



## Principles for Responsible Credit

- P1: Responsible and affordable credit must be provided for all.**
- Credit is an essential for full participation in society
  - Banks should not discriminate and should provide real access.
  - Credit to Consumers and Small Businesses must be supervised.
- P2: Credit relations have to be transparent and understandable.**
- Competitive transparency requires a standardized mathematically correct form of “one-price” disclosure (the Annual Percentage Rate of Charge or APRC).
  - Social transparency requires a standardized pre-contractual payment plan.
  - Consumers should be provided with adequate time for reflection and with access to independent advice.
  - Consumers should have access to independent financial, credit and debt advice.
  - Both parties in the credit markets have to take part in a mutually productive process of financial education
- P3: Lending has at all times to be cautious, responsible and fair.**
- Credit and its servicing must be productive for the borrower
  - Responsible lending requires the provision of all necessary information and advice to consumers and liability for missing and incorrect information.
  - No lender should be allowed to exploit the weakness, need or naivety of borrowers.
  - Early repayment, without penalty, must be possible.
  - The conditions under which consumers can refinance or reschedule their debt should be regulated.
- P4: Adaptation should be preferred to credit cancellation and destruction.**
- There is a need for effective protection against unfair credit cancellation.
  - Default charges should be adequate to cover losses only.
- P5: Protective legislation has to be effective.**
- Credit regulation has to cover all non-commercial users.
  - Credit regulation has to cover all commercial forms of credit provision.
  - Credit regulation has to cover the whole process of credit extension as experienced by its users.
  - Credit regulation has to encourage efficient social and economic effects of credit extension.
- P6: Overindebtedness should be a public concern.**
- Profit-driven systems cannot cope with over-indebtedness.
  - Consumers should have a right to discharge.
  - Bankruptcy procedures should lead to rehabilitation and not to retorsion.
- P7: Borrowers must have adequate means to defend their rights and be free to voice their concerns.**
- There should be adequate individual as well as collective legal procedures to enforce borrowers’ rights.
  - Critical public awareness is crucial for the development of a fair and responsible distribution of credit.

## Section A. Why we are concerned

1. For today's consumers, **consumer credit** contracts now rank as high in importance as contracts for employment. But **overindebtedness** has also become a similar threat in modern times to unemployment in the last century. Sustainable development therefore requires access to responsible credit products and services.

At the present time many consumer credit agreements are far from transparent, and involve terms and conditions that are at best confusing and at worst, deliberately misleading to consumers. These agreements often involve multiple firms, and anticipate that consumers will pay additional fees for unforeseen contingencies; many also require the purchase of linked services such as insurance of unpaid balances. The consequences for consumers who are unwilling or unable to pay attention to these details can be devastating.

2. Consumer Credit makes potential future income available for current spending on items such as consumption, education, starting a business, and paying for health care. As such, consumer credit is a basic element of participation in the economic life of modern society. The benefits of access to credit are many, including developing national wealth and meeting basic consumer needs. However, there can also be a dark side to consumer credit — in some cases, it can destroy families, and lead to the loss of valuable assets including homes. The continued extension of credit at high cost to people on inadequate incomes only serves to deepen the levels of poverty that they experience.
3. In Europe, most consumer credit is provided by private-sector firms. If their activities are not tempered by moral institutions, public awareness, protective law and administrative supervision, firms might irresponsibly provide credit in the sole interest of gaining maximum profit. Borrowed money does not itself provide real wealth but only holds the potential to create that wealth. Vulnerable people can be harmed by greed, usury, exploitation and predatory lending, all leading to a lifelong entanglement in debt. This insight has become an integral part of the European legal tradition which bans usury, *laesio enormis*, extortionate credit, and the exploitation of need; this tradition goes on to require social responsibility and the exemption from seizure for some property and income.
4. Consumer credit is part of a cultural process of reproduction. Left unimpeded, market forces in the financial services sector tend to favour the rich and to discriminate against the poor. Trust in the "invisible hand" has never safeguarded the interests of the disadvantaged, — not with regard to poor countries and not with regard to poor people. Credit markets need rules that allow the benefits of credit provision to flow to all people and not just to the more fortunate, whilst rules are also required to protect those who are most vulnerable to exploitative lending practices. This balance, between providing access to credit whilst preventing the worst excesses of an unbridled market, is central to the concept of 'responsible credit'.
5. The EU, in article 152 of the Maastricht treaty as well as in the proposed new constitution, acknowledges that the State must guarantee a high level of consumer protection and must actively oppose social discrimination. If the EU comes to see its primary goal as opening markets for the most influential (and sometimes also the most unscrupulous) lenders, without respect for national culture in credit regulation and morality, it will be seen as a threat to the idea of a unified Europe. Europe needs banking for, and not against, its people. Law and justice must therefore create a credit market that promotes the productive use of credit, including a consideration of social needs.

6. The current draft of the EU Consumer Credit Directive, which differs from previous versions, threatens consumers by allowing the sale, in all Member States, of financial services that will exploit the disadvantaged. The Directive includes virtually no consumer protections nor guarantees existing national protections, whilst it opens up the existing markets of all Member states to competition from lenders based in other countries. For this reason, the wider market for financial services threatens to undermine existing consumer protection laws in many Member States.
7. In order to uphold cultural diversity, to further social responsibility and “good morals,” and to keep up the bona fide principle of ius commune, the following requirements for a responsible European Consumer Credit Directive can be identified. The new proposal of a Consumer Credit Directive has been evaluated in the light of these principles. This evaluation shows that, at a minimum, the European Commission wants to apply significantly different principles to the European credit culture that have been in place thus far and we consider that to do so would be to the disadvantage of many consumers.

## **Section B. Principles for Responsible Lending**

### **P1: Responsible and affordable credit must be provided for all.**

#### **a. Credit is an essential for full participation in society**

In the industrialized society credit has become a service essential for full participation in society. . By giving people access to their own future income, credit provides the opportunity to obtain the use of advanced goods and services that require capital investments like cars, household appliances, permanent education or homeownership. Access to credit makes it possible to bridge variations in income and expenditure and thus provide the flexibility that modern labour markets require.

While credit may not currently be available in all countries, the creation of small business and self employment requires capital everywhere. While individual capital is difficult to access, credit plays the role of seed capital in self-employment. Accordingly, providing access to credit realises a human right to use one’s own future resources properly. To this extent, credit has to be accessible for people in society irrespective of their social, biological, or cultural differences.

To realise this right requires the creation of banking facilities to be supported where no banking facilities are currently available, and needs people who are currently excluded from financial services to have access to banking facilities where they already exist or could be provided by the existing banking infrastructure. Regulation should under no pretext therefore prohibit access to the best and most affordable forms of credit under competitive conditions for all. This includes facilitating forms of Microlending and alternative credit institutions. But such alternative credit institutions which have lower technical and protective standards, and operate with less cost efficiency than existing banks should be used primarily as gateways to the general system of financial services provision.

#### **b. Banks should not discriminate and should provide real access.**

Banks have been trusted to administer the savings of their depositors and thus the monetary form of our wealth of nations. The public should monitor that they use this trust properly, without any discrimination, and that they reinvest it into our communities in ways that are ethical and which meet the needs of humanity across the world. Access to credit should empower communities, not leave them disenfranchised or open them to exploitation.

Developed banking systems under competitive market structures tend to exclude vulnerable consumers from their main business by providing direct or indirect services which do not meet their own standards. This is why markets require active state supervision and regulation to stir all providers of credit to accept poor or disfavoured consumers and communities by raising public awareness (e.g. through Community Reinvestment Legislation), creating obligations for inclusion (basic bank accounts, equal credit opportunities) or engaging in subsidies or support that can remove obstacles for these customers to be accepted. (rate subsidies in fair housing finance, free credit and debt counseling, state guarantees etc)

**c. Credit to Consumers and Small Businesses must be supervised.**

The non-commercial use of credit requires active supervision, comprehensive protective regulation and the strengthening of good morals in order to protect the borrower's position in the market and from the market.

Consumer credit, housing finance and start-up credit is directly linked to the livelihood of families and their social well-being. Its use is not only a function of profitable calculations. Its users are often unskilled and have to manage unforeseeable events out of a weak individual market position. When they have to default, the rules of the market society alone cannot offer adequate answers. This is why from the very beginning of money societies debtors have been protected and modern legislation has enlarged these regulations in line with the extension of credit. Regulation does not replace consumer awareness and individual responsibility but has to strengthen it where this is required and needs to provide social solutions where the borrower is at a disadvantage in the marketplace.

**P2: Credit relations have to be transparent and understandable.**

Two types of transparency should be delivered to potential borrowers to allow market forces to operate as intended. Competitive transparency gives consumers a chance to choose the cheapest and best product. But social transparency, indicating the potential impacts of credit on future household liquidity, is also necessary.

**a. Competitive transparency requires a standardized mathematically correct form of "one-price" disclosure (the Annual Percentage Rate of Charge or APRC).**

The APRC should include all credit-related payments that will repay the borrowed capital. The calculation of the APRC must include all cost elements that will, in practice, burden household income in the future: payments on linked cross-selling products, endowments, brokerage fees, and fees associated with acquisition, risk coverage or debt collection. Such cost elements represent services for which alternatives exist and the existence of these alternatives should be disclosed in a form which makes comparison and exit easy. The lack of transparency on insurance costs also leads to a lack of price competition in this area and runs contrary to the aims of the Directive in opening up markets to deliver better outcomes through increased price competition.

**b. Social transparency requires a standardized pre-contractual payment plan.**

This pre-contractual plan should disclose the likely impact of future payments on consumers' household liquidity and future purchasing power, impacts that can be predicted by statistical analysis of past experience with similar contracts. Pre-contractual plans that demonstrate an ability to repay are the cornerstone of responsible lending but they rely on full disclosure of outstanding liabilities. The extension of credit that occurs without proper attempts to discover full outstanding liabilities (for example through credit card balance transfers and the unilateral

raising of credit limits without borrower agreement) is a particular problem that must be addressed.

**c. Consumers should be provided with adequate time for reflection and with access to independent advice.**

The right to cancel an agreement exists only once a binding offer has been made. This system provides little time for reflection by the consumer or for independent advice to be sought. Where the amounts of the agreement are large, there should be improved systems to allow for advice to be taken and there needs to be facilities to provide advice to people who are in a particularly weak bargaining position.

**d. Consumers should have access to independent financial, credit and debt advice.**

Consumers and small businesses have most need of advice and help when they are in difficult financial situations. This is the situation in which vulnerable consumers are most active information seekers and take the most disadvantageous decisions. In this situation they need to know about their legal rights, the economic and social consequences of their adjustments and help to cope with the effects of their problems on family, labour income and consumption. It is in this situation that the market cannot provide adequate services which require a consumer who has a free choice and adequate means to pay. Both is not available at this point. This is why credit and debt advice has to be provided at low cost by unselfish institutions monitored by society. To uphold such offers is a public task.

**e. Both parties in the credit markets have to take part in a mutually productive process of financial education**

Consumers need to understand and use financial services properly with respect to their potential and risks. But they also have to learn that products and services can be changed and made more adequate if they are able to voice concern, evade credit, and engage in a collective process to develop better market conditions. Equally, the process of financial education includes learning on the part of the creditors about the needs and necessities of borrowers in order to adjust their profit driven offers to consumer requirements. Banks are not the teachers of consumers but they can provide answers to their questions.

**P3: Lending has at all times to be cautious, responsible and fair**

**a. Credit and its servicing must be productive for the borrower**

Not every access to credit is productive. Especially in Europe and the US, lack of access is no longer the core problem. Credit is now offered to all through damaging forms of credit that are used for unproductive investments, increase the dependency of consumers, and lead to exploitation and overindebtedness. This is why credit contracts have to be monitored and carefully regulated.

**b. Responsible lending requires the provision of all necessary information and advice to consumers and liability for missing and incorrect information.**

Advice links consumers' needs with their future income and purchasing power and illuminates the impact that the provided services might have on the future lives of borrowers and their families. Responsible lending requires that lenders assume liability for misrepresentation, false advice or missing information as well as for the sale of services known to be inadequate, except where there has been a

deliberate and malicious intent on the part of the borrower to defraud. Creditors must take all reasonable steps to validate information provided to them and must in particular share data on outstanding liabilities and repayment levels.

**c. No lender should be allowed to exploit the weakness, need or naivety of borrowers.**

If markets encourage exploitation and dependency by favouring the rich and discriminating against the poor, the law must set minimum standards for the operation of those markets. Effective rate ceilings are a starting point.

There needs to be a social guarantee that lenders will not abuse their position when the borrower's circumstances worsen through no fault of their own. In these circumstances lenders should not be able to seek higher charges on default or to worsen the position of the borrower further. There also needs to be a more sophisticated understanding of risk and a proper consideration of risk across the credit portfolio rather than an attempt to identify an individual risk based price for each and every social group. The repayment of debts should be regulated so that early repayment is possible and so that refinancing conditions are closely regulated.

**d. Early repayment, without penalty, must be possible.**

Consumers should always have the right to repay their debts without penalty. It is unacceptable that profit-driven systems should be able to keep consumers indebted when economic efficiency suggests that debts can and should be repaid.

**e. The conditions under which consumers can refinance or reschedule their debt should be regulated.**

Refinancing is not the repayment of credit. It can often represent a deterioration of credit conditions at a time when the debtor is economically weak. Regulation should guarantee that this weakness is not exploited, and in particular limit the amortization of interest and other charges. "Solutions" where future expectations are traded off for temporary relief should be controlled.

**P4: Adaptation should be preferred to credit cancellation and destruction.**

If debtors experience adverse circumstances, changes in credit relations by adjustments and adaptation should be preferred to acceleration, cancellation and destruction of the credit relationship.

**a. There is a need for effective protection against unfair credit cancellation.**

Credit relations are as important as labour and housing rent contracts in relation to individual lives. The principles of protection against unjustified or premature cancellations in these relations should be extended to credit.

**b. Default charges should be adequate to cover losses only.**

Default charges should be regulated in a way that prevents lenders from recovering more than the true cost of the default and lenders should aim to ensure the speedy restoration of the original contract terms.

Default interest rates should not exceed the refinancing cost of the lender plus additional administrative costs

**P5: Protective legislation has to be effective.**

It must cover any form of credit that is linked directly to the lives of borrowers and especially to credit provided for consumption, education, housing and the start-up of a small business. Exemptions on the basis of size of loan or type of loan only serve to confuse consumers and have adverse impacts on market behaviour.

**a. Credit regulation has to cover all non-commercial users.**

It should include consumers, homeowners and individuals starting up small businesses (all hereafter called “consumers”).

**b. Credit regulation has to cover all commercial forms of credit provision.**

Definition: Credit comprises all activities which bring people into debt through the commercial offer of purchasing power, irrespective whether this is done in the form of loans, deferred payments, leasing, rent or any other legal form and irrespective whether payments are called interest or fees.

**c. Credit regulation has to cover the whole process of credit extension as experienced by its users.**

The economic development of suppliers has tended to divide the process of providing and servicing credit contracts into ever more distinct pieces, each undertaken by different types of firm. The impact of credit on consumer households, however, has become ever more integrated and unified. Credit was historically extended as part of one contractual relation in which a consumer bought goods and services through installment purchases. A single institution was creditor, broker and debt collector and that institution was accessible for consumers' concerns. This relation was later split into two separate types of contract, one for purchases/service agreements and one for loans. This has led to the creation of lenders who operate without any regard for the consumption purposes of the loan.

Cost efficiency, as expressed in the “value chain” approach, drives suppliers into horizontal co-operation and into the development of a whole bundle of separate contracts. The provision of money, the acquisition of clients, the securing of debts and the servicing of credit contracts (and adapting them to the changing living conditions of the borrowers) and, finally, debt recovery have been put into different hands. Each player is solely focused on its own profit, freed from direct concern about consumers' employment problems and consumption needs. In addition, modern global competition among the most profitable multinational financial conglomerates has led to the increased exploitation of the dependency inherent in the creditor-debtor relations. Such institutions engage in the cross-selling of linked insurance, investment and financial products at above market rates. For consumers, there is only one process —getting money for present expenditures and paying it back from future income. Nonetheless, suppliers pretend to deliver hundreds of valuable services. It is an important task of our political culture to ensure a unified vision of the demand side as a leading perspective in law and to guarantee a market whose final goal should remain the satisfaction of the needs of the people.

**d. Credit regulation has to encourage efficient social and economic effects of credit extension.**

Protective regulation has to adopt an economic and social language and should not use only legal language that is open to the manipulation by those who provide financial services. Providing legitimacy to usury through the device of “borrowers' consent”, for example, would ignore 1,000 years of experience in which credit contracts voluntarily undertaken by needy persons have led to their exploitation

and dependency. Indeed we consider that usury, by definition, is undertaken with the borrowers' consent as it is precisely the desperation of the borrowers' financial circumstances that drives them to seek out usurious loans. However, the extension of credit at usurious prices is not a solution to the problem of poverty and should not be entertained as such by credit regulation.

**P6: Overindebtedness should be a public concern.**

Dealing with failed credit relations and overindebtedness should be a public responsibility. The goal should be to rehabilitate and reintegrate consumers into the economic life of society.

**a. Profit-driven systems cannot cope with over-indebtedness.**

Refinancing, revolving credit, and predatory lending to economically over-indebted people, are not solutions to poverty. Instead, they can be a way into long-term poverty and dependence.

**b. Consumers should have a right to discharge.**

Consumers should have a right to a public procedure of discharge through which their duties to repay debts are adapted to the remaining productivity of the borrowed funds.

Where credit no longer reflects a productive investment into the economic life of the borrower, a system of discharge and devaluation of debts is necessary. Firms vanish when they fail and their debts are written off in bankruptcy. Individuals, however, do not vanish and therefore their debt burden must be adapted to the value of their labour where this is the only source of income for repayment. Discharge is a fresh start for debtors and their families.

**c. Bankruptcy procedures should lead to rehabilitation and not to retorsion.**

Discharge requires rehabilitation and reintegration into a productive life. It must involve independent advice, shelter from creditors, and help to readapt their income to their expenditures.

**P7: Borrowers must have adequate means to defend their rights and be free to voice their concerns.**

**a. There should be adequate individual as well as collective legal procedures to enforce borrowers' rights.**

Creditors address legal matters strategically and calculate risks and cost with respect to the whole of their business. A single consumer, however, takes on an enormous risk when he or she sues a creditor. In practice, creditors dominate the selection of cases which come to the higher courts. It is therefore important to seek remedies for this strategic weakness of consumers in the process of further legal developments. In order to cover the financial risks pro deo procedures are especially important for credit law because the vulnerable poor are least likely to defend their rights in court. In theory, class actions are adequate remedies, if the state can guarantee funding for consumer organizations which effectively care for the rights of the poor. Ombudsman schemes, and other non court based systems, whilst useful for individuals seeking redress should also be able to address broad issues within the credit industry where on the evidence of the number of individual cases being dealt with it appears that these are apparent. This may be, by example, by placing a duty on ombudsman schemes to report to state regulators on the specific concerns arising on a regular basis.

**b. Critical public awareness is crucial for the development a fair and responsible distribution of credit.**

Financial institutions exercise enormous influence within the media through their advertising budgets and through their investments in media firms. They can also use anti-defamation laws quite effectively to suppress critical journalism. In addition, most credit-related research in economics and law is partly financed by the supplier side. If the state does not counterbalance this enormous power, the prospects for critical responses are dim.

The provision of information on lending patterns of private sector lenders is critical to the development of public awareness and ensures that measures can be taken to address the unfair exclusion of lower income social groups from credit. The EU should therefore ensure that there is a standard obligation for lenders in the Member states to disclose information relating to lending patterns by social group and geography and that there is an affirmative obligation placed on lenders to address financial exclusion.