



**UK CROSS INDUSTRY GROUP SUBMISSION ON
HOUSE OF LORDS EUROPEAN UNION SELECT COMMITTEE
INQUIRY INTO EU PROPOSALS ON CONSUMER CREDIT HARMONISATION
(16 MAY 2005)**

1. The UK represents over 30% of the EU's consumer credit market. The UK Cross Industry Group (CIG) represents a range of organisations from across the credit industry and was established solely with the Consumer Credit Directive (CCD) in mind.
2. We welcome the European Union Select Committee Inquiry into the CCD. The Committee's inquiry notice makes reference to the Commission's amended proposal (COM 2004/747 dated 28 October 2004), though it should be noted that this is not a consolidated version of the CCD and is full of ambiguities. Although it provides specific wording on some issues, it is primarily a response to the European Parliament amendments. Its assertion in section 4.3 that all other amendments "can be accepted in part or subject to reformulation" leaves much open to guesswork.
3. Our submission focuses on two key provisions of the proposed Directive: 'responsible lending' and the 'duty to advise' (section 4.3.4 of the amended proposal). We also contend that mortgages and lending secured on property should be excluded from the CCD as they differ in character from other forms of consumer credit in their lending process.
4. The Commission's original proposal (COM 2002/443 dated 11 September 2002) had two intended outcomes. It would:
 - provide a dynamic impetus to the EU economy and
 - better protect consumers and so help combat over-indebtedness.
5. On the former, the thinking was that there would be more cross-border lending. On over-indebtedness, this would reduce because the new law would force lenders to take greater 'care' in lending.
6. Philosophically, the CIG supports both anticipated outcomes. We are in favour of boosting economic growth and of reducing over-indebtedness.
7. Where we differ is in how these ends can be achieved. In fact, our research and analysis strongly suggest that the original text would produce results opposite to

those intended and would depress economic growth and increase over-indebtedness.

What does 'a cross-border market' mean?

8. This is a vital question which the original proposal does not clarify. The text implies a scenario where a lender in State A lends – cross-border – to a borrower in State B. This thinking sounds plausible. After all, in most other fields of commerce and finance the Commission has aimed for this outcome and usually made it possible. So, for example, a UK citizen should be able to - and can - buy a car (cross-border) from a supplier in Germany.
9. But the text seems not to address a unique feature of credit - residual risk¹ - that sets it apart from all these other products. Residual risk is the reason why a cross-border market in mass-market consumer credit is unlikely to emerge. The Commission proposal assumes that ability to carry out a cross-border credit reference check will be enough to kick-start cross-border lending. In fact, risk assessment and management is much more complex than just referencing.
10. Take, for example, a large UK lender with a wide UK customer portfolio. That firm is likely to use scoring systems that will assess risk by reference to distinct - and fairly large - 'pools' of customers. For example, the risk profiles of customers borrowing to buy boats will differ from the profiles of those who borrow to buy motorcycles. It is clear from this that if a single French-based consumer contacted that UK lender, the lender would have no way to gauge the risk of lending to that person.
11. Lenders need also to understand and assess the legal recovery processes which can be used if the customer refuses to pay. Again, a UK lender will know how well the UK processes work and how much they cost to use. But if a Frenchman were to contact that UK lender, the lender would probably have no knowledge of French recovery systems, and so be unable to gauge the cost and ease of legal recovery.
12. No matter what text is in the Directive - a general 'cross-border' market (in the format previously envisaged by the Commission) is unlikely to develop².

The commercial implications of going 'cross-border'

13. UK creditors have long sought out overseas markets and this remains the case. But normally, only scale market entry is commercially viable. Scale entry can justify the high cost of learning about the lending risks in that market, and of assessing the efficacy and cost of recovery processes.
14. By contrast, for the reasons we set out above, ad hoc cross-border loans usually make no commercial sense. So even if consumers wanted to deal cross-border in this way (through the achievement of 'increased consumer confidence'), lenders would not want to lend to them.

¹ By 'residual risk', we mean the risk that the lender assumes when he parts with his funds against the debtor's promise to repay them in the future.

² We think this would become a realistic possibility only if the legal systems of all the Member States were swept away and replaced with a common structure. This is unlikely to happen for many decades (if at all).

15. If scale entry is the preferred model, will the Directive as originally drafted assist here? There might possibly be some very marginal advantage³. However, regulatory frameworks play a very small part in a firm's decision to trade cross-border⁴. So the current text would be largely irrelevant to decision-making processes.

An internal market in credit is already here

16. Our arguments make it seem that no internal market in credit is possible. In fact, CIG contends that such a market does exist and is thriving, but not in the form which had been envisaged. We think the market is being created via cross-border mergers, joint ventures and solus scale market entry (i.e. entry by a business into a market on a solo basis), all of which have been developing rapidly in recent years.
17. In all these cases, lenders have chosen to enter new markets. But they have done this by electing to set up operations in the target Member State itself. So they have recruited local staff, with local expertise. These employees can guide the business efficiently through the culture, risks and legal systems in that market. And because this is scale entry, it can support paying for professional advice on local recovery systems and tax regimes.
18. So the internal market in credit exists and is growing. But the form of that market is dictated by efficiency imperatives and by the practical problems in lending cross-border. The overall net effect for consumers will still be positive, since these rationalisation processes will increase efficiencies.

What would really be the economic effect of the proposal?

19. The thrust of the current text is that lenders take insufficient 'care' with their lending decisions. So lenders have to be directed to be 'responsible' and to 'advise' their customers as to whether the deal is right for them.
20. Rules like this create a second layer of artificial risks for lenders to cope with. As well as the normal lending risk, the creditor now has to make a second assessment. He has to decide whether his normal lending judgment will also match up to a set of new theoretical standards.
21. To protect himself, the lender will have to accumulate 'evidence' with which he can defend himself against claims of 'irresponsibility' or 'failure to advise'⁵. Ironically, none of this has much to do with the lending risk itself.
22. We cannot speak for other Member States, but in the UK at least, these rules would lead to a significant new bureaucratic load. The lender would have to ensure that he had the processes in place to amass a sufficient weight of protective 'evidence'. He would also have to routinely audit those processes to ensure compliance with these new rules.

³ But as explained later, these are almost certainly outweighed by serious disadvantages in other areas.

⁴ Language, culture, fiscal and legal (i.e. recovery) differences are cited as the most common barriers to cross-border trade

⁵ A process one commentator has fairly accurately described as a 'pseudo fact-find'.

23. Credit granting would become more unwieldy and more costly as these new systems were put in place. Over the last 25 years, the UK industry has moved forward, making credit granting processes quicker and more efficient. The current text would reverse these developments and undo past efficiency wins.
24. These new costs and fact-finds would be especially bad news for those on lower incomes who wanted smaller loans or who were higher-risk. Lenders will also be more risk-averse, which will result in more credit rejections.
25. These 'responsible lending' and 'duty to advise' approaches were central to the analysis carried out by OXERA in its June 2003 study (*a summary is attached*). They concluded that UK GDP would fall by around 0.2% and that 2 million consumers would become increasingly credit-constrained.
26. So new rules on a similar model would become a deadweight on UK economic growth. And even if there were no direct adverse effects within other Member States, the impact on the UK economy itself would carry through into those other States.
27. There is also another paradox in all this. Since responsible lending and duty to advise will make lenders more risk-averse, they will be less likely to lend cross-border, because this is riskier than lending into a domestic market.

Market distortion effects

28. Putting aside cross-border deals, we think that the Commission proposal will distort domestic markets.
29. The original thinking was to treat all credit formats in the same way. At first glance, this sounds fair. Aspects of the text severely increase point-of-sale bureaucracy. This will naturally distort the market in favour of running-account (where a contract can run for decades) and fixed-sum credit (where the contract ends when the loan is repaid).
30. Elsewhere, parts of the duty to advise requirements fall disproportionately on products commonly sold at a distance rather than face-to-face, and propose additional bureaucratic requirements when credit limits are increased on open-ended agreements.
31. With a 'light touch' bureaucracy (as under the existing 1987 Directive) the different credit formats can compete on equal terms. Once the load increases dramatically (as under the Commission's proposal), bureaucracy inequalities start to skew market function.
32. So overall, the Commission's proposal would set up market distortions. The CIG believes that such distortion is bad for competition. Running-account and fixed-term systems should be able to contest markets on a relatively even footing.
33. We would be happy to provide any further written and oral evidence to the inquiry. Our details can be found on the covering e-mail.