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AK Position Paper

AK EUROPA-position on credit agreements relating to residential property

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About us

The Federal Chamber of Labour is by law representing the interests of about 3.2 million employees and consumers in Austria. It acts for the interests of its members in fields of social-, educational-, economical-, and consumer issues both on the national and on the EU-level in Brussels. Furthermore the Austrian Federal Chamber of Labour is a part of the Austrian social partnership.

The AK EUROPA office in Brussels was established in 1991 to bring forward the interests of all its members directly vis-à-vis the European Institutions.

Organisation and Tasks of the Austrian Federal Chamber of Labour

The Austrian Federal Chamber of Labour is the umbrella organisation of the nine regional Chambers of Labour in Austria, which have together the statutory mandate to represent the interests of their members.

The Chambers of Labour provide their members a broad range of services, including for instance advice on matters of labour law, consumer rights, social insurance and educational matters.

More than three quarters of the 2 million member-consultations carried out each year concern labour-, social insurance- and insolvency law. Furthermore the Austrian Federal Chamber of Labour makes use of its vested right to state its opinion in the legislation process of the European Union and in Austria in order to shape the interests of the employees and consumers towards the legislator.

All Austrian employees are subject to compulsory membership. The member fee is determined by law and is amounting to 0.5% of the members' gross wages or salaries (up to the social security payroll tax cap maximum). 560.000 - amongst others unemployed, persons on maternity (paternity) leave, community- and military service - of the 3.2 million members are exempt from subscription payment, but are entitled to all services provided by the Austrian Federal Chambers of Labour.

Herbert Tumpel
President

Werner Muhm
Director

Executive Summary

In any new regulations for credit agreements should be modelling the terms and formulations as closely as possible on the Consumer Credit Directive

• AK basically welcomes the initiative of the Commission to regulate credit agreements relating to residential property. It is **concerned, however, about this task being done at the current time and under time pressure.**

• Many Member States, including Austria, introduced new regulations for credit agreements relating to residential property while implementing the Consumer Credit Directive about one year ago. In Austria, all essential provisions apply equally to consumer credit agreements and residential property credit agreements with the exception of the right of withdrawal.

Several provisions of the Austrian Consumer Credit Act did not go into force until the fall of 2010. For this reason, it has not yet been possible to conduct a comprehensive evaluation of these new regulations, a sensible prerequisite for amending any law.

• This directive is of central importance to consumers. AK finds it inappropriate not to allow sufficient time for assessing, evaluating and issuing opinions and suggestions for changes.

The Commission and the Hungarian Presidency apparently would like to complete this process by the start of summer. That is out of the question as far as AK is concerned.

•In any new regulations for credit agreements relating to residential property, AK thinks special attention should be paid to modelling the terms and formulations as closely as possible on the Consumer Credit Directive.

• **AK has grave concerns** about the proposed **provisions on data protection.**

• **"Responsible borrowing"** is one principle the proposed directive is seeking to anchor. AK believes the suggested provisions could lead to the introduction of unreasonable duties and penalties for consumers. The proposed directive even implies that borrowers should bear equal responsibility with creditors for responsibly handling the awarding of credit.

AK believes that the creditor is definitely the party "calling the shots" in the awarding of credit and that the consumer's role is greatly overestimated.

Shortcomings in the proposed directive

AK regrets that the proposed directive has no provisions on the following points:

- **Right of withdrawal from a credit agreement relating to residential property**

- **Right of withdrawal from a credit intermediation agreement or from an agreement relating to credit advice**

- **Formal requirement** (requirement for effectiveness) for consumers to sign their own signature or use a qualified electronic signature for credit agreements relating to residential property or agreements on credit intermediation and credit advice

- **Protective provisions against "sale of credit":** AK supports a ban on debt assignments, particularly for technical accounting reasons. These kinds of assignments can in fact strongly impair consumers' contractual position. This is one lesson to be learned from the financial crisis.

- Regulations for all parties to the credit agreement – co-debtors and providers of security, especially **rights of withdrawal for all co-liable parties**

The AK position in detail

Article 3 Definition

In many cases, the **annual percentage rate of charge** (total cost of the credit) is reported **without the inclusion of insurance premiums.** This is a common practice even though the creditor makes absolutely clear to the credit applicant in their meeting together that the credit will not be extended without the insurance policy. Excluding these costs undermines genuine price transparency.

AK proposes that EU lawmakers provide for a right of withdrawal from credit intermediation agreements and agreements regarding credit advice

To prevent this circumvention, **AK advocates the introduction of a legal assumption that an insurance policy taken out in connection with the credit agreement is a prerequisite for the actual credit being granted and that the insurance costs should therefore usually be included in the annual percentage rate of charge.** It should be assumed for mortgage-backed credit agreements in particular (size of credit, length of term) that a life insurance policy must be taken out.

Tied credit intermediary: Tied credit intermediaries are defined as credit intermediaries acting on behalf of **only one creditor.** It is questionable whether this is a suitable definition, because the provision in Article 10.1.c contradicts it. There, creditors are explicitly mentioned in the plural in connection with tied credit intermediaries.

Chapter 2 Conditions applicable to creditors and credit intermediaries

The basic question arises as to whether it might not be better to have a **separate directive for all forms of credit intermediation** rather than to create special rules for individual matters. Austria has a fragmented legal basis governing credit intermediation, so that broker law largely regulates personal credit intermediation agreements, complete with maximum commissions. The intermediation of mortgage loans (credit agreements secured with liens in the Land Register) falls under the area of law governing real estate agents.

Consumers in Austria have filed many complaints in recent years on the intermediation of private loans in particular. The complaints have revolved mostly around consumers being billed inadmissible costs and high cancelation charges. **AK proposes that EU lawmakers provide for a right of withdrawal from credit intermediation agreements and agreements regarding credit advice.** AK believes this protective measure is urgently required.

Article 6 Minimum competence requirements

AK considers it desirable to define minimum requirements.

Information and practices preliminary to the conclusion of the credit agreement

The directive should explicitly state that all pre-contractual information must be free of charge

It is striking that the proposed directive defines **no compulsory information for credit agreements** of the kind provided for in the Consumer Credit Directive. AK sees no justification for this deviation. In the Austrian Consumer Credit Act the provisions on compulsory information in credit agreements **are the points upon which penalties under civil law hinge.** AK considers it crucial that this proposed directive also dictate minimal content for credit agreements relating to residential property.

Article 8 Standard information to be included in advertising

The proposed directive should contain an explicit prohibition against putting standard information in advertising or the representative example in the fine print. In Austria this practice continues to be customary for credit advertising involving figures (consumer and mortgage loans) even after the Consumer Credit Act went into force. AK welcomes that the directive requires the information to be "easily legible" but thinks this wording gives too much room for interpretation.

Representativeness should be defined in the directive. Great Britain and Germany already have similar provisions for consumer credit agreements. Applicants must be able to assume an annual percentage rate of charge for which they can expect that **at least two thirds** of the agreements that come about because of the advertising are concluded at the given annual percentage rate of charge or a lower one. This more specific formulation is urgently needed because lenders in Austria still advertise with the most favourable interest rates even though those rates are not representative.

Article 9 Pre-contractual information

The directive should **explicitly state that all pre-contractual information must be free of charge.** The directive as proposed merely provides that consumers be given a draft credit agreement free of charge on request. The Consumer Credit Directive does not contain a provision about pre-contractual information being basically free of charge either.

The Payment Services Directive, for its part, does have explicit provisions guaranteeing that pre-contractual information has to be free of charge.

From a consumer standpoint, clarification is also needed in the credit sector. After all, banks in Austria have been known in the past to chargefees or bill costs for pre-contractual information (offer of credit or conditions) if the credit agreement ultimately failed to materialise.

Pre-contractual credit information should basically only be allowed to be presented in standardised and uniform form so it is easier for consumers to compare offers

Article 9.1.g requires that general information include **an indicative example** instead of a representative example. **AK advocates the representative example be retained under general information** because an indicative example could refer to any numerical model. As so often in the past, the probable result would be a sample calculation using conditions that are the most favourable but certainly not representative. The directive should ensure prevention of these practices in advertising and in the general information on the credit agreement.

The proposed directive introduces an additional term alongside "general information about credit agreements", namely an "**offer binding** on the consumer". This term is not contained in this form in the Consumer Credit Directive. Apparently, this binding offer is what triggers the duty to hand over the European Standardised Information Sheet (ESIS).

The ESIS is (only) supposed to accompany the offer. This arrangement makes little sense to AK, because the binding offer together with ESIS might form a confusing bundle of papers. This would be **detrimental to the desired transparency** and the standardised pre-contractual information would not meet its intended purpose.

Pre-contractual credit information should basically only be allowed to be presented in standardised and uniform form so it is easier for consumers to compare offers. Even the voluntary code of conduct for credit agreements relating to residential property intended to make it compulsory that essential information be handed out to the consumer in standardised form at the first meeting. The prospective borrower requires standard information to compare different credit arrangements based on total costs and other essential parameters.

Several surveys by the Austrian Chambers of Labour (AKs) in years past have shown that Austrian banks are remiss in complying with the voluntary code of conduct in connection with pre-contractual information on credit agreements relating to residential property.

According to these AK studies, several banks did not even hand out an EU standardised form (with terms and conditions at the initial meeting) or handed out standard forms with inadequate content, for example, without the complete costs. Extensive standardisation appears to be urgently required, especially for the diversity of possible costs and expenses that are incurred once and billed continuously.

From our initial experience with the new standard information following passage of the Consumer Credit Act, we know that this information is not always handed out after the first meeting or sometimes not until the agreement is being signed. The customary "old" forms of credit offers are apparently still being used.

AK therefore advocates that every pre-contractual offer be drawn up in the form of the ESIS, so consumers receive just one document. The ESIS should contain information on whether or not the bid is binding and on how long the offer is valid.

Article 10 Information requirements concerning credit intermediaries

The directive should explicitly state for credit intermediaries, too, **that all pre-contractual information must be free of charge.** In actual credit intermediation practice, it often happens that an intermediation contract "must be" concluded very quickly (either at the first information meeting or during an Internet inquiry).

This makes it all the more important to regulate clearly the principle of obtaining pre-contractual credit information free of charge also when prospective borrowers contact credit intermediaries.

Article 10.1.f mentions only the fee payable by the consumer to the credit intermediary. According to Article 3.e under Definitions, the pay of the credit intermediary can also take the form of **"any other agreed form of financial consideration".** According to this definition, the credit intermediary should also have to **inform** the prospective borrower of the form of financial consideration it obtains from the creditor or other third party.

AK believes the regulation and scope of application of Article 3.h should be expanded in any case. **It should extend to commissions covered not by the creditor but by a third party** (e.g. intermediation companies lying in-between). Basically, **tied credit in-termediaries** should be required to disclose their commissions.

Article 10.2 has a provision **on disclosing commissions. This disclosure should be obligatory and not just contingent on a request** from the consumer.

Article 12 Calculation of the annual percentage rate of charge

The Consumer Credit Directive states that the only instance in which account expenses are not required to be included in the calculation is if maintaining the account is optional (Article 19.2 Directive 2008/48). Article 12.2 sentence 2 deviates from this formulation. AK cannot comprehend why a less stringent provision is applied to credit agreements relating to residential property and why this requirement is eliminated in the proposed directive.

AK calls for **all costs related to furnishing collateral** or to the mortgage to be included in the **calculation of the annual percentage rate of charge.**

AK considers the newly introduced possibility of obtaining advice in exchange for remuneration extremely problematic

Articles 14 to 16 – Consult the section on data protection problems

Article 17 Advice standards

AK considers the newly introduced possibility of obtaining advice in exchange for remuneration extremely problematic. According to current Austrian law, a fee for credit intermediation is only owed if credit intermediation was successful. **If a new regulation is to be introduced, steps must be taken to ensure in any case that consumers obtain the individual pre-contractual information free of charge according to Article 9 prior to the conclusion of a credit agreement or a credit intermediation agreement.**

It appears unclear how the line will be drawn in actual practice between advice for a fee and a suitable face-to-face free explanation of the credit/credits offered. It should be kept in mind that credit applicants are often under great financial pressure and clear protective provisions are needed in this situation in which they could be potentially taken off guard. That is evident in actual practice today with current law.

In our opinion, the planned regulations do not ensure that the credit applicant can obtain pre-contractual credit offers free of charge in order to compare different offers.

One can assume advice agreements will be concluded even though consumers are only interested in obtaining free initial information, especially when potential borrowers contact credit intermediaries. This practice would run completely contrary to the intended purpose of the directive.

The proposed directive provides **just one option** for cases in which advice is offered, namely that this can be done through additional pre-contractual information. This option is insufficient in AK's view.

If advice for remuneration is to be regulated in the directive, then corresponding mandatory standard information is needed. Consumers often have a difficult time understanding concepts such as "advice" and "intermediation". Consumers are unfamiliar with the legal distinctions and associated legal consequences. Advice is often thought to be a free service.

Chapter 8 Early repayment

The purpose and background described in reason 32 of the proposed directive for allowing early repayment prior to the expiry of the credit agreement is greatly restricted by the relatively generous options granted to the Member States.

From the point of view of consumers, an unrestricted right to early payment is needed. Competition also demands this unrestricted right.

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AK explicitly welcomes the provision requiring all credit intermediaries in future to hold professional indemnity insurance. This closes one of the gaps in this area

Article 18.2 grants the **option** that **if the early repayment falls within a period for which the borrowing rate is fixed, exercise of the right may be made subject to the existence of a special interest on the part of the consumers. AK vigorously objects to this provision.**

The provision means that early repayment is not possible even if the consumer were willing to pay a penalty. This option makes a clear judgement in favour of the credit industry that is objectively unjustified, especially in view of the protective purpose of the right of early repayment for consumers. If banks agree to fixed borrowing rates, one can assume in any case that the interest rate is higher than with variable interest.

The other options in paragraph 2 (time limitations and different treatment depending on the type of the borrowing rate) are inexplicit in our view and do not seem objectively justified either. Nor does reason 32 indicate the cases to be covered by this provision.

Article 21 Professional requirements applicable to credit intermediaries

All financial service professions should be required to take out professional indemnity insurance.

AK explicitly welcomes the provision requiring all credit intermediaries in future to hold professional indemnity insurance. This closes one of the gaps in this area.

Article 24 Penalties

From the point of view of consumers, criminal and administrative sanctions must be supplemented with effective sanctions under civil law. For example, if someone fails to perform the main information duties in the directive, this failure should also have consequences under civil law. For example, if they indicate an overly low annual percentage rate of charge, the actual rate should be lowered. The formulation in paragraph 1 should be changed and the option of civil law sanctions should be explicitly allowed.

AK opposes the planned sanctions against consumers. Refer to the explanations on Article 15 Disclosure obligation on the part of consumers. There are already sanctions in criminal law and general civil law.

AK welcomes the disclosure of infringement of the provisions along with the measure or sanction imposed as set forth in paragraph 2. AK assumes, however, that the disclosure duty does not apply to consumers in any case.

Annex II European Standardised Information Sheet (ESIS)

To implement new regulations for standard information on residential property credit agreements at European level, the existing regulation based on the Consumer Credit Directive must be evaluated.

Under the proposal, Member States must ensure that the creditor assesses the consumer's creditworthiness based on certain criteria

This evaluation has not yet been possible because the above directive was enacted so recently. Basically, AK feels the two directives should be closely aligned with each other.

AK welcomes the following points in the ESIS which are not yet provided for **in the Consumer Credit Directive in this form:**

- **Illustrative repayment table:** The table should also contain supplementary scenario calculations that make it clear to the prospective borrower how the monthly rate, for example, can change if interest rates start rising. This additional information is needed because of the long term involved with credit agreements relating to residential property.

- **Consequences for the borrower** in the event of non-compliance with the com-mitments linked to the loan

- The ESIS must indicate the date up to which the information in the ESIS applies. This provision should be **supplemented** to require that an indication be made in the ESIS as to whether **the offer is to be non-binding on the creditor.** AK believes consumers should also receive an ESIS even if the bank is not (yet) willing to issue a binding offer.

BEUC problems with data protection

Re Article 14 Obligation to assess the creditworthiness of the consumer

- Under the proposal, Member States must ensure that the creditor assesses the consumer's creditworthiness based on certain criteria. Explicitly, these criteria include the consumer's income, savings, debts and other financial commitments.

For reasons related to data protection law, AK believes it is essential to make a distinction between positive and negative data. Steps must be taken to ensure that the creditor can request positive data such as income and savings only from the consumer. The number of existing loans including total money borrowed is another data item that should only be allowed to be given out to credit reference agencies based on the contractual consent of banks. The provision must not be allowed to be used as grounds for credit reference agencies to argue they have to collect positive data on each consumer to comply with legitimate demands for information from banks. From the standpoint of data protection, there is a compelling and legitimate interest regarding the passing on and requesting of data to or at credit reference agencies (without the consent of the party involved) solely for negative data relevant to creditworthiness (qualified outstanding payments for which reminders have been sent and which are not disputed by the consumer, execution and insolvency data).

The Directive must clearly state which data categories are allowed to come from internal sources and which from external sources

• The types of data about which banks can inquire are listed as examples only. **AK believes this Directive must contain a limiting, complete list to ensure legal certainty and uniformity within the EU internal market.**

• Against this backdrop, it is also highly unsatisfactory that the Proposal merely refers to general data protection standards without setting down more specific rules on the data flows for the purposes of credit checks, especially limiting it only to the extent absolutely necessary: "That assessment shall be carried out on the basis of the necessary information, obtained by the creditor or, where applicable, credit intermediary from the consumer and from relevant internal or external sources and shall respect the requirements with regard to necessity and proportionality set out in Article 6 of Directive 95/46/EC."

The Directive must clearly state which data categories are allowed to come from internal sources and which from external sources. According to the Proposal, the assessment of data must comply with the Data Protection Directive with regard to necessity and proportionality. However, the data procurement itself must be viewed in this light as well.

As regards access to external sources, the Proposal absolutely must be supplemented to read that only **"reliable" sources** be allowed. The Member States should be called upon to **introduce certification or licensing procedures and regular supervision for and regarding such customers of databases.**

Re Article 15 Disclosure obligation on the part of the consumer

• According to the Proposal, Member States must ensure that consumers provide creditors and, where applicable, credit intermediaries with complete and correct information on their financial situation and personal circumstances. That information should be supported by documentary evidence from independently verifiable sources.

• It should once again be made clear that this requirement for banks shall not be used by credit reference agencies as grounds to save everything about a person's circumstances and excessive content from databases. Many items of positive data are allowed to be verified only by consumers themselves with suitable evidence.

• AK firmly rejects burdening consumers with additional sanctions in the event of incomplete or incorrect information. The only exception is general instruments for fighting incorrect information under criminal and civil law.

• As regards information the consumers must furnish to allow the creditor to assess their creditworthiness, the Proposal notes that this Article "shall be without prejudice to the application of Directive 95/46/E". This practice in regulation must be rejected for reasons of legal clarity if nothing else: In other words, the provision is only to be applied to the extent that it does not contravene the Data Protection Directive. **AK believes the Directive should state as precisely as possible the ac-**

tual items of consumer data for which there is "a compelling and legitimate interest" as this term is used in the Data Protection Directive.

• If **automated credit scoring** is used, the Proposal says the creditor must "inform the consumer thereof and explain the logic involved in the decision and of the arrangements". **AK basically welcomes this duty,** because it could be an improvement in the right to information in Directive 95/46 EC. When banks are asked to give an understandable explanation of the data used, of how the data is weighted and of the interpretation of the results, they always object that this information is a business secret. The accuracy of detail in the duty to provide information is therefore disputed. To improve consumers' legal position, **the Directive should define the degree of detail and state that the provisions on operating and business secrets do not take precedence over the duty to provide information.**

• The detailed purpose of paragraph 4 is completely unclear to AK ("Further to assessing a consumer's creditworthiness, Member States shall ensure that creditors and credit intermediaries obtain the necessary information regarding the consumer's personal and financial situation, his preferences and objectives…"). **The provision appears too vague and excessive in any case and AK rejects it in its current form.**

• Moreover, to identify products suitable for the individual consumer, banks rely on "information that is up to date … and on reasonable assumptions as to the consumer's situation over the term of the proposed credit agreement". Scoring methods are actually the only way to comply with this forecast duty. **This Directive or a flanking one must therefore set down sufficient provisions on the reliability and limits of scoring.**

• **AK rejects the Commission receiving special powers,** namely "Powers … to specify and amend the criteria to be considered in the conduct of a creditworthiness assessment…" Instead of these kinds of special powers for the EU Commission, one should abide by the general procedure for directive preparation with the involvement of the EU Parliament.

Article 16 Database access

• According to the Proposal, "each Member State shall ensure non-discriminatory access for all creditors to databases used in that Member State for assessing the creditworthiness of consumers and for monitoring consumers' compliance with the credit obligations over the life of the credit agreement." **AK is firmly opposed to powers to engage in on-going monitoring.** According to the Data Protection Directive, a compelling legal interest in this monitoring must exist. **As long as the customer pays his loan back as contractually agreed, inquiries should not be allowed to be made without reason.** Banks say they want to act preventively and hedge against deteriorations in creditworthiness (e.g.

consumers taking out additional loans and the like). This argument is not compelling. The provision would ultimately lead to completely excessive monitoring: Each bank would respond to each tiny change in the rating profile to be the first to demand additional collateral before each of the other creditors do.

- According to the Proposal, these databases comprise databases operated by private credit bureaus or credit reference agencies and public credit registers. **To protect consumers against a negative rating based on incorrect, out-dated and/or missing data, the Proposal must be supplemented to read that providers of these services must be certified, approved and subject to supervision.**

- The Commission is to be empowered "to define uniform credit registration criteria and data processing conditions to be applied to the databases" referred to in paragraph 1 of Article 16. **AK strongly objects to this approach. In making these types of important decisions, the EU must abide by the process for passing directives.**

In the end, the Proposal falls far short of the expected minimum standards under data protection law: The data to be processed for rating purposes must be listed completely. Database operators are not subject to any special supervision (beyond that exercised by general data protection authorities). Largescale use is therefore made in actual practice of data that is out-of-date, incorrect or from unlawful sources.

Given the serious consequences of a negative rating for consumers, more stringent regulations must be put in place for the creation and operators of these types of databases. The Proposal suggests the use of scoring meth-ods. Many studies have come out in the meantime warning about the un-scientific nature of these practices and about interventions involving the use of estimates that are inadmissible under data protection law. Others report on discriminating characteristics and much more. The Directive itself must lay down strict provisions in accordance with data protection law. These provisions must ensure that consumers are thoroughly screened only if absolutely necessary, that they are not subject to arbitrary scoring practices and that database operators have the necessary qualifications and reliability for this activities. Under no circumstances should the EU Commission be given special powers to regulate these matters.

Should you have any further questions please do not hesitate to contact

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