multiple payday loans as a result of financial difficulties. These financial difficulties often stem from the fact that payday loan consumers are charged usurious fees. Our study findings showed that the average APR for payday loans is around 1447% and that the APR can even be as high as 5632%! In addition, late payment fees can reach €40.8 per month on loans as small as €120, i.e., 34% of the original value of the loan. Moreover, default fees can be more than the loan amount, reaching €229, and roll over charges can reach up to 32.5% of the amount due per 30 days. Hence, these loans are extremely dangerous from the consumer protection perspective, as they can put vulnerable consumers in a spiral of over-indebtedness, low financial means, and low quality of life. Moreover, in 90% of cases, consequences in case of default and late payments are not prominently displayed in the advertising material related to payday loans (Graph 7).

Our mystery shopping exercise showed that there is a high likelihood of these risky products being mis-sold to consumers who are unable to afford them. One of the key tools to ensure responsible lending is an adequate creditworthiness assessment. Our data showed, however, that proper creditworthiness assessments are often lacking when these products are sold on the market. In only 10% of cases, creditworthiness assessments related to the sales of payday loans could be considered good-quality assessments (Graph 6). In addition, in 25% of cases, data about the consumer's household budget balance, which is the financially relevant data to determine if a consumer is able to afford the loan, was not requested.

Graph 6: Quality of creditworthiness assessments for payday loans – Question: How would you rate the overall quality of the CWA? (1 = Very Poor, 5 = Very Good)



Graph 7: Consequences of default and late payment fees for payday loans – Question: Was information on the consequences in case of default and late payments prominently displayed in the advertising material?



1.3. Peer-to-peer lending

Peer-to-peer lending, often known as P2P lending or crowdfunding, is typically done through online platforms. It is a direct method for individuals or organisations to borrow and lend money without the involvement of a formal financial institution acting as an intermediary. Peer-to-peer lending is currently unregulated, which is dangerous for both borrowers and lenders. For the purpose of this study and the CCD revision, our focus is on the borrower side, as the CCD only addresses borrower protection.

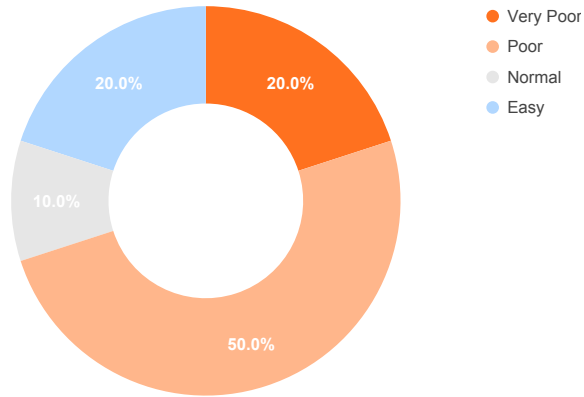
Our study showed that consumer borrowers who gravitate to P2P lending platforms usually lack adequate information prior to borrowing via P2P lending platforms. Our study also showed that ease of access to pre-contractual information for these types of credit was poor in 70% of cases (Graph 8) and that the clarity of pre-contractual information on costs was poor in 50% of cases (Graph 9). As a consequence, most consumers are unable to make an informed decision when borrowing via P2P, which was confirmed by our mystery shoppers who reported that they were unable to make an informed choice in more than 70% of cases (Graph 10). In addition, our data showed that the explanations consumers receive about this type of loan from suppliers are inadequate. Our mystery shopping exercise revealed that 50% of consumers do not receive any explanations about costs (Graph 11). Moreover, 60% do not receive any information regarding the financial effect of the loan on them as consumers such as the fact that it is a liability and can lead to financial difficulties, legal issues and potentially over-indebtedness. (Graph 12).

In terms of advertising practices, our results also showed that consumers are being delivered poor and misleading information. In 38% of cases, information presented in advertising material was deemed to be low quality (Graph 14), and in a shocking 88% of cases, information on the consequences in the case of default and late payments was not prominently displayed in the advertising material (Graph 15).

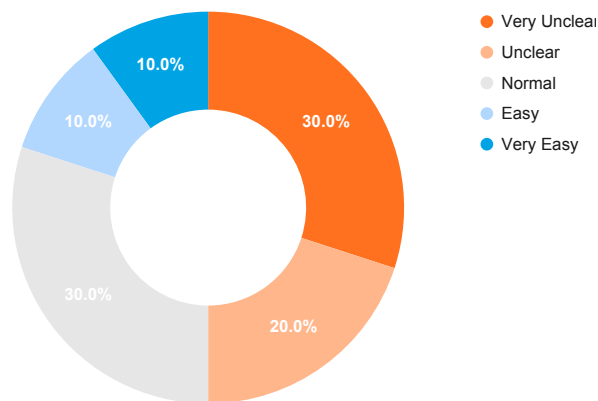
Hence, there is a high risk for consumers, including vulnerable ones, making use of these loans even if they are not financially able to afford them, as they have not been adequately informed about the costs and risks at the pre-contractual phase.

In addition, our mystery shopping exercise showed that inadequate creditworthiness assessments are too common in relation to the sales of these loans and are therefore another source of the mis-selling of peer-to-peer lending products. In 38% of cases, creditworthiness assessments were not conducted at all (Graph 13).

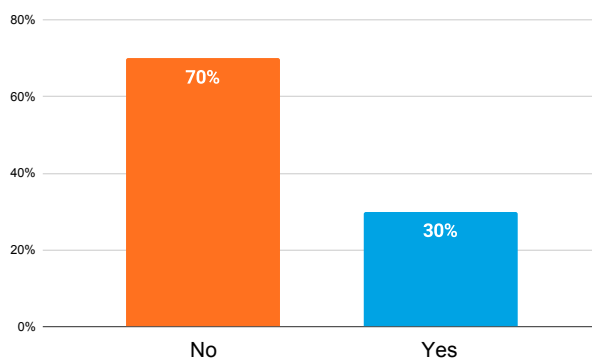
Graph 8: P2P ease of access to information – Question: Rate the ease of access to information (1 = Very Poor, 5 = Very Easy)



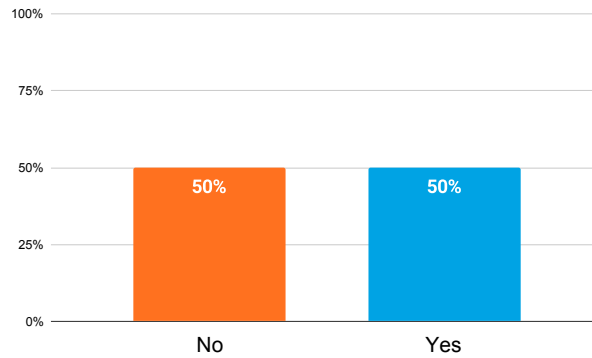
Graph 9: P2P Clarity of pre-contractual information – Question: Rate the clarity of the pre-contractual information on costs (1 = Very Unclear, 5 = Perfectly Clear)



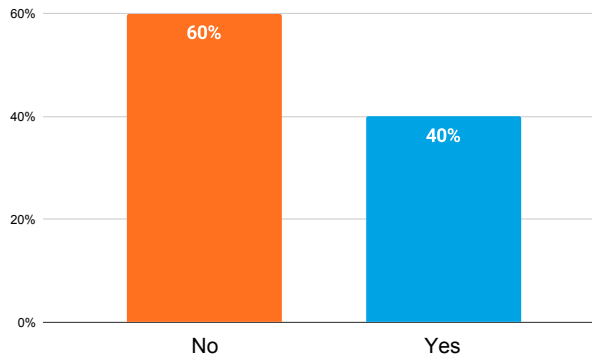
Graph 10: Are P2P borrowers able to make informed decisions? – Question: Do you believe the information presented is adequate for you to make an informed choice?



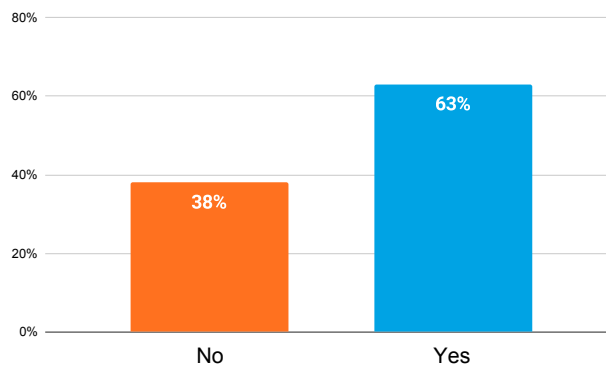
Graph 11: P2P lending and information on costs—Question: Have you received explanations from the credit provider on the key characteristics of the loan (costs)?



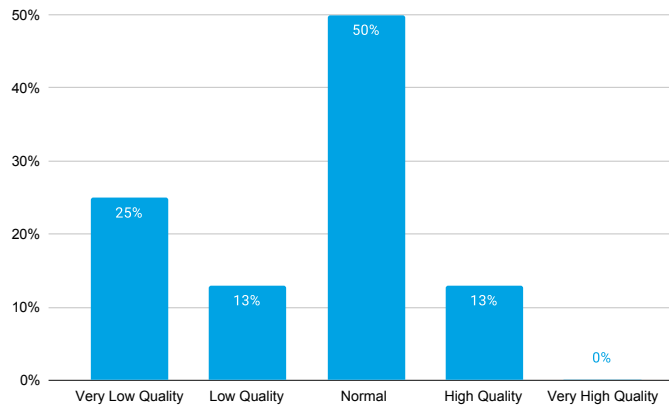
Graph 12: P2P and information received regarding financial effects on consumer—Question: Have you received information about the financial effects the product may have on you as a consumer?



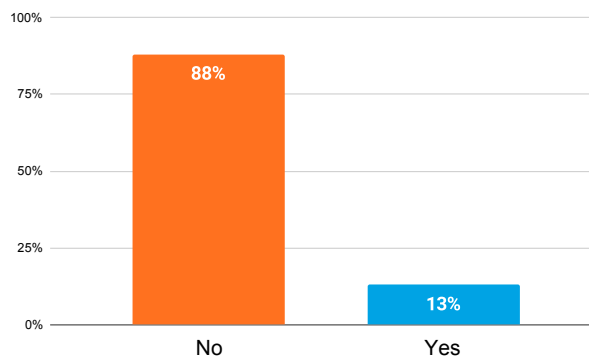
Graph 13: P2P and creditworthiness assessments—Question: Has the credit provider assessed your creditworthiness?



Graph 14: Advertising and P2P lending: quality of information—Question: Rate the quality of the information on the key characteristics of the loan communicated in the advertisement (1= Very Low Quality, 5 = Very High Quality)



Graph 15: P2P lending—Was information on the consequences in case of default and late payments prominently displayed in the advertising material?



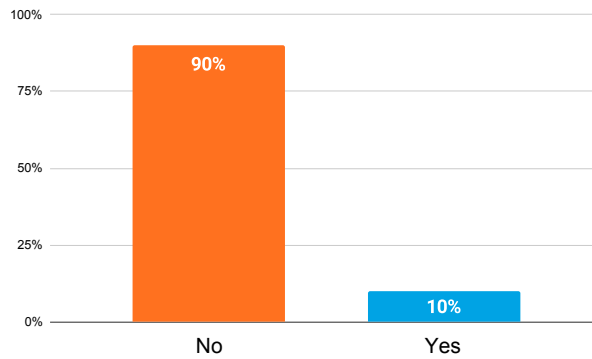
1.4. Leasing

Car leasing is the leasing of a motor vehicle for a fixed period of time for an agreed amount of money for the lease. After the term of the lease, the vehicle either has to be returned to the leasing company or in the case of leasing agreements that provide an option to purchase the product, it can be purchased for a residual value. One potential problem with car leasing is that a car loan would be a more suitable financial service for many customers with regards to their situations and needs. Some customers lease for a long term and purchase the car after the leasing period ends. For instance, in one of the mystery shopping cases in France, the original car price was €14,890, the lease amount was €191/month for 48 months, and the residual value of the car was €7,634. Hence, the total cost for the consumer if they decided to purchase the vehicle after 48 months would be €16,818 (excluding insurances and facultative costs). This car could be financed via a regular car loan from a French bank via monthly payments of €338 for 48 months; thus, a total cost for the consumer of €16,248. In such a case a loan would be a less expensive option, as the client could save €569 on the total cost of the vehicle purchase.

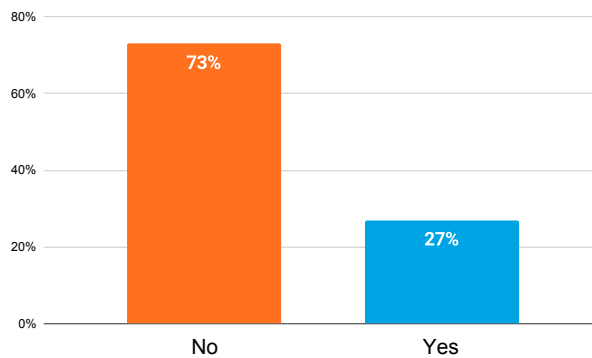
However, little, if any, information on this is provided to consumers, and they are therefore unable to compare leasing options and regular car loans. Our mystery shopping exercise of the car

leasing market showed that in 90% of cases, the provider did not clearly explain the differences between a car loan and car leasing, which confirmed our concerns (Graph 16). Moreover, in 73% of cases, the overall pre-contractual information presented on car leasing was inadequate for consumers to make informed choices (Graph 17), and in more than 57% of cases, pre-contractual information on costs specifically was unclear (Graph 18).

Graph 16: For car leases only— Question: Did the provider clearly explain the difference between a car loan and car leasing?

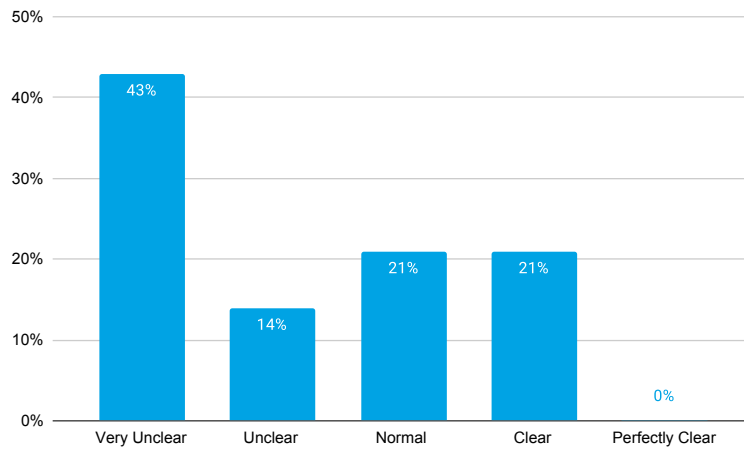


Graph 17: For car leases - Question: Do you believe the information presented is adequate for you to make an informed choice?¹⁰



¹⁰ This question refers to whether the key information a consumer needs to make an informed choice were provided. Key information are, for example, the costs and risks of the product.

Graph 18: For car leases - Question: Rate the clarity of the pre-contractual information on costs (1 = Very Unclear, 5 = Perfectly Clear).



1.5. Overdrafts and overrunning

Overdrafts can be categorised into two types. The first type is a kind of revolving credit facility where the bank grants the consumer a revolving line of credit. Usually, a minimum monthly payment is required, and interest fees charged are higher than for regular loan types. One of the dangers of using this type of credit is that since the interest fees are calculated based on the amount withdrawn, they can be accumulated, and the consumer can end up in a difficult situation to settle these dues. In addition, vulnerable consumers who are not completely aware of how this product functions could withdraw the whole line at once, have difficulties repaying it, and end up in a vicious cycle of only paying the interests, and not the principal, that are being accumulated on the original withdrawn amount. Our quantitative data from Italy suggests that the APR on these loans can exceed 20%. The late payment fees can also exceed 20% of the amount due. Hence, it is important that this type of overdraft is not mis-sold to vulnerable consumers.

Another type of overdraft is a tacitly accepted case when an account is overdrawn either accidentally or temporarily to cover urgent cash needs. This type of overdraft is also known as ‘overrunning.’¹¹ Our study showed that this type of low value loan is very common in some countries like Italy and Germany and is being used as a substitute for payday loans. Information gathered from our qualitative data questionnaire indicates that these overdraft facilities are mainly used by workers with medium or medium-low wages who have difficulty making ends meet. In these cases, banks may allow temporary overdrafts, especially if these consumers have salaries that are being credited on a monthly basis. The costs of these types of credit are high, in particular from the perspective of lower-income consumers. Our qualitative data from Italy shows that consumers taking out these types of overdrafts are required to pay high interest levels (in the first quarter of 2022, the threshold rate was 22%), plus commission for rapid processing, which is charged unless the credit is repaid within seven days.

¹¹ For example, in the CCD, this kind of overdraft facility is defined as overrunning.

In addition, pre-contractual information for both types of overdrafts is not clear, and creditworthiness assessments are often overlooked. Our study showed that in 100% of cases, ease of access to information, the clarity of the pre-contractual information on costs and consequences in case of default is poor. Furthermore, in 100% of cases, providers do not make available information regarding the financial effects the product may have on consumers. These results are a clear indication that urgent policy action is required to ensure that these products are properly regulated to protect consumers, in particular vulnerable ones, from mis-selling.

2. Creditworthiness assessment practices (CWAs)

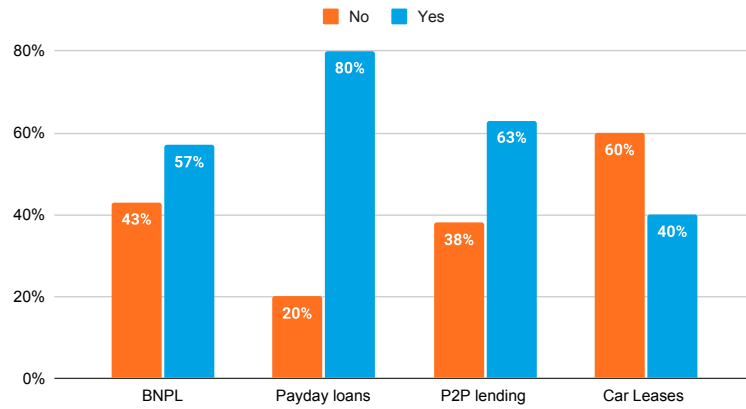
Adequate creditworthiness assessments are one of the key instruments for avoiding the mis-selling of consumer loans and eventually over-indebtedness. An appropriate creditworthiness assessment evaluates whether a consumer can afford to repay the credit based on an accurate study of the consumer's financial status. It also allows the credit provider to tailor the credit proposal in terms of amount, duration, and cost to correspond to the consumer's needs, financial situation, and risk profile. As highlighted in Finance Watch's paper 'Responsible Lending and Privacy Protection: A Consumer Perspective,'¹² the most appropriate method to assess the ability of a consumer to repay a loan is a thorough study of their household budget, which entails an assessment of the consumer's income and expenses, as well as outstanding credits and debts.

However, our research revealed that there are many poor creditworthiness assessment practices on the consumer credit market. Our study showed that creditworthiness assessments were not conducted in 37% of our mystery shopping cases. Broken down by credit type, creditworthiness assessments were not conducted for more than 40% of BNPL cases, 60% of car leases, and 38% of P2P loans (Graph 19). If we look at country-specific data, we see that creditworthiness assessments were overlooked mostly in France (44%) and Italy (58%) (Graph 31). In addition, in 58% of cases, our mystery shoppers were not asked to provide supplementary documents (evidence) to prove the accuracy of the information and data provided for the CWA (Graph 20).

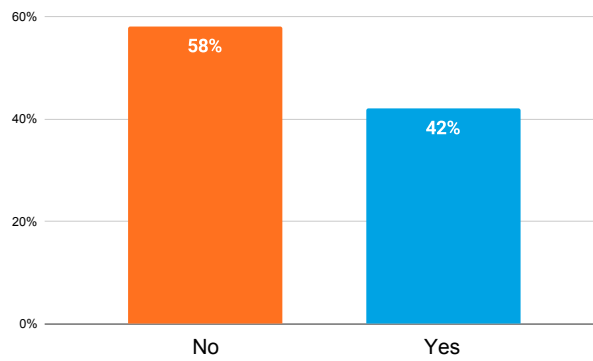
Moreover, data or information required to conduct a proper analysis of a consumer's budget balance such as data on consumers' income and expenditures was not requested in 62% of cases, as some loan providers only gathered information regarding income levels and did not request information regarding expenditure levels (Graph 21). Finally, in 38% of cases, creditworthiness assessments were deemed poor (Graph 22).

12 https://www.finance-watch.org/wp-content/uploads/2020/10/FW-paper_Responsible-lending-and-privacy-protection_Oct2020.pdf

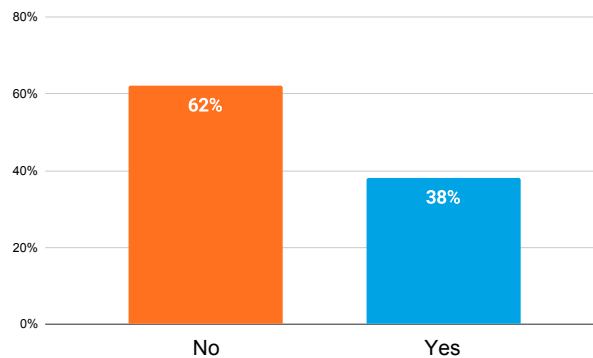
Graph 19: CWA for different types of loans – Question: Has the credit provider assessed your creditworthiness?



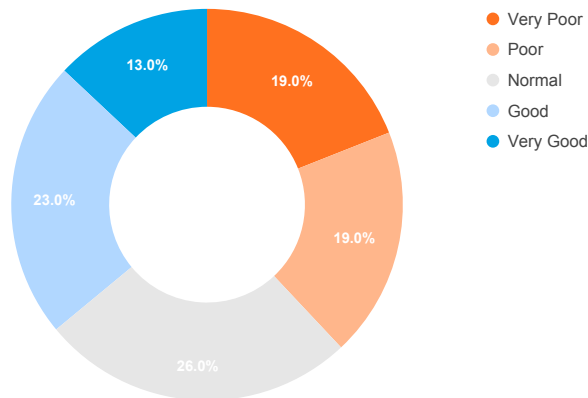
Graph 20: Question: Have you been asked to provide supplementary documents (evidence) to prove the accuracy of the information/data you provided?



Graph 21: Question: Were you asked to provide data/info about your budget balance (level of income/level of expenditures)?



Graph 22: Question: How would you rate the overall quality of the CWA? (1 = Very Poor, 5 = Very Good)

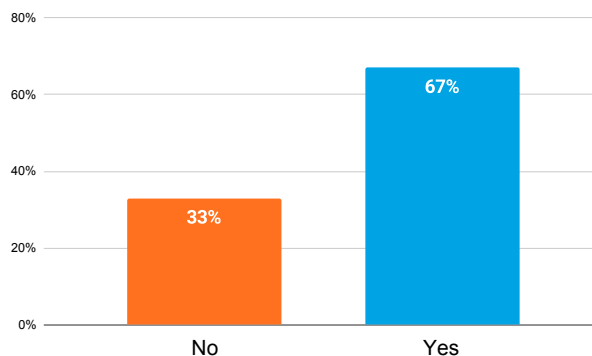


3. Advertising practices

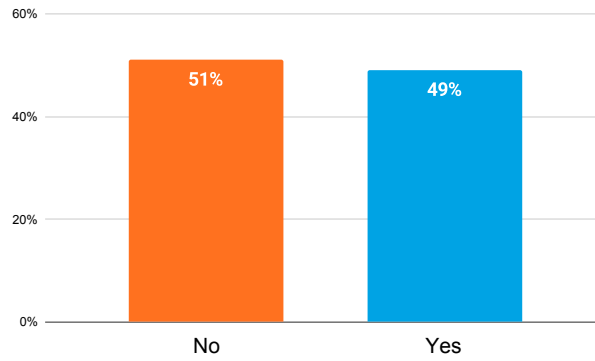
Advertising is a powerful tool that has the ability to persuade consumers to purchase a specific product or service. As a result, it is critical that promotional materials, especially those related to a complex and risky product like credit, provide consumers with clear, non-misleading, and comprehensive information on the key aspects of the product. Misleading, incomplete, and inaccurate information can lead to the mis-selling of credit products, especially to vulnerable consumers, and thereby contribute to the problem of over-indebtedness.

Our study revealed serious advertising malpractices in the consumer credit market. Important pieces of information regarding credit products are their key characteristics, such as cost, duration, consequences in case of default or missed payments, and other additional charges. These key features provide consumers with necessary and impartial information to make an informed decision about whether the loan meets their needs and is compatible with their financial situation. Our study showed that in 33% of cases, however, information regarding these characteristics of the loan was not communicated in advertisements (Graph 23) and in 67% of cases, it was of low quality (Graph 25). More specifically, in 51% of cases, information regarding costs was not advertised (Graph 24). Most surprisingly, in 95% of cases, information on the consequences in case of default and late payments was not prominently displayed in the advertising material.

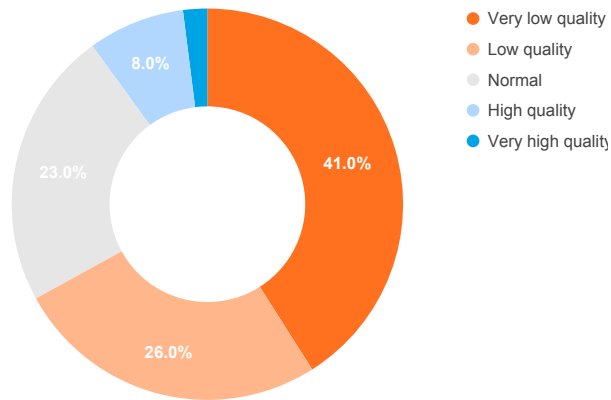
Graph 23: Question: Was information about the key characteristics of the loan communicated in the advertisement?



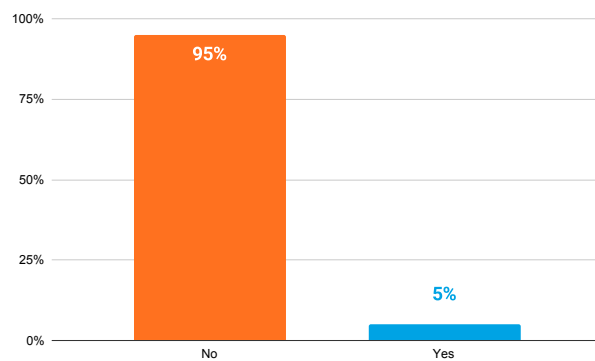
Graph 24: Question: Was information on costs prominently displayed in the advertising material?



Graph 25: Question: Rate the quality of the information on the key characteristics of the loan communicated in the advertisement (1= Very Low Quality, 5 = Very High Quality)



Graph 26: Question: Was information on the consequences in case of default and late payments prominently displayed in the advertising material?



4. Forbearance measures

When borrowers fail to meet their repayment obligations, lenders may choose to initiate enforcement proceedings. In the context of credit, forbearance is an exceptional arrangement between a lender and a borrower to postpone any enforcement proceedings. In a forbearance agreement, lenders and borrowers agree on forbearance measures to help borrowers, especially vulnerable ones, get back on track. Examples of forbearance measures are a total or partial refinancing of a credit agreement, extending the term of the credit agreement, or changing the type of the credit agreement, amongst others.

Our qualitative data from Denmark showed that consumers who have financial difficulties will often seek help from family and friends instead of being granted forbearance measures. Forbearance measures are more easily granted when borrowers seek help from a debt adviser such as the Danish Consumer Council's debt counselling, whereas forbearance measures should be granted to all consumers in need equally, regardless of whether or not they seek help from debt or legal advisers.

In Italy, our qualitative data indicated that forbearance measures are voluntary and require the consent of both the creditor and debtor. Forbearance measures have played an essential role in allowing people in difficulty to meet their financial commitments while still having decent living conditions for themselves and their families. The fact that the repayment rate after forbearance is usually high confirms the positive effects for consumers and for the whole market. However, this is not the case for non-performing loans that are often transferred to debt collectors. In these instances, debt renegotiations are often difficult or even impossible - hence the importance of granting forbearance measures to consumers in financial difficulties before reaching the stage where a loan becomes non-performing.

Our data from Germany indicated that first signs of repayment problems are not usually adequately investigated by creditors. It is only when financial difficulties grow and late payments become more prominent that efforts are made by creditors to investigate the matter. Consumers, especially vulnerable ones, would have accumulated more debt and could have become over-indebted. Hence, it is important that financial difficulties are investigated upon the first early warning signs of any issues to avoid aggravating the problem and over-indebting consumers.

Shockingly, our data from the Czech Republic indicated that national forbearance measures are not effective at solving the issue and helping consumers repay their debts while still leading decent lives. Existing forbearance measures are weak and only lead to a delay of recovery or postponement of enforcement proceedings. Our data showed that at the end of October 2021, 711,939 people were facing enforcement proceedings. In these instances, it is practically impossible for these consumers, especially vulnerable ones, to maintain decent living standards.

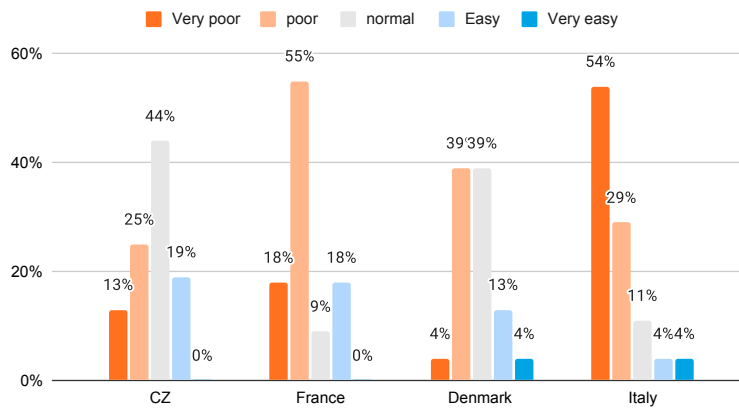
Therefore, our data indicated that forbearance measures in the EU are overall weak. Yet, the Commission's proposals regarding forbearance measures are not strong, as they do not oblige creditors to exercise forbearance measures in cases where consumers are facing financial difficulties, nor do they prescribe any binding forbearance measures that must be considered. This must be changed to ensure that creditors have to consider reasonable forbearance measures in circumstances where consumers are in financial hardship in line with the EBA Guidelines on the management of non-performing and forborne exposures.¹³

13 <https://www.eba.europa.eu/sites/default/documents/files/documents/10180/2425705/371ff-4ba-d7db-4fa9-a3c7-231cb9c2a26a/Final%20Guidelines%20on%20management%20of%20non-performing%20and%20forborne%20exposures.pdf>

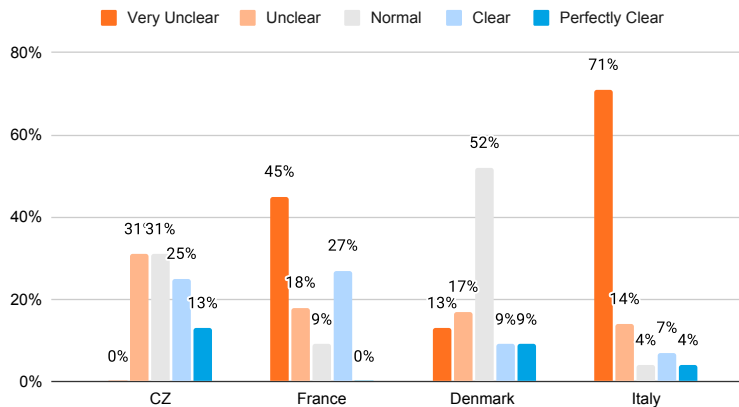
VI. Annex: Country-specific data

1. Pre-contractual information (only for the following products currently not in the scope of the CCD: payday loans, P2P lending, car leasing, and BNPLs)

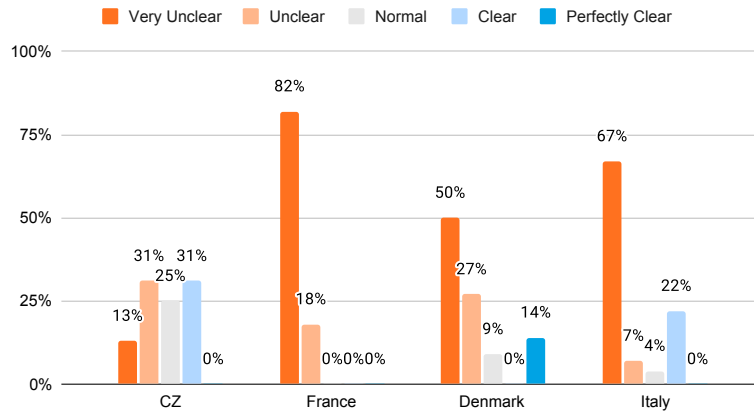
Graph 27: Question: Rate the ease of access to information (1 = Very Poor, 5 = Very Easy)



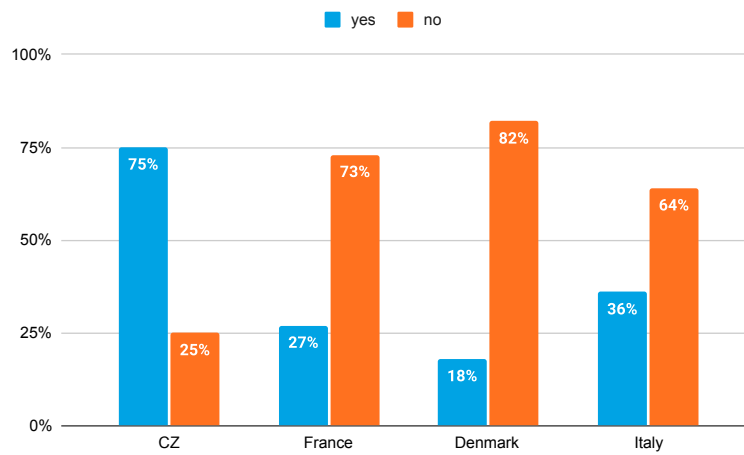
Graph 28: Question: Rate the clarity of the pre-contractual information on costs (1 = Very Unclear, 5 = Perfectly Clear).



Graph 29: Question: Rate the clarity of pre-contractual information on the consequences in case of default and late payments (1 = Very Unclear, 5 = Perfectly Clear).

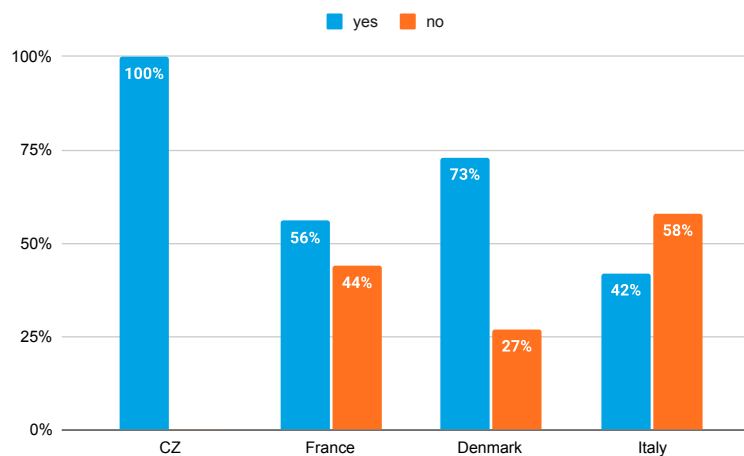


Graph 30: Question: Do you believe the information presented is adequate for you to make an informed choice?

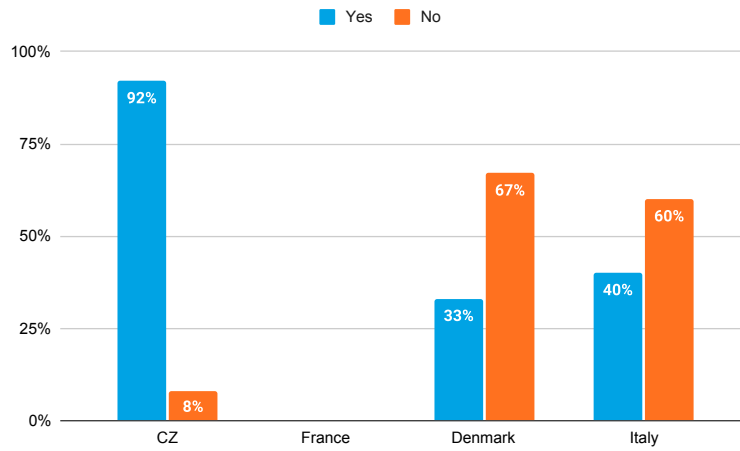


2. Creditworthiness assessments

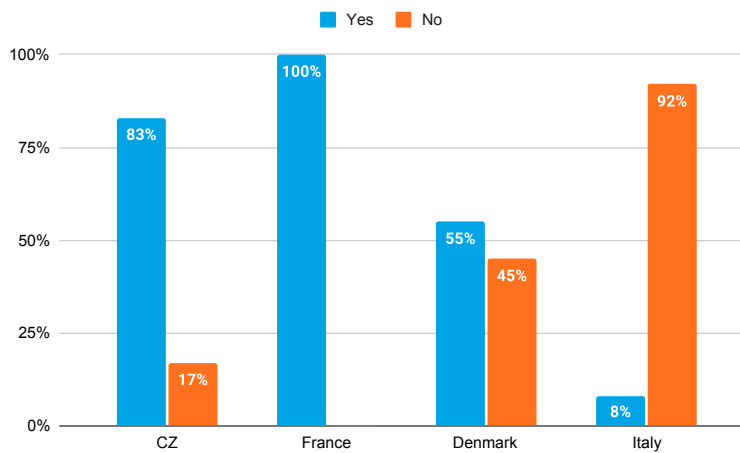
Graph 31: Question: Has the credit provider assessed your creditworthiness?



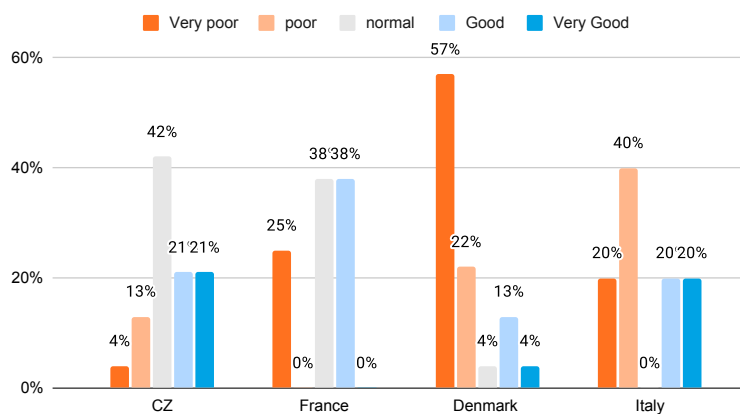
Graph 32: Question: Have you been asked to provide supplementary documents (evidence) to prove the accuracy of the information/data you provided?



Graph 33: Question: Were you asked to provide data/info about your budget balance (level of income/level of expenditures)?

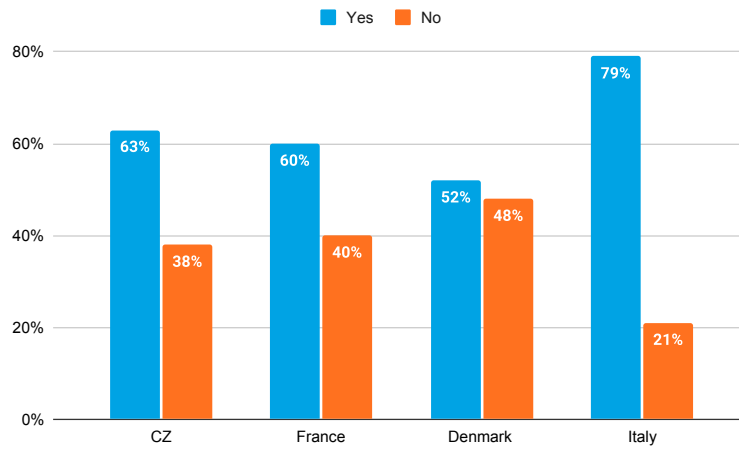


Graph 34: Question: How would you rate the overall quality of the CWA? (1 = Very Poor, 5 = Very Good)

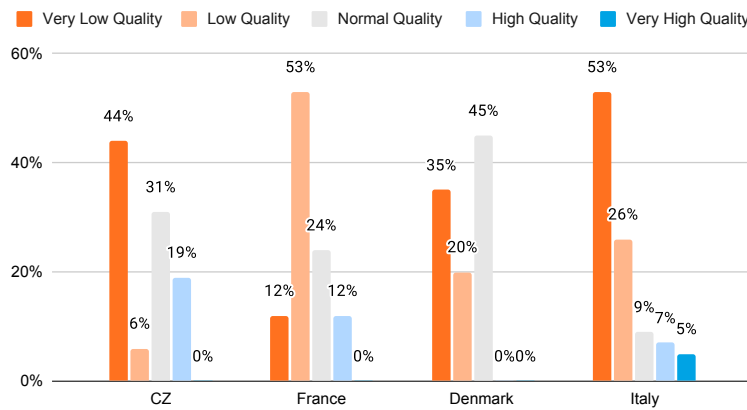


3. Advertising practices

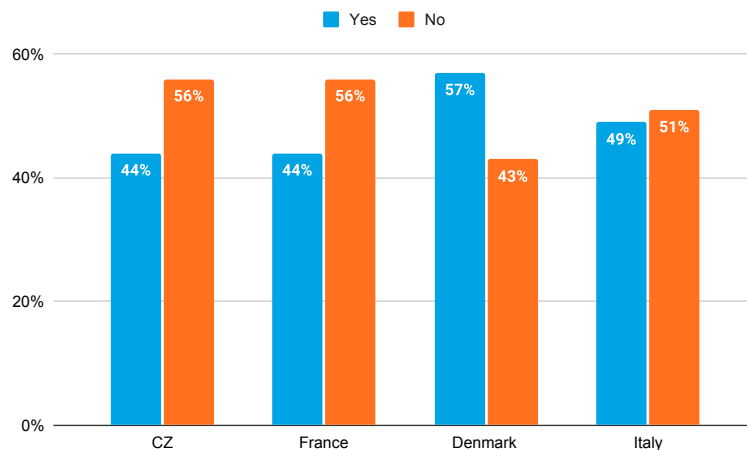
Graph 35: Question: Was information about the key characteristics of the loan communicated in the advertisement?



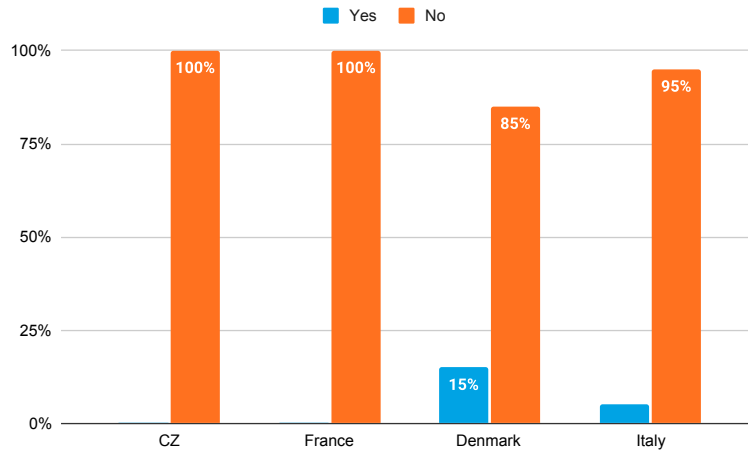
Graph 36: Question: Rate the quality of the information on the key characteristics of the loan communicated in the advertisement (1= Very Low Quality, 5 = Very High Quality)



Graph 37: Question: Was information on costs prominently displayed in the advertising material?



Graph 38: Question: Was information on the consequences in case of default and late payments prominently displayed in the advertising material?



About Finance Watch

Finance Watch is an independently funded public interest association dedicated to making finance work for the good of society. Its mission is to strengthen the voice of society in the reform of financial regulation by conducting advocacy and presenting public interest arguments to lawmakers and the public. Finance Watch's members include consumer groups, housing associations, trade unions, NGOs, financial experts, academics and other civil society groups that collectively represent a large number of European citizens. Finance Watch's founding principles state that finance is essential for society in bringing capital to productive use in a transparent and sustainable manner, but that the legitimate pursuit of private interests by the financial industry should not be conducted to the detriment of society. For further information, see www.finance-watch.org

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